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# Regulating CMOs by competition: an incomplete answer to the licensing problem?

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# Regulating CMOs by competition: an incomplete answer to the licensing problem?<sup>\*</sup>

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## Abstract

While the three functions of Collective Management Organisations - to licence use, monitor use, and to collect and distribute the revenue - have traditionally been accepted as leading to a natural (national) monopoly, digital exploitation of music may no longer support such a conclusion. The European Commission has challenged the traditional structures through reforms that increase the degree of competition. This paper asks whether the reforms have had the desired effect and shows, through qualitative research, that at least as regards the streaming of music, competition has not delivered. Part of the reason for this may be that the services required by the now competing CMOs have changed.

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Contents

Introduction..... 1

Background: The role of the CMO before digitalisation ..... 2

The Digital Challenge..... 5

A new regulatory regime..... 6

Methodology..... 9

Findings: the problems for online users..... 10

The Directive and the limitations of competition ..... 13

    The User Lost in the Labyrinth ..... 13

    Everyone Loses Out: the Income..... 15

    The Freedom of the Rights Holder: meet the new boss, same as the old boss..... 18

    To the Benefit of Who? ..... 19

Conclusion ..... 22

References..... 25

## Introduction

The licensing of copyright protected works has been a feature of the music market for decades, allowing a large variety of users - bars, broadcasters, concert venues etc. - to play music as part of the services they offer. This system rests on central licensing agencies, most commonly Collective Management Organisations (CMOs). These administer the rights of copyright holders from a central point, offering licenses to the users. While the system has been in place for a long time and has worked reasonably well (although not perfectly) for analogue uses, the rise of the internet and digital technology has changed the game. By expanding the possibility of, and demand for, cross-border uses, the traditional system has come under considerable strain, and is now reaching breaking point as new types of services, such as streaming, emerge. These services need to license musical works on an EU or global basis to use the technology's full potential. This is difficult because, until now, the CMOs in the EU have been nationally-based monopolies.<sup>1</sup> To obtain a license that covers Europe, 28 different licenses are, in principle, required. Such an arrangement clashes directly with the EU's ambition to create a Digital Single Market (DSM).<sup>2</sup> As a result, the current regulatory regime, particularly as it relates to CMOs, has become a prime concern of the EU.

The functioning of CMOs in the digital domain is of key importance for the DSM.<sup>3</sup> The single market is, after all, intended to allow for the free movement of goods and services across borders, giving citizens access to what they most prefer. The inability of the current copyright system to issue cross-border licenses means that CMOs can provide services only on a member state by member state basis, due to the threat of copyright infringement (and therefore high costs) that any unlicensed cross-border use would entail. The result is geo-blocking: individual users are not able to access services once they enter another member state, even if they have paid for those services. Rather than having a single market, online music continues to operate through multiple, separate markets.

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<sup>1</sup> This contrasts with the US, where since 1941, there have been three CMOs for music, see Katz (2005).

<sup>2</sup> For a discussion of the DSM, see European Commission (2015)

<sup>3</sup> See, for example, Intellectual Property Office (2015)

The EU's response to this situation has been to issue a Directive,<sup>4</sup> due to be implemented in 2016, that introduces competition between CMOs and places obligations upon them to serve better the interests of users and right holders. In this paper, we assess the likely effect of this initiative, and argue that there might be more effective ways to address the problem posed by creating a DSM. We confine our attention to the music market, which is feeling the effects of the digital revolution most acutely, at least among the creative industries. We also confine our attention to the streaming of music. Similar issues arise in the sales of digital music, for example through electronic stores (see Gómez and Martens, 2015).<sup>5</sup>

## **Background: The role of the CMO before digitalisation**

As Handke and Towse (2007) point out, the licensing market for musical works in an analogue world was (and remains) highly complex. A large number of creators and products (typically, artists and songs) have to be matched with a similarly large number of diverse users. Asymmetry of information in such a situation creates prohibitive transaction costs for individual licensing between a copyright owner and a user. In other words, individual licensing represents a case of market failure in which copyright owners and the users would both lose out. The copyright owner would not generate the income they seek while the user is not able to play legally the music they want. The solution to this problem has involved several intermediaries, including publications offering music reviews and CMOs streamlining the financial transaction between creator and user.

CMOs act to reduce the market failure (Handke and Towse, 2007; Haunss, 2013). In general, they have three functions: 1) to license works for specific uses; 2) to monitor the use of works and

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<sup>4</sup> Directive on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online use in the internal market (Directive 2014/26/EU) (CMO Directive).

<sup>5</sup> While some of these issues have been addressed through new structures, e.g. Merlin, or coalitions of old structures to create broader organisations which can offer bundled clearing of copyrights, not all Copyright Management Societies in the EU are members of such structures. Thus transaction costs are incurred to provide pan-EU availability of digital music. As Gómez and Martens (2015, 3-4) note: "We find that in August 2013 there was still substantial variation in availability in the iTunes country stores across the EU DSM. Less than half of all song tracks and music albums are available in all EU27 country stores. Overall, music availability in the EU DSM is somewhere between 73 and 82 per cent of what it could be in a fully open DSM where all song tracks and albums would be available in all EU27 countries." However, Gómez and Martens (2015) do acknowledge that matters are improving.

collect the revenue; and 3) to distribute the revenue to its members (Andersen et al., 2000: 21). The CMOs collect the revenue for low-value, high volume secondary uses; that is, uses where the individual licensing fee is small but the number of licenses which need to be issued sum up to a substantial revenue stream. CMOs manage the rights of its members collectively, providing blanket licenses to users. By managing the rights collectively, they are able to lower the transaction costs as well as providing a stable licensing framework. In economic terms, they enable the market to function by ensuring copyright effectiveness in circumstances where copyright owners cannot contract directly. A blanket license gives users – especially broadcasters – the right to use any music within the CMO’s repertoire. The blanket licenses reduce the transaction costs because they do not require negotiations on the price or the exact size of the rights bundle for each individual transaction.<sup>6</sup>

