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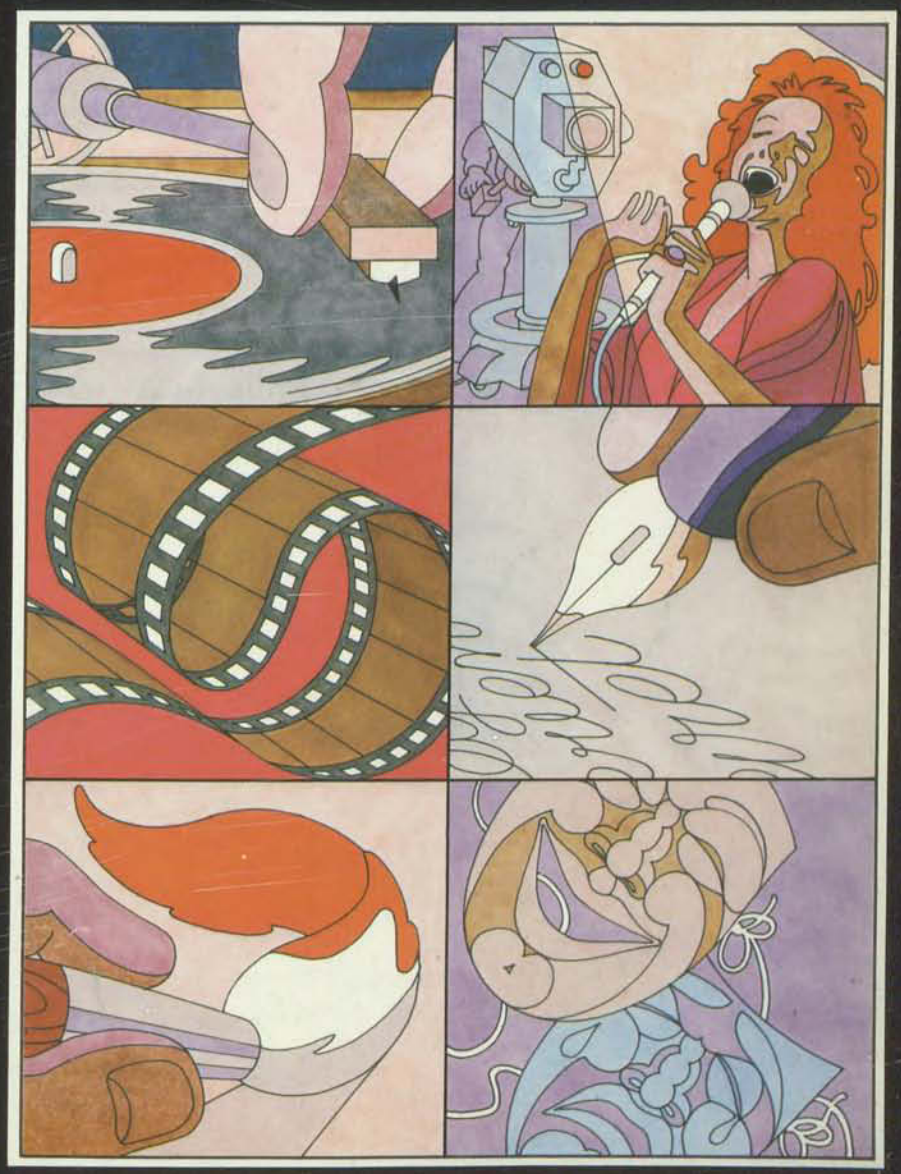
The Mechanical Reproduction of Musical Works in Canada

Mike Berthiaume
Jim Keon



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THE MECHANICAL REPRODUCTION OF MUSICAL WORKS IN CANADA

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and
Jim Keon

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FOREWORD

This series of studies concerning aspects of copyright law was initiated to provide a better understanding of some important problems and issues involved in the revision of the Canadian Copyright Act. The present Act is now more than fifty years old. The wide breadth of legal, economic and technological developments since the Act was proclaimed underlie the significance of the revision process. The creation and dissemination of information is becoming an increasingly important resource of our society. In addition, the copyright community including authors, publishers, the film and video industries, broadcasters, the recording industry, educators, librarians and users, contributes hundreds of millions of dollars to the economy. For these reasons the Research and International Affairs Branch of the Bureau of Corporate Affairs felt it necessary to undertake in-depth economic and legal research into the cultural, economic and legal implications of the most important of the copyright issues.

