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Lost in Translation?

A Critique of the Katz Papers

The European Commission's Competition Unit has cited two new academic papers by Ariel Katz as being influential in their thinking about Performing Rights organisations (PROs). And their negative title - "The Potential Demise of another Natural Monopoly" - should raise eyebrows, if not concerns. In this issue of Insight, Will Page, Executive Director of Research at the MCPS-PRS Alliance, offers a critique of the Katz Papers. Whilst welcoming Katz's contribution to the debate, the objective here is to highlight where his economic theory gets 'lost' in the applied world of collective licensing.

Ariel Katz published two papers which challenge the collective administration of performing rights. The first questions the natural monopoly paradigm, whereas the second argues that technology has lowered transaction costs which further undermine the justification for collective administration. The author previously worked for four years at the Israeli Anti-trust Authority (IAA) and is now Assistant Professor of Law at the University of Toronto. The papers were published in the Journal of Competition Law and Economics in 2005 and 2006.

These papers are of particular interest as there has been little in the way of economic literature on copyright collectives since the Besen et al 1992 paper; which enhances the necessity to challenge Katz's view of PROs. Moreover, both of Katz's papers were based largely around the US and Canadian experience, where many of the arguments get lost when translated to the UK and European context. For example, Katz focuses much of his attention on Payola (a US phenomenon) and little on commission rates (an EU concern).

That aside, a core set of economic arguments are put forward, namely: source-licensing, rebundling rights, and disintermediation through DRM. Source licensing is proposed as a way of replacing the PROs blanket licence with direct licensing from the publishers. This, in turn, would lead to incentives to re-bundle right, thus reducing fragmentation and, with it, the need for collecting societies. Finally,

DRM would accentuate this process, by lowering the cost of licensing rights. Consequently, Katz argues that many of the cost efficiencies that are attributed to PROs are usually simply assumed and, in many cases, could be achieved under less restrictive arrangements.

What's most alarming about Katz's proposals is that they are skewed toward the view of the intermediary, and neither show little understanding of how the creator works, nor how they are compensated for their work. What follows, therefore, is a concise distillation of ten key economic arguments which show how the regulatory impact of the Katz proposals would be, at best, counter productive for writers and composers. Whilst Katz's work should be welcomed, the objective here is to highlight where economic theory gets 'lost' in the applied world of collective licensing.

- **Lost in Theory** - His core argument for 'source licensing' is theoretically sound, but much of what he is proposing seems to come full circle: from having a not-for-profit monopoly which has no barriers to entry towards a for-profit oligopoly, where there are barriers to entry. Wouldn't this result in deeper market concentration of rights ownership by the existing intermediaries and less negotiation power for individual creators?
- **Lost in Application** - He argues that "re-bundling rights might provide writers with the proper incentive to avoid fragmentation". However, this ignores the actual way compositions are created and would force writers to work only with other writers in their 'bundle', effectively restricting their creative freedom. In addition, those artists who can't "re-bundle" (largely for reasons beyond their control) would be discriminated against.
- **Lost in Translation** - The 'Payola conundrum', which Katz refers to throughout his first paper, is based around the US experience, and does not translate easily to Europe. In addition, incentives for payola are skewed towards the master recording right, and not the underlying composition. Finally, the inverse of payola could



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perceivably operate with a public broadcaster whose mandate might be to invest in culture - which could make the PROs monopoly-based fees be viewed as a form of 'wealth transfers'.

- **Lost in Pricing** - Katz views blanket licences as a monopoly forcing an 'all or nothing' bargain to extract a higher value for the licence. However, in reality, blanket licences are based around a formula which usually takes account of the licensee's level of music usage and either the licensee's revenue or audience figures. Also, the blanket licences are often negotiable to take account of the unique circumstances of the end user. Blankets can also encourage a wider use of the available repertoire at no incremental cost.
- **Lost in Governance** - Katz fails to fully understand the unique membership-governance structure of PROs. Think causation: models for clearing rights, whether collective or individual, respond to new models for consuming intellectual property. When a new market evolves, rights holders have the choice in deciding how best to clear those rights. Whereas Katz refers to PROs as suppressing choice, the PRS board are the rights holders and it is they who have the right to change the mandate of collection.
- **Lost in the Interests of the Rights User** - Katz focuses solely on undermining collective rights management without explaining what the impacts will be on the other actors involved - namely the rights user. For example, the music user will need to identify the individual master, mechanical, performing, and synch rights for each individual holder and then apply to each of them for a licence. Consequently, these additional transaction costs could lead to adverse distortionary effects in terms of the overall demand for music.
- **Lost in the Interests of the Rights Holder** - Whereas Katz proposals could lead to increasing transaction costs to the user, they might also increase 'shoe leather costs' to the rights holder. The fragmentation of registration, statements, and enforcement and royalty payments due to multiple intermediaries would be increasingly burdensome to manage. Consequently, his proposals would be akin to having five sets of bank accounts for five different income streams - and if the market was truly contestable, it might even be more!
- **Lost in the Definition of DRM** - Katz's presents a very high level theoretical overview of DRM without acknowledging its true complexity in

areas such as global standardisation. Thus, the term DRM should be viewed as a broad, catch-all phrase that comprises a number of highly complex technical components that include the following rights management (Identification; Metadata; Rights Language; Persistent Association; Privacy; Payment and Event Reporting) and technological protection (Encryption, Watermarking and Fingerprinting).

- **Lost in Market Concentration** - Katz cites a UK inquiry into PROs which found that, in 1993, the highest-earning 19.5% of writers accounted for some 92% of the royalty distributions. He draws a similar comparison with publishers too. However, what he fails to do is to (i) question this measure of concentration and (ii) come off the regulatory fence and state whether (and why) this level of concentration is a good thing, or not.
- **Lost in Contestability** - Its worth noting that Katz, rightly, raises the theory of contestable markets which requires that entry is economically viable (and exit is absolutely costless), and free entry for this purpose means that the entrant suffers no cost discrimination compared to the incumbent. In reality, though, the entrant might be able to contest on information goods like repertoire, but he does not explain how the less-contestable markets such as data and credibility would play out under his proposals.

Finally, Katz appears to have ignored developments such as the 'Long Tail', where the internet has acted as a catalyst for the growth of niche markets. This development goes against Katz preferred view of market concentration, (where power is held within an oligopoly of 4-5 publishing houses), as the writer/composer could effectively use the PRO as a sole intermediary between their works and the consumer. Furthermore, the long tail effect could also be used as a negotiating tool for individuals to get better terms from existing intermediaries.

Similarly, in a Katz world, it's plausible to see smaller independent publishers would become swamped by this new form of market concentration. Whilst economic arguments might play out as to the pros and cons of this, it's worth understanding that - in the real world - smaller publishers provide an important service to the majors in terms of scouting and developing new talent. Consequently, a sceptic could view Katz's proposals as representing an intermediaries' knee jerk reaction- that is anti-competitive - to the Long Tail's increasing empowerment of individuals and independents.