CMOs have been a core feature of the licensing market within the EU (and beyond) for more than a century. Based on a system of reciprocal agreements between CMOs, they have been able to license a world-wide repertoire. A user can, therefore, use any song they want and to pay their only local CMO. The transfer of funds across borders is done by the CMOs themselves and are of no concern to the user. As a result, CMOs have established a system of national monopolies which do not compete with each other, but instead operate under a set of agreements which determine the cost of licenses. While this broad coverage in works, the economies of scale and the resulting monopoly status contribute to efficient licensing in practice, it is also the source of the European Commission’s main concern. While the licences are “blanket”, their price may well differ according to the type of organisation which request the blanket licence. No stakeholder is able to judge the price charged and the lack of a viable alternative has meant that a copyright holder has no incentive to defect to a rival CMO, no matter how dissatisfied they are (Handke and Towse, 2007). The CMO’s monopoly status has given rise to typical monopoly concerns, namely the potential abuse of a

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<sup>6</sup> There is an extensive economics literature on what is often termed “buffet” pricing inspired by the “all-you-can-eat buffets”. Much of this literature has focused on behavioural aspects, in particular those which lead to obesity, which does not appear to be particularly relevant in our context. The behavioural literature is summarised in Lambrecct and Skiera (2006) – see also Just and Wansink (2011).

dominant position.<sup>7</sup> Market prices can form neither for the users in terms of how much they pay for their license, nor for the copyright owners, in relation to the cost of administration that the system entails (Kretschmer, 2005a: 7).

EU case law has established that the CMOs are undertakings which hold a dominant position, meaning that they are subject to the full force of competition law, including both article 101 TFEU relating to agreements and article 102 TFEU relating to the abuse of a dominant position (Graber, 2012: 6). This required restrictions on how they operated. However, the CJEU also ruled that CMOs serve the public interest, and that, therefore, competition law was not to be strictly applied (Graber, 2012: 6). In other words, while the Court found the monopoly status and reciprocal agreements justifiable in the broader public interest, it also recognised the negative impact the system could have for users and right holders. For this reason, CMOs are required to offer users reasonable licensing terms, while at the same time giving their members as much freedom to administer their rights as independently as possible (as long as this was consistent with the functioning of the CMO as a whole). Copyright owners should be able to administer their rights individually as long as the changes do not impose undue cost on the CMO. For example, while withdrawing all one's works or the online rights attached to those works is acceptable, withdrawing the online rights for works A, B and C, but not D, and G, is not, because keeping track would be too expensive for the CMO (Kretschmer, 2005a: 5). In essence, the regulations have attempted to balance the threat of monopoly against effective rights administration (Dietz, 2002: 908). Given that there was no viable alternative to the CMO system, the Commission tolerated it. The rise of the internet has changed the rules of the game.

Some authors, it should be noted, have questioned the treatment accorded CMOs have been treated in the analogue world. Katz (2005) in particular challenges the claim that in the analogue world the CMO is a natural monopoly. He observes that more than one CMO may operate in a single

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<sup>7</sup> Assessing such abuses is made complicated by the two-sided nature of the market, where the intermediary can decide from which side of the market, copyright holders or users, to extract rent, either in terms of funds or a "quiet life".

territory. Unlike most other countries, where the CMO is a monopolist, the US has three CMOs (ASCAP, BMI and SESAC) of which one (SESAC) is rather smaller than the others (less than 5% in 2000) and has coexisted with ASCAP since 1931 and all three have been in the market since 1941. The traditional argument in favour of natural monopoly, economies of scale, is not compatible with the persistent existence of such a small firm.

Katz (2005) reminds us that, while the CMOs charge for a blanket licence, they do not charge all users the same price. Thus they use their monopoly power to engage in third degree price discrimination, charging different prices to different type of business, a practice which has an ambiguous effect on both total and consumer surplus. Katz (2005:550) also points out that the existence of different licences for performance of the work adds an extra tool to the CMO to practice successful price discrimination because it enables the CMO to identify the nature of each user.

In a companion article, Katz (2006) explores how his argument would apply in the digital world. Given his conclusion for the analogue world, it is hardly a surprise that he is sceptical about the monopoly argument. However, given when it was written, his paper has to engage in speculation. While it undoubtedly was ahead of its time in 2006, and many of the speculations have come to pass, it adds little to the current debate. It does, though, help us understand why the Commission viewed the digital world differently when it comes to competition.

## **The Digital Challenge**

As digital technology, and especially the internet, rose in importance, the needs of users changed dramatically. A new breed of users came to the fore, most notably, the streaming services (Spotify, Deezer, Amazon Music, etc). They differ from analogue users in the kind of licenses they require. Analogue users only require territorial licenses. Their services do not cross national borders<sup>8</sup> and therefore they do not require licenses that extend further. However, the internet (and digitalisation)

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<sup>8</sup> While strictly speaking not true, this is the assumption which has been made in the industry, motivated by a view that Broadcasters are (supposed to) focus on their national audience, not least because of language barriers. The exception is broadcasting with the Simulcasting Agreement which resolves the issue by treating broadcasters as geographically limited users.



creates the possibility of easy access to music irrespective of tariff barriers or broadcasting regulations. Any legal service seeking to exploit these possibilities requires multi-territorial licenses. To cater to this need, CMOs reacted first by offering Simulcasting agreements, providing cross-border licenses to internet radio. The Commission accepted this solution (which began in 2004) (Guibault and Van Gompel, 2015: 160-161). However, it remained the exception, even as the Commission came to realise that digital technology was not only changing user requirements but the system as a whole.