With respect to the appropriateness of the economic studies of this series the following passage from the 1971 study of the Economic Council of Canada entitled Report on Intellectual and Industrial Property is perhaps the most perceptive and eloquent.

> It is sometimes implied that where cultural goals are important, economic analysis, with its base associations of the market place, should take a back seat. But this involves a serious misconception of the proper and useful role of economic analysis. It may well be true that in the final analysis, economics is much more concerned with means than with ends, and that the really fundamental "achievement goals" of a society are largely, if not wholly, non-economic in nature. It is also true, however, that, in practice, means can have an enormous influence on ends, whether for good or ill, and that as a result, the systematic analysis of economic means is indispensable both in the specification of social goals and the planning of how to achieve them. In the case of cultural goals, among others, economic analysis can be of great help in bringing about a clearer identification of the goals in the first place, and then in planning for their attainment by the shortest, least costly and most perseverance-inducing route.
>
> It is particularly important that the relevance of cultural goals in a policy-planning situation should not be used as a smoke screen behind which material

> interests are allowed to shelter unexamined. In an increasingly service-oriented and knowledge-based society, cultural matters in the broadest sense are to a growing extent what economic life is all about. They must not fail to be studied in their economic as well as their other aspects. (pp. 139-140)

It is within this spirit that the economic studies completed for the Branch have been commissioned and carried out.

In addition to internal studies, the Branch has contracted with research academics from the Canadian university community who have a special interest in copyright. The external funding of research provides the Branch with new insights and perceptions from some of the most highly skilled academics in Canada with respect to the many complex issues inherent in the revision of the Copyright Act. Additionally, it serves to foster an interest and involvement in these important policy issues amongst others within the academic community. Such involvement and input can only lead to a better understanding and a consequent improvement in the copyright policy formation process.

This study by Jim Keon and Mike Berthiaume of the Research and International Affairs Branch examines the many facets of the present compulsory licensing provisions regarding the mechanical reproduction of musical works in Canada. These provisions have governed the operation of the recording of musical works in Canada since their introduction in 1921. The authors examine in detail the rationale for the continuance of the system and make recommendations regarding the two central issues of the method of calculation of the royalty rate and its level. In addition, recommendations are made in regard to the administrative procedures with an eye to eliminating any problems or inconsistencies with them.

The questions surrounding the need for and the specifications of a compulsory licensing system provide a particularly strong example of one of the many copyright issues on which there are diametrically opposing views and interests. The authors of this report have provided a serious and intelligent examination of the many facets of the compulsory licensing scheme and this will undoubtedly provide policy makers as well as other interested private and public sector groups with a greater understanding and appreciation of the difficult decisions which need to be made.

The results and recommendations contained in this study are those of the authors and do not necessarily imply acceptance of same by Consumer and Corporate Affairs Canada. We

believe that this approach is optimal for the purpose of encouraging the researchers to employ the widest scope in both the creation and presentation of their views.

Fenton Hay

Dr. Fenton Hay
Director
Research & International Affairs
Branch

Executive Summary

A recording or mechanical reproduction right was provided to the owners of copyright in literary, dramatic and musical works in Canada in the Copyright Act of 1921. The exercise of the right was, however, controlled by the incorporation of a system of compulsory licensing. This system remains in place today and has formed the basis upon which the functioning and growth of the recording industry in Canada has taken place. In essence, the compulsory licence provisions of the Act provide that once a mechanical reproduction of a musical, literary or dramatic work has been made, with the consent of the owner of copyright in the work, anyone else can make a recording of that work subject to meeting the requirements of the Act.

The report examines the several different facets of the compulsory licensing system and offers recommendations for its improvement. The major conclusions of the report include the following:

a) A compulsory licensing system should be maintained.

b) Literary, dramatic and audio-video works incorporating musical works should not be subject to the compulsory license.

c) The calculation of the rate should be on a per tune basis and the rate itself should be amended to reflect current industry practice in Canada.

d) A system for providing for increases in the rate was recommended.

e) A scheme for directly funding Canadian composers and lyricists in addition to the rewards provided in the Copyright Act was put forth.