The driver of change was not just user demand, but the very nature of licensing itself. Handke and Towse (2007: 13) have argued that digital technology, first, makes the gathering and processing of information much easier. Secondly, they argue that it enhances market signalling: on one hand, the use of individual works can now be assessed with more precision than previously; on the other, the potential for price discrimination, charging every user what they are willing to pay, is also facilitated. Finally, as a result of these factors, CMOs are able to reduce their costs. New technologies such as Digital Rights Management (DRM)<sup>9</sup>, which enables rights to be administered individually (Kretschmer, 2005a: 17), can enhance efficiency. This, of course, undermines the CMO's justification for their monopoly status (Ficsor, 2002: 98). There are now real alternatives to them.

## **A new regulatory regime**

The change in the Commission's attitude first became clear when it refused to accept the Santiago and Barcelona Agreements which aimed to extend the analogue licensing system to the digital domain (Fabbroni, 2009). The Commission's attitude was made yet clearer when it rejected CISAC's model contracts. CISAC, the world-wide umbrella organisation for CMOs, devised model contracts to allow its members to offer multi-repertoire, multi-territorial licenses. The contracts had three core features: a national allocation clause, an exclusivity clause and a non-intervention clause. The last

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<sup>9</sup> DRM is in our context a tool to control the type of access one has to digital music. It controls both access and usage. For a discussion of the merits of DRM, see e.g. Cory Doctorow, 'What happens with digital rights management in the real world?', *Guardian*, 5 February 2014.

two in combination had the effect of maintaining the national delineation of CMOs, guaranteeing their monopolies. While these clauses were not new, the Commission now considered them unjustified: digital technology meant that a local presence was not required to ensure efficient enforcement (Guibault and Van Gompel, 2015: 162). The Commission argued that digitalisation enabled CMOs to compete with each other in the field of digital exploitation, meaning in practice online use. Overall, it found the model contract contrary to competition rules under article 101 TFEU (European Commission, 2008: 220-223), although this decision was overturned by the General Court in 2013.<sup>10</sup> Instead, CMOs should, the Commission believed, compete with each other to attract members and users. This in turn should lead to increased efficiency in the rights administration, helping the emergence of new markets (Sparrow, 2006: 1). The Commission shifted from viewing the CMO as a necessary evil for ensuring the effective licensing of works, to seeing it as an unnecessary anti-competitive undertaking which harmed both right holders and users. This stance was to become clear Commission policy.<sup>11</sup>

While Katz's analysis (2005, 2006) casts doubt on the survival of the past monopoly elements of collective rights management, the move to digital exploitation could, at least in theory, give rise to a new monopoly element. This has so far attracted little comment. With more data available electronically, a comprehensive database of all right holders and associated material would not only be essential, but also display increasing return to scale both in its creation and maintenance. For full functionality it is important that the database is comprehensive. Given the cost of establishment and maintenance, it would be inefficient to have two parallel fully comprehensive databases. By contrast, the other elements - such as monitoring and collecting money - seem to have less of a claim to monopoly status once services become digital. Given the international nature of such a database, there is a serious issue as to who regulates the terms of access and how the database is to be funded. One possibility, building on existing databases held by CMOs, would be for these to set up an

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<sup>10</sup> CISAC v. European Commission (Case T-442/08).

<sup>11</sup> For a more detailed analysis tracing back competition presumptions through the policy, see also Street et al. (2015).

institution to hold, transform and maintain these databases. This has, to some extent, happened. Most CMO databases (and all of the ones examined here) are part of CIS-Net, the most comprehensive database for musical works and their neighbouring rights. It is owned by FastTrack, which, in turn, is owned by the CMOs. The question is whether competition among the CMOs (in the EU) is sufficient to generate a comprehensive database and at the same time to generate meaningful and valuable choice.

In 2005, the Commission reported on the lack of cross-border licenses for users in the online market. It proposed that rights holders should be free to choose their CMO, the rights that they assign to it and their associated territorial reach (EU, 2005). The underlying rationale is a typical competition remedy: by giving the individual the choice over the provider, they can choose the service that matches their preferences most closely. In other words, by allowing right holders to vote with their feet, CMOs would be bound to become more efficient in order not to lose members. Furthermore, CMOs would issue pan-European licenses, and rights holders, by choosing their CMO carefully, would be able to ensure that each CMO would be able to offer coherent bundles.<sup>12</sup> The Commission's recommendation rejected the analogue services' use of a reciprocal licence agreements and full harmonisation (Kretschmer, 2005a: 13-14). Their approach became law in the 2014 CMO Directive 2014/26/EU. The Directive focused on more competition rather than on harmonisation or an extension of the traditional system of reciprocal agreements. The Directive aims at providing an environment in which competition can be fully effective. It sets minimum standards for the transparency and supervision of CMOs by their members and therefore the right holders (EU, 2014: Part III). Both of these are typical competition remedies, which have been applied to areas such as the energy market. In the case of the music industry, EU policy is based on the distinction between the analogue and the digital licensing market for musical works, and the need to alter the role played by CMOs in the latter. However, the major CMOs are already meeting the Directive's demands (Street et al., 2015), so the question is whether the Commission's intervention will have its

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<sup>12</sup> Note that rights holders would have an incentive to seek out CMOs who "managed" material similar to their own to give that CMO more bargaining power vis-à-vis the users.

intended effect. After all, if the database existed and access was regulated/mandated, then the right holder would genuinely have choice based on the quality of service.<sup>13</sup> To answer our question, we investigated the problems that actually affect users in the digital realm.

## **Methodology**

To understand the current state of licensing in the EU, we compared the experience of an analogue user with that of one who seeks a license for online exploitation. We simulated the path a potential broadcaster or web-streaming service would follow in acquiring a license, starting with the first search to identify CMOs all the way to the final license. It is assumed that the broadcaster seeks a multi-repertoire, single-territory license because they want to be able to use all kinds of music in their programming which, by the nature of the broadcasting sector, is assumed to reach a national audience. By contrast, a web-streaming service would also want to offer all kinds of music but on a multi-territorial basis, making its programmes accessible around the world, or at least within Europe. We used these two licensing scenarios to explore the practical issues raised by providing multi-repertoire, cross-national content.

The empirical research was designed in such a way as to give a realistic picture of the situation and challenges faced by practitioners. For this reason, it was carried out by a research associate who has legal training but is not working in the field of intellectual property or licensing copyright material. In our view, this mimics the experience of those individuals who have to acquire licenses for commercial services. The researcher was asked to keep track of how she identified relevant organisations, noting down the challenges that she encountered. We chose a representative set of European case studies: the UK, France, Germany and Sweden. The findings are striking: while the analogue user finds a system in place to satisfy their licensing needs, the same is not true for those who want to run streaming services.

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<sup>13</sup> For music, there may be an unnecessary stumbling block as rights can only be assigned on an exclusive basis to a CMO and therefore not to more than one collecting agent at the same time.

## **Findings: the problems for online users**

The main finding is that CMOs are either unable or unwilling to satisfy the demand of online-services. When a broadcaster seeks a license, all of our case studies were able to provide them with a multi-repertoire license for the rights in musical works. This was because of the reciprocal agreements that CMOs have with each other. The broadcaster has in this sense access to a one-stop-shop. Table 1 below summarises the steps taken as well as the key difficulties in obtaining the right to make copyrighted content available across borders in the case of broadcasting. It is clear from Table 1 that there are only limited difficulties in obtaining a licence for traditional broadcasting.

**Table 1: Broadcasting**

	<b>France</b>	<b>Germany</b>	<b>Sweden</b>	<b>UK</b>
<b>Licenses Required</b>	SACEM (covers other CMOs for musical works) SCPP/ SPFF	GEMA GVL	STIM SAMI IFPI	PRS/ MCPS PPL
<b>Information on Coverage</b>	Yes	Yes	Limited	Yes
<b>Broadcasting Tariff available online</b>	Yes	Yes	No	Yes
<b>Indemnity for Licensees (coverage of non-uses)</b>	No	Limited (presumption of management)	No	Limited (presumption of management in some cases)
<b>Information available in English</b>	Partial (does not include substantive licensing information)	Partial (does not include substantive licensing information)	Yes	Yes

In contrast Table 2 below demonstrates the considerably greater difficulties encountered in obtaining licences for webstreaming. The licenses for online uses are a lot more complicated, not least because the descriptions used by the CMOs are very vague. Although some multi-territorial licenses exist, it is not clear which works are covered by them. For example, in the UK it is apparent that PRS, the CMO for songwriters, composers and publishers, is able to license the Anglo-American repertoire of certain publishers on a multi-national basis. However, there is no way to check what is actually included in this description. They are not blanket licenses like the ones available to broadcasters in the analogue system. This means in practice that more than one license is necessary to cover the same category of works, increasing the cost for the user.

Secondly, just because the license is described as multi-territorial, it does not follow that this involves EU-wide coverage.<sup>14</sup> For example, the French CMO SACEM is only able to license France, Luxembourg and Monaco, the three countries in which it is the main CMO anyway. It would have always been able to license these, even without a change in EU policy. Similarly, the other CMOs also only offer licenses that cover a very limited number of countries, but none of them provided clear

<sup>14</sup> A similar problem was observed for the sale of digital music, see Gómez and Martens (2015).

information as to what countries were included. As a result, not only is there no comparable one-stop shop, the territorial gaps in the license are also unclear, giving rise to major concerns about what is allowed. In summary, while a broadcaster is provided with a one-stop-shop to satisfy their licensing needs, the same route is not available to online services wishing to operate across borders. In fact, they struggle with a more fundamental problem: a lack of information about the coverage of the license.

**Table 2: Webstreaming**

	<b>France</b>	<b>Germany</b>	<b>Sweden</b>	<b>UK</b>
<b>Relevant CMOs</b>	SACEM but does not cover phonograms or performances	GEMA but does not cover phonograms or performances	STIM but does not cover phonograms or performances	PRS but does not cover phonograms or performances
<b>MTL Licenses</b>	Not available. SACEM offers a license limited to specific territories but truly MTL. No information available from other CMOs	Not available. GEMA offers an online tariff covering Germany and some limited multi-national licenses but not Europe-wide. No online tariff by GVL	Not available. STIM offers some limited MTL, especially for Scandinavia. No information available from other CMOs	Not available. PRS/ MCPS offers a license limited to specific territories but truly MTL. No information available for PPL
<b>Tariff available online</b>	Only SACEM for limited territories	Only GEMA for limited territories	Only for STIM for limited territories	Only for PRS/ MCPS for limited territories
<b>Indemnity for Licensees (extent to which non-members are covered)</b>	No	Limited (presumption of management)	No	Limited (presumption of management in some cases)
<b>Information available in English</b>	Partial (does not include substantive licensing information)	Partial (does not include substantive licensing information)	Yes	Yes

A second notable insight from the two tables is the similarities across the countries and hence the relevant CMOs. If competition was driving new or better licencing services, one would expect to see more variation.