The first chapter examines the relationship between the Canadian compulsory licensing provisions and Canada's international obligations under the international copyright conventions. It was determined that neither the present compulsory licensing provisions nor the proposed amendments conflict with either of the two major conventions to which Canada adheres.

The next chapter investigates the rationale for compulsory copyright licensing systems in general and considers the rationale for continuing the Canadian mechanical reproduction compulsory licensing system. It is argued that this compulsory licensing scheme should be maintained for two major reasons:

1) The present system appears to have been successful in encouraging competition in the recording of musical compositions.

2) Most of Canada's major trading partners, including the United Kingdom, the United States and Japan, have legislative provisions for compulsory recording licenses. Thus, if Canada were to remove its provisions, Canadian record companies could be placed at a serious disadvantage vis-à-vis foreign competitors.

The report next analysed questions surrounding the scope of the compulsory licensing system, i.e., what works should be included and what factors should trigger the license. Under the present Act, literary and dramatic works are subject to the compulsory licensing provisions when they are recorded. It was recommended that the system should be limited to musical works exclusively and should not include purely literary or dramatic works. This position was a reflection of the fact that, while sound recordings are the primary mechanism for exploiting musical works, this is not the case with respect to literary or dramatic works. The returns to the owners of copyright in literary and dramatic works that would be mechanically reproduced would be unfairly low when compared to the returns to copyright owners of musical works, due to the difference in sales volume.

The main complication which arises from audio-visual entities, such as films with sound tracks and analogous media, is that, due to the broad language of the present Act, they can fall within the ambit of the compulsory licensing section, notwithstanding their hybrid nature. Thus the dialogue and music in a movie or videotape could be reproduced under a compulsory license. The report recommends that the compulsory license of section 19(1) apply to forms of media which include sounds only. This proposal could have important implications since it ensures that the music contained on videotapes and videodiscs will be excluded from the section.

It was further recommended that Canadian record companies should have the right to record any musical work, once it has been recorded anywhere in the world with the consent of the copyright owner. Failure to provide this right could result in conflict among the various owners of copyright in musical works contained on a long-playing album or tape where certain owners wished to have the album reproduced in Canada while others did not. This recommendation would clearly establish in the Act what has long been industry practice.

From a practical economic perspective, the two major items to be determined were: a) the method of calculation of the royalty rate, and b) its level. With respect to the former, it was recommended that the status quo be maintained with the calculation remaining on a per-composition basis. Administratively, a percentage of retail price system is more complex but, in addition and more importantly, it entails a system whereby as prices increased there would be a continued increase in mechanical royalties - the majority of which would flow out of the country. Yet it is not at all clear that it is in Canada's best interest to have these royalties increase.

With respect to the rate, it was recommended that it be increased from the two cents per side as presently stated in the Act to reflect those rates which existing market forces have produced. Despite strong suggestions by composer and publisher interests that the present industry rate is too low, there are a number of other factors to be considered.

First, the empirical evidence indicated that the level of both mechanical and performing right royalties being paid in Canada has consistently increased. Second, the diminished role of music publishers who, in the majority of cases share the royalties equally with the composers/lyricists, supported the equity of a comparable decrease in the publishers' relative returns from the sale of works embodying musical compositions. Third and equally important, much of any increase in mechanical royalties would go to the most successful composers/lyricists, most of whom are non-Canadian, and their publishers. In the present Canadian music industry, the bulk - over 90 per cent of increased royalties - would go to foreign copyright holders.

For all of these reasons it was recommended that the mechanical royalties rate should be specified as two cents per composition plus one-half cent per minute in excess of five minutes for each record sold, which reflects current industry practice.

It was provided, however, that the rate be subject to review by a tribunal at five-year intervals. This is an important and necessary recommendation as it will provide greater flexibility in allowing the rate to be changed if and when the royalty payments are felt to reflect inadequately the existing market situation.

Finally it was proposed that, to the extent that it appears appropriate to direct more funds to less established Canadian composers/lyricists, there are far more efficient means of providing for such transfers than by an increase in mechanical reproduction royalties. The authors are of the opinion that such measures could be introduced prior to or coincident with the introduction of new copyright legislation and should be given due consideration.

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INTRODUCTION

A recording or mechanical reproduction right was provided to the owners of copyright in musical works in Canada in the Copyright Act of 1921. The exercise of the right was, however, controlled by the incorporation of a system of compulsory licensing. This system remains in place today and has formed the basis upon which the functioning and growth of the recording industry in Canada has taken place. In essence, the compulsory license provisions of the Act state that once a mechanical reproduction of a musical work has been made, anyone else can also make a recording of that work, subject to meeting the requirements of the Act.

This paper examines the different facets of the present compulsory licensing system and offers recommendations for its improvement. In Chapter I the relationship between the Canadian compulsory mechanical reproduction provisions and Canada's international obligations under international conventions is examined.

Chapter II contains an investigation of the rationale for compulsory copyright licensing systems in general. This is followed by a discussion of the reasons for the introduction of the Canadian scheme of compulsory mechanical reproduction licensing, and finally arguments in support of its continued existence are presented.

Chapter III presents a clarification of the scope of the compulsory licensing system. Questions concerning the definition of a musical work, the desirability of excluding literary and dramatic works and sound tracks of cinematographic works from compulsory licensing, and the factors that trigger the system are discussed, and recommendations for clarification and improvement are offered.

Chapter IV deals with the fundamental and contentious questions of the appropriate basis for royalty calculation and the determination of the optimal royalty rate. In addition, an examination is undertaken of the contrasting proposals concerning whether royalties should be paid in respect of all records made or only in respect of records that have been sold. The apportionment of royalties and the frequency of payment are also discussed in this chapter.

The final chapter of the paper deals with the mechanics of the system. Issues such as the need for, and the required type of, notices as well as the remedies to be provided for non-compliance with the compulsory license requirements are presented, and recommendations regarding these matters are set out.

CHAPTER I

COMPULSORY LICENSING IN CANADA AND THE INTERNATIONAL COPYRIGHT CONVENTION

Canada

As explained in a recent paper on the possibility of introducing a performing right in sound recordings (Keon, 1979, p. 2), whether a recording takes the form of a phonorecord, tape, cassette or other contrivance, it "contains" two separate and distinct copyrightable entities and entails two separate copyright owners.

> As well there are two major separate and distinct rights which can be protected under the copyright provisions. One must distinguish between a) the physical object, the phonorecord or the magnetic tape, b) the musical composition and c) the sound recording which is contained within the physical object. It is therefore important to distinguish between the copyright protecting the underlying musical composition which accrues to the author/composer and the copyright protecting particular renditions of these compositions which accrues to the person responsible for the fixation of the work in a recording. (Keon, 1979, p. 2)

Among the various rights exclusively reserved to the author/composer by virtue of the definition of "copyright" in section 3(1)(d) of the Copyright Act, is the sole right:

> in the case of a literary, dramatic or musical work, to make any record, perforated roll, cinematograph film, or other contrivance by means of which the work may be mechanically performed or delivered; ... and to authorize any such acts as aforesaid. (Copyright Act, 1970, s. 3(1)(d))

The above-described right is commonly referred to as the mechanical reproduction right and, in effect, it provides the author/composer with the exclusive right to make, or to authorize someone else to make, a mechanical contrivance reproducing his work. Thus, it would appear that the author/composer has absolute control over mechanical reproduction of his work. However, the mechanical reproduction right is subject to a significant qualification in the form of the so-

called[1] compulsory licensing system in section 19 of the Copyright Act.

Under subsection 19(1), it is not deemed to be an infringement of copyright to make, within Canada, a mechanical contrivance that reproduces a literary, musical or dramatic work, if one proves that (a) the work has previously been reproduced by or with the consent or acquiescence of the copyright owner, and (b) that the prescribed notice and royalty payment requirements have been met. Therefore, once a literary, musical or dramatic work has been recorded by, or with the consent or acquiescence of, the copyright owner, the work may be similarly recorded by anyone else without the express consent of the copyright owner. So long as the statutory conditions relating to notice and royalty payments are also complied with, what would otherwise constitute infringement of the copyright owner's mechanical reproduction right will be deemed not to be such an infringement, by virtue of section 19. The provision of subsection 19(1) is the crux of the compulsory licensing regime, and the nine other subsections of section 19 and regulations 21 to 26 merely provide detailed mechanics of same. The material in these subsections and regulations will be dealt with later.