## **The Directive and the limitations of competition**

It would appear from our research that the Directive not only offers no solution, but in fact makes the problem worse in some areas. The reasons can be found in its inadequate conceptualisation of copyright, especially its dynamics and the interests involved. In fact, in its current form, it is likely to make the situation more difficult for the majority of authors and users, only really benefitting a small group of large right holders.

## **The User Lost in the Labyrinth**

The real loser of the changes are the users in the online environment. Having a blanket licenses, as broadcasters do, means that most of the identification costs associated with licensing is carried by the CMO. They have to identify the relevant right holders, and they have to transfer revenues to sister CMOs for the repertoire that is used. In the digital environment, the cost is shifted entirely onto the user. Online users, however, have to identify the relevant right holders because CMOs are not able to offer blanket licenses. Instead, the user needs to contact a large number of CMOs, hubs aggregating the repertoire of different CMOs, and even individual right holders.

Where the local CMO cannot provide licenses with multi-territorial cover, the user has to contact the CMOs in all member states as well as those right holders that have withdrawn their rights.<sup>15</sup> This poses major problems for all aspects of the licensing process. First, there is the problem of identifying the repertoire which requires an additional license and the right holders associated with it.<sup>16</sup> As we have seen, statements about the scope of the repertoire and rights managed by the CMO can be very vague, making it difficult to tell what is and is not included. Even if this is clear, the user still has to identify the right holder for these works. Databases, such as CIS-Net, are not publicly

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<sup>15</sup> An alternative would be to “boycott” songs which were not obviously covered by readily available licences. This may lead to either pressure from the rights holders of those songs to have them included or to migration of those rights holders to another CMO.

<sup>16</sup> How big the problem is depends on the activism of the rights holders. If they are very active users of the services, they will identify which CMO offers the best home in terms of repertoire and shift their licences to that CMO. More generally it is important not to treat the rights holders as passive actors.



accessible.<sup>17</sup> As a result, the only way<sup>18</sup> a user could guarantee a multi-repertoire, multi-territorial blanket style license would be to contact all CMOs or the necessary combination of hubs and CMOs. This difficulty is exacerbated by the absence of authoritative and complete lists to identify CMOs, especially across borders. Our research revealed (especially the second row of Table 2) that it is difficult to identify all relevant CMOs without resorting to the academic literature, a resource which is not easily accessible to the general public. In fact, determining which CMOs need to be contacted has proved to be yet more complex because the information provided is vague. A potential user has to read around the topic, relying on blogs and similar searches. While this may work in practice, the lack of verifiable information is a source of concern. Furthermore, while CMOs provide significant amounts of information on their homepages, it tends to be in their national tongue. If English sections exist, they are significantly smaller. Licensing forms in particular are not available in translation. By comparison (Table 1), broadcasting tariffs are clearly accessible and explained by all the relevant organisations on their websites.

Given the complexity of the task, users can never be sure if they have actually covered everything and potentially expensive infringement claims remain a possibility. Given the problem of securing the necessary complete clearance, one might reasonably wonder whether it would be better not just for the user, but possibly also for overall welfare, if it was accepted that there might be occasional copyright violations but that these would be resolved through out of court settlements.<sup>19</sup> Key issues here are what the costs and fines are in cases of infringement; whether the fine is proportional to the loss suffered by a rights holder; and whether the latter ought to have a duty to make it clear which CMO or other vehicle is used for revenue gathering. The extent of the damages depends too on the type of business requiring the licence. In the case of YouTube-style ones, they will be told to take something down. If they do not comply reasonably fast, then they will

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<sup>17</sup> An interesting question is whether an exclusion could be challenged on competition grounds as an abuse of dominance. The databases may be seen as essential facilities to which some users might be able to force access in return for a reasonable fee.

<sup>18</sup> Given the current set-up. As Katz (2005) points out, there are alternative solutions if the rights holders and publishers are ready to embrace them. Inspiration for this could potentially be drawn from the ebook market.

<sup>19</sup> See *Viacom International, Inc. v. YouTube, Inc.*, No. 07 Civ. 2103.

be held liable. If the service is a Spotify-style one (i.e. no user uploads), then they will be liable straight away as licenses have to be sought before the service is made available. One question is whether the strategic re-assigning of rights can be used to trip up users in order to cash in later, essentially by acting in a manner equivalent to patent trolls.

Large awards have been made for infringements in the past. In June 2015, Sirius paid \$210 million to resolve a long-running lawsuit over its broadcast of older tracks. Online radio provider Pandora has been required to pay out some \$90 million to the three major record companies, Universal, Sony and Warner, along with ABKCO, as payment for use of pre-1972 recordings. Pandora will also pay \$60 million for the use of recordings through 2015, and another \$30 million to cover use in 2016. Last year, recording companies filed a lawsuit in the New York State Supreme Court, accusing Pandora of violating the state's copyright protections by using recordings of older songs without permission. The move followed the success of Flo & Eddie (once of The Turtles) in garnering copyright protection for sound recordings under state laws in both New York and California - although they failed to convince a judge in Florida on the same arguments (Ben, 2013).

### **Everyone Loses Out: the Income**

The complexity of the current system is also likely to lead to overall lower licensing income, simply because users cannot manoeuvre the system efficiently. As a result, they either do not offer a service on the scale they would prefer, or they do not pay all rights holders as they should.