International Obligations

Canada, as a member of the global community, has established copyright relations with other countries through international copyright conventions. There are two principal conventions: the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention) and the Universal Copyright Convention (UCC). Although the conventions do not have a direct effect in Canada, since they are not part of our domestic law, they do have an indirect affect in that certain obligations arise under them. Insofar as these obligations are sought to be fulfilled by enactments in domestic statutes, such as the Copyright Act, the conventions have some importance both in setting objectives for domestic provisions and in construing them once enacted (Fox, 1967, pp. 547 and 548). Therefore, in any examination of our

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[1] There is some disagreement as to whether the scheme of section 19 ought to be characterized as compulsory licensing, statutory licensing or merely an exception to infringement dependent upon fulfillment of certain conditions. However, despite this, inasmuch as the term "compulsory licensing" has had long general use, and satisfactorily describes the effect of section 19, it will be so used in this paper.

Copyright Act such as is undertaken here, consideration must be given to the relevant conventions.

The Berne Convention

Canada at present adheres to the 1928 Rome text of the Berne Convention.[2] Article 13 of the Rome text addresses, among other things,[3] the mechanical reproduction right in musical works. This Article, introduced in the 1908 Berlin text of the Convention, represented an about-face in the principles governing mechanical reproduction of such works. Previous to 1908, the guiding principle was Article 3 of the Closing Protocol of the Berne Convention of 1886 which provided that:

> the manufacture and sale of instruments serving to reproduce mechanically musical airs in which copyright subsists shall not be considered as constituting infringement of musical copyright.

In 1886, the phenomenon of mechanical reproduction was, on the whole, a novelty of little apparent economic importance. However, by 1908, approximately 20 years after the development of the flat record disc, the fledgling industry had reached such proportions as to dictate the addition of Article 13 in the Berlin text (Spicer Report, 1959, p. 32).

Article 13 was retained in the Rome text of the Berne Convention and we will focus on paragraphs 1 and 2. Paragraph 1 establishes that authors of musical works should have a mechanical reproduction right in such works. In purported conformity with this paragraph, the mechanical reproduction right was provided for in subsection 3(1) of the Canadian Copyright Act. It is noteworthy that this right is provided in the Convention only with respect to musical works, whereas in subsection 3(1)(d), the scope of the right is considerably broader in that it applies to literary and dramatic works as well. It is doubtful that the broader Canadian provision contravenes the Convention in a strict sense, since Article 19 of the Convention specifically adverts to the possibility of broader protection in the laws of member countries:

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[2] The Berne Convention has been revised three times since 1928, most recently in 1971 at Paris, France. Canada, however, has not yet acceded to any later text of the Convention than the 1928 version.

[3] Article 13 also deals with a performance right which is outside the scope of this paper.

> The provisions of the present Convention shall not prevent a claim being made for the application of any wider provisions which may be made by the legislation of a country of the Union in favour of foreigners in general.

Thus the rights laid down by the Convention are merely minima, and as such do not prevent the enactment of, or the claim to, broader rights in a Berne country's legislation. On the other hand, it would be only logical that going beyond the Convention minima ought to be based on cogent reasons. Inasmuch as no such reasons for ascribing a mechanical reproduction right to literary and dramatic works can be found in published material dealing with the deliberations preceding the enactment of the present Act, one wonders why the Canadian Copyright Act extended such protection. Furthermore, in view of the fact that the Canadian Act evolved from British law, which did not explicitly provide a compulsory license with respect to literary or dramatic works, it would seem that the breadth of the Canadian statute is an inexplicable anomaly.

Paragraph 2 of the Rome text provides, in effect, that reservations and conditions with respect to the mechanical reproduction right in musical works may be determined by the domestic laws of each Berne country, so long as the effect is strictly limited to the country adopting such reservations and conditions. The reservation introduced into Canada's law in conformity with paragraph 2 was the compulsory licensing system (Keyes and Brunet, 1977, p. 91) of section 19. Inasmuch as the reservations and conditions are left entirely to each member country, Canada was, and remains, free to establish a scheme of reservations and conditions in respect of the mechanical reproduction right, such as the compulsory licensing system, without conflicting with the Berne Convention. Thus, despite the distinction between the Canadian provisions and those of the Convention, it is submitted that the former conform to the minima established by the latter.