Looking at the system in practice clarifies this. Today, those CMOs that are able to offer truly multi-territorial licenses are managing Hubs. Hubs refer to the separate legal entities founded by a (large-scale) right holder for the purpose of licensing. Most of them cooperate very closely or are even managed by one or more CMOs. These CMOs are as a result able to license this repertoire in addition to their own repertoire. However, the CMO which had originally held these works will not be able to issue a license anymore. Major publishers have bundled their rights in these Hubs but the repertoire is not universal. Instead, repertoire coverage is divided by publisher or even certain by sections of a publisher's repertoire (for example, Latin-American music). The management of Hubs

overlap so that specific CMOs are able to license rights of more than one repertoire. For example, PRS for Music in the UK is involved in 'Peer Music Publishing Anglo-American repertoire, Imagem Anglo-American repertoire, IMPEL Anglo-American repertoire, CELAS and SOLAR<sup>20</sup> (EMI and Sony/ATV Anglo- American repertoire) and Warner Chappell Music Publishing repertoire as a PEDL partner' (PRS, 2015). However, depending on what type of repertoire the user requires, it is likely that she will have to contact more than one CMO to cover all the required rights. The multi-repertoire license has been sacrificed for multi-territorial coverage. The licenses do not combine both.

In addition, these Hubs cover only musical works. All other types of works for which licenses are required cannot be cleared this way. Record labels which own the rights in the performance and phonogram usually manage their rights individually, but on a multi-territorial basis. The exception is Merlin which licenses for a range of Independent labels.<sup>21</sup> There is also some limited cooperation for cross-border licensing among the CMOs in this area. For example, GVL, the German CMO for performances and phonograms, offers multi-territory licenses, but these cover only about 20 member states and is therefore not sufficient for EU-wide clearance, as Europeana<sup>22</sup> requires. Europeana only accepts works which will be accessible in all EU member states (GVL, 2015). As a result, it would be necessary in most cases to contact the record label in order to clear the rights in the records and performances. Contacting the CMOs alone would not be sufficient. Finally, there is still no authoritative list of Hubs and CMOs and of what works and rights are covered, making the process more laborious. As a result, the MTL licensing of musical works is entirely divorced from other works, even when they are intrinsically linked - such as musical works and performances.

Finding Hubs take a significant amount of effort in practice. They are not prominently featured or promoted by the CMOs. There is also no database or similar facility to help users

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<sup>20</sup> SOLAR combines the Hubs from PAECOL (GEMA) and CELAS. GEMA, *Sony/ATV Launches Joint Venture with PRS for Music and GEMA* ([https://www.gema.de/en/aktuelles/sonyatv\\_launches\\_joint\\_venture\\_with\\_prs\\_for\\_music\\_and\\_gema-1/](https://www.gema.de/en/aktuelles/sonyatv_launches_joint_venture_with_prs_for_music_and_gema-1/), last accessed 14/9/15).

<sup>21</sup> Actual membership is not known and therefore may not represent a specific Indie label in question. (<http://www.merlinnetwork.org/>, last accessed 10/9/15).

<sup>22</sup> Europeana is the common gateway where users can access materials digitised and hosted by European cultural heritage institutions. It can be accessed here: <http://www.europeana.eu/portal/>.

determine if there is a Hub able to provide them with the license they seek. Furthermore, even these projects are very limited in scope. In fact, most focus on the Anglo- American repertoire. These Hubs also do not have separate homepages with licensing facilities that can be contacted directly; they are managed by the CMOs. Thus, the number of potential actors has increased, rather than decreased - another step away from the one-stop-shop that broadcasters enjoy.<sup>23</sup> If musical works cannot be licensed, incomes cannot be generated and therefore the incentivising effect of copyright is itself weakened.

This is made even worse in practice as the Directive omits a key part of the licensing process. Licensing music is a direct result of copyright law, especially the right to control the public performances of musical works and sound recordings. The Directive only sets licensing standards for the rights in musical works. However, from a copyright point of view, performing a work in public, such as streaming or broadcasting it, requires a license covering the performance and the recording of the work. These are considered neighbouring rights and administered by a distinct and separate set of CMOs.

The clearest indication of this is the lack of streaming tariffs via CMOs for neighbouring rights. For example, in Germany a broadcaster needs a license from GEMA for the musical work and from GVL for the performance and the sound recording. For streaming the situation is more complicated and more fragmented. The GVL, for example, does not offer a streaming tariff and in fact also does not mention how to acquire the license in practice. This means that a user has to contact the right holder directly - a very onerous process in practice, given the large number of record labels and other right holders involved. The situation is not any different in the other member states: in all our cases the access to neighbouring rights for online exploitation is limited in comparison to analogue uses (such as broadcasting). In this respect, it is unrealistic to expect users to acquire the correct license in

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<sup>23</sup> This highlights the fundamental trade-off between the greater convenience of dealing with a single firm, a monopoly, and that with a monopoly there is no competition. A similar dilemma has in the past arisen in the case of “yellow pages”, where both advertisers and consumers would prefer a single provider so long as that provider did not abuse its monopoly position.

a system that is vague, highly complex and unable to meet the demand. The failure of licensing practices to change quickly enough could actually harm the aim of copyright as whole.

### **The Freedom of the Right Holder**

For the user, the fragmentation of the rights is the root of the problem. However, the Directive explicitly allows copyright holders to split their rights into bundles, based on the type of right and the territorial scope. This results in a worsening of the situation: the administration of rights has become increasingly fragmented (Cooke, 2015). In particular publishers and record labels can now administer their rights themselves, having withdrawn them from the CMO system (Arezzo, 2015: 545; EU, 2014: Part III). However, they have not withdrawn the works as a whole, but instead only the online rights. In other words, while the CMO may be able to license the work for broadcasting, it cannot do so for online exploitation. This fragmentation places a substantial burden on CMOs and right holders to keep track of who holds what right to which work. This task should not be underestimated.<sup>24</sup> Some CMOs themselves struggle to identify the specific works and rights that they administer (Ranaivoson et al, 2013: 674).

Secondly, by allowing not only CMOs but also rights management organisations (which focus on licensing without the collective component)<sup>25</sup> to administer rights, the Directive has effectively endorsed the licensing Hubs. Given the demand for multi-territorial licenses, CMOs have had to cooperate with each other and with major publishers to offer multi-territorial licenses. While these Hubs are managed by the CMOs, they are distinct from them. What this means is that rather than compete with each other to offer multi-territorial licenses, CMOs are being hired by right holders to do this via a clearing house system. It also means that the usual social and collective features of the CMO, a key element in the justification of their existence is being marginalised.

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<sup>24</sup> In this respect some may argue that the CMOs are simply left with the wrong “technology”, i.e. data bases, which may make the intervention by the Commission looking harsh. An unresolved question is whether the CMOs have innovated less than on other sectors because they were part of a set of cosy monopolists or because there are some issues which make it fundamentally harder to bring music into the 21<sup>st</sup> century.

<sup>25</sup> CMOs license works and use some of their income for services to the membership as whole, including social insurances, pensions and cross-subsidising of genres. Rights management organisations license works and distribute the income to the right holders, without providing broader services like CMOs do. As a result, the cross-subsidising from successful to less successful right holders is significantly more limited.

In summary, the remedy which was supposed to bring about CMOs that provide multi-territorial licenses has instead created a fragmented system where it is no longer clear anymore what a license covers. Right holders have now got the power to choose where to register their rights. Their decision will be determined both by the nature and offerings of those who are willing to have the rights registered to them and the users of the services of those organisations, such as the streaming services themselves and their consumers. While it is unhelpful to look at this market through the lens of the theory of two-sided markets, it is important to keep in mind that to achieve the best financial outcome for the rights holders, creating appropriate bundles of music is clearly valuable (Arezzo, 2015). In other words, there is a natural tendency to have CMOs that cover all works and represent all rights.

### **To the Benefit of Whom?**

In addition to the problems of rights fragmentation, there are questions about the benefit to be derived for the majority of authors. The clear winners of the changes are successful artists and large right holders, such as publishers and labels. They have the resources to administer their rights on their own (Ficsor, 2002: 97; Handke and Towse, 2007: 10).<sup>26</sup> This trend has been confirmed by Arezzo (2015) who sees the publishers as exploiting the new options. Withdrawal of rights in order to ensure efficient administration is not a realistic option for most right holders, a problem that is compounded by the fact that CMOs are not required to use a common language.

In addition to the practical and technical issues not addressed by the Directive, the Commission has a highly simplistic view of author preferences. It does not allow for how interests within the right holder group may differ. Larger right holders have an interest in leaving because, for them, economic performance is key.<sup>27</sup> Successful artists and commercial copyright holders have an interest in generating revenue, as compared to a less successful artist who may rely on a wider

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<sup>26</sup> They also have more lobbying power and it is important to be alert to the dangers that such lobbying power leads inappropriate regulation and potentially slower convergence.

<sup>27</sup> This is a well-known problem for cooperatives – and at least for some aspects of the business model, one can equate a CMO with a marketing cooperative. When cooperatives have members with very diverse interests and aims, the cooperative tends to malfunction and the more powerful members tend to leave as they can do better on their own.

distribution of their works in order to generate a fan base (Kretschmer, 2003). In terms of rights administration, this translates into the larger owners preferring efficiency above other services that CMOs provide (for example, social insurance).

Following Commission logic, relying on increased competition protected through competition law can make CMOs focus both on getting faster, more accurate practices as well as lowering overheads. However, there is no accepted measure for CMO performance (Towse and Handke, 2007: 6) and, therefore, for 'efficiency'. The one figure indicating the cost of rights administration for the copyright owner is the administration rate. It measures the percentage of royalties which are used for administration and indicates its relative cost. This is the only figure which the CMO Directive requires to be published (EU, 2014: art. 22 and Annex). For copyright holders focusing on economic value, therefore, a lower administration rate is more attractive.

The reliance on administration rates, however, has two major drawbacks. First, in a world with choice between CMOs this would seem an inadequate measure of performance. Having a measure which focuses solely on the cost side is rather limited, since an artist is interested in the absolute amount of money she receives. To be satisfied with the current measure would amount to always preferring a CMO which had low costs, but which generated very little revenue, to one with high costs but also high revenue.

Secondly, if CMOs choose to compete, as the Commission intends, it would be on the basis of the administration rate as an indicator of economic efficiency. This would attract the right holders with the most valuable repertoire. The administration fee is currently the same, irrespective of the actual cost of collection. However, as more successful works are easier to administer in practice, larger right holders are cross-subsiding less successful ones (Wallis et al., 1999: 14-15). They, therefore, have an incentive to leave; as a result, the cross-subsidy is likely to unravel.<sup>28</sup> CMOs seeking to prevent this are more prone to the influence of these larger right holders. As their threat to exit is also the most credible, it will enhance their influence within CMOs (Handke and Towse,

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<sup>28</sup> Competition typically leads to an unravelling of cross subsidies.

2007: 10). As CMOs have in practice significant leeway in determining both the tariffs as well as the distribution policies (Handle and Towse, 2007: 6), smaller right holders are more likely to be losing out.

A possible casualty of a more economic/competition approach in this market is the demise of the social and cultural features of the old CMOs. These required a cross subsidy between artists. With the focus on the economic value of the organisation, the incentive to provide these subsidies will decrease. CMOs with a stronger social component would be left with repertoire of a lower market value, raising the costs per work even more (Handke and Towse, 2007: 10). At the same time, it is hard to see the justification for these services being bundled with the other activities of a CMO and being protected through competition law. Channelling the funds from online exploitation past the established CMO system is likely to work in the same way.

This situation feeds back into one of the main issues raised by the effect of copyright. Copyright protection, and especially its strengthening, is usually linked to the harm it does to creators, rather than to the larger corporations which do not create works, but exploit them. This concern derives from the assumption of 'the romantic author': the lone creator who works independently.<sup>29</sup> This paradigm is further reinforced by the language used to describe unauthorised use, most notably the moral condemnation of piracy (Ricketson et al., 2006: 21). A similar argument has been made in relation to the term extension for performers. Famous artists, especially Sir Cliff Richard, have actively lobbied on this basis (Atkinson, 2013).<sup>30</sup> However, as the licensing regime moves away from income from shared performance rights as a CMOs guarantee<sup>31</sup>, the benefits to the creator are further undermined. The fear is that the regime is increasingly serving the interests of the large stakeholders, whether corporate or individual.<sup>32</sup>

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<sup>29</sup> For a more detailed description, see Rose 1993 and Campbell 2006.

<sup>30</sup> Cliff Richard does not write songs, he only performs them. This makes him a performer but not an author under copyright law. However, it shows how the notion of creativity has expanded over time.

<sup>31</sup> Most commonly, the income is divided 1:1:1 between the composer, lyricist and publisher, with payments directly to the right holder.

<sup>32</sup> For a detailed empirical analysis of copyright reforms from this angle, see Schroff (2014).



## Conclusion

Our empirical investigation clearly shows that the current system in place for online music licenses is falling significantly short of the Commission's aims.<sup>33</sup> First, it is nearly impossible to determine who can offer an online license, covering which works for what territories. The information asymmetry faced by users has been made even more problematic by Hubs with limited coverage because it increases the number of relevant players. (This issue has been known about for at least a decade, yet no obvious solution has emerged). Secondly, the price of licenses is also unknown. While a system of tariffs is supposed to reduce the transaction costs by addressing the information asymmetry, this is not the case for online licenses. Standard online licenses are not pan-European. At the same time, there is virtually no information available on the cost of pan-European licenses as granted by Hubs. Thirdly, rather than competing with other, CMOs are hiring out their administrative capabilities to large scale right holders, in particular publishers. All of the major Hubs are associated and run out of the offices of a major CMO, in particular PRS, GEMA, SACEM and SGAE. Their changes are not aimed at the individual creator but instead large intermediaries. As these Hubs are separated from the CMOs, the revenue they generate is separate too, and may, therefore, not contribute to the social/cultural aspects of the CMOs work. In other words, CMOs are helping large right holders to channel income past the established system. As the major CMOs are already complying with the CMO Directive, we are left to ask: what is wrong with the EU's attempt to meet the demands of digitalisation?

The current insistence on rights being assigned to a single CMO makes the problems worse. Right holders are unable to create competition through multi-homing. As Katz (2005 and 2006) argues, CMOs were not necessarily natural monopolies under the analogue regime and are even less likely to be so under the new digital regime. Some components, such as the databases of works and

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<sup>33</sup> The same is true for the sales of digital music, see Gómez and Martens (2015).

right holders, may be, but the collection of revenue and the single assignment of rights clearly need not be. Because there is a strong commercial interest on the part of all stakeholders to have a comprehensive CMO, at least within genres, monopolies are likely to emerge naturally. It is difficult to see how competition will remain. Whether this will ultimately lead all to be in the same organisation or bodies organised along the lines of a particular repertoire is difficult to predict. One thing which seems abundantly clear is that national organisations are unlikely to survive. By allowing right holders to assign their rights in any way they want, but not permitting simultaneous assignment, the result is likely to be a new system of monopolies or oligopolies. The only difference will be the basis of the distinction, from national monopolies to repertoire-based ones.

Our reading of the Directive and our case studies suggest that

- By mis-conceptualising CMOs, the remedies to ensure more competition have had unintended effects – for instance, the creation of clearing houses managed by CMOs rather than competition between CMOs
- The Directive does not go far enough: rights are still assigned on an exclusive basis and therefore cannot be assigned to several agents at the same time
- In the matter of non-exclusive rights assignment: several CMOs can license a work, so the user is not detrimentally affected; at the same time, right holders can exclude some badly managed CMOs, while remaining within the licensing regime

Our research has also enabled us to identify a number of further questions:

- Given that licensing is intimately linked to the copyright system, should the copyright system be reformed to accommodate changes in licensing - in particular, for the protection of consumers and less successful authors?
- Are performing rights and their licensing really different from other works and rights (for example, ebooks)?

- What problems should a reformed licensing system have to address? Is streaming equivalent to other disruptive technologies and/or initiatives in other markets such as Uber and Airbnb?

Given the importance of licensing practice to the legitimacy and effectiveness of copyright more broadly, linking the two directly at EU level is a potential avenue of fruitful reform. Although beyond the scope of this paper, future research should investigate how the effect of copyright is shaped by the licensing process. Key to this is the current absence of copyright contract law rules to cushion the effect of changes in the licensing practices for less successful artists. Furthermore, research should investigate the option of resorting to harmonisation (potentially in combination with a re-adjusted competition approach), as was done with areas of protection, to standardise licensing practices and the availability of licenses across borders. Examining the effects of copyright in this context is especially important, given the ongoing EU copyright review.

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