The Universal Copyright Convention

Canada also adheres to the 1951 Geneva text[4] of the Universal Copyright Convention (UCC). In contrast to the Berne Convention, which attempts to delineate minima with respect to a variety of specified rights, including the mechanical reproduction right, the UCC simply states in Article 1 that each contracting state must provide for "adequate and effective pro-

[4] The UCC was revised in Paris in 1971 but Canada has not acceded to this latest revised text.

tection of the rights of authors and other copyright proprietors." What protection will satisfy this "adequate and effective" yardstick is left open to interpretation (Bogsh, 1972, p. 25).

It is submitted that, in view of the vagueness of Article 1, the Canadian provisions with respect to the mechanical reproduction right and the coincident compulsory license system fit into the yawning chasm of "adequate and effective protection." Enhancing this submission is the fact that the UCC recognizes, in Article 5, the expediency of subjecting an "exclusive right" to a compulsory licensing mechanism.[5] This suggests that the UCC's "adequate and effective protection" does not preclude compulsory licensing.

Further, a number of UCC countries, including the United States, the United Kingdom and Australia, provide for a mechanical reproduction right, limited by compulsory license similar to Canada's, in relation to musical works. To the extent that such schemes are in compliance with the UCC, it is submitted that the Canadian scheme also conforms with Article 1.

In summary then, while compulsory licensing with respect to the mechanical reproduction right in literary, musical and dramatic works is not specifically addressed in the UCC, it is not thereby precluded. Thus, the Canadian Copyright Act does not conflict with the UCC in this respect.

Other Conventions

There are two other international conventions which might have some bearing on phonorecords and which merit brief mention. First, there is the International Convention for the Protection of Performers, Producers and Phonograms and Broadcasting Organizations, otherwise known as the Neighbouring Rights or the Rome Convention. Second, there is the Convention for the Protection of Producers of Phonograms Against Unauthorized Duplications of Their Phonograms, known simply as the Phonograms Convention. Canada has not acceded to either of these conventions.

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[5] Article 5 provides an exclusive right of translation, which is subject to a compulsory license for the translation of a work into the language of a contracting state under certain specific conditions (Lahore, 1977, p. 392).

Article 1 of the Rome Convention states that the protection of the Convention shall in no way affect the protection of copyright in literary and artistic works. Inasmuch as "literary and artistic works," as defined in the Convention, include both dramatic and musical works, the Convention does not affect copyright matters regulated by the Canadian Copyright Act. By the same token, since the Convention deals in part with performance rights of performers, which rights have no equal in the Canadian Copyright Act, the Convention is not relevant to the Copyright Act. The Convention also provides for the reproduction right with respect to phonograms, for the benefit of phonogram producers, somewhat akin to the copyright protection accorded mechanical contrivances in subsection 4(3) of the Canadian Copyright Act. Finally, the Convention deals with certain rights for broadcasters which have no equal in the Canadian Copyright Act. Since the Rome Convention deals with neither the mechanical reproduction right nor any coincident compulsory license, it is not relevant to the focus of this paper and may be disregarded.

In a manner similar to the Rome Convention, the Phonograms Convention seeks to protect the producers of phonograms from the unauthorized duplication or "piracy" of the phonograms that they produce. Again, since this Convention does not deal with either the mechanical reproduction right in musical, literary or dramatic works, or with a coincident compulsory license, it is irrelevant to the subject matter of this paper and may be disregarded.

Conclusion as to the Conventions

The compulsory license provision in section 19 of the Canadian Copyright Act does not conflict with either the Berne Convention or the UCC but, in effect, fulfills their basic tenets. The Rome Convention and the Phonograms Convention are not relevant to our discussion or to compulsory licensing vis-à-vis the mechanical reproduction right in musical, literary and dramatic works.

CHAPTER II

RATIONALE FOR COMPULSORY LICENSING

A system of compulsory licensing is one in which the users of a copyrighted work make payment to the owners for use of the work without direct negotiation. Normally the rates are either set by a tribunal or fixed in the Copyright Act. In Canada the two major income-producing rights (the performing right and the mechanical reproduction right) of the holders of copyright in musical works are both subject to forms of compulsory licensing.

The performing right is administered by the two performing-rights societies (CAPAC and PROCAN) who collect, assess and distribute the royalties. The fees paid by commercial users for the right to perform music publicly are authorized by the Copyright Appeal Board. While negotiation between the commercial users (broadcasters, etc.) and the performing-rights societies does take place, any negotiated rates are subject to the approval of the Board. Rate structures are subject to annual revision.

The mechanical reproduction royalties, on the other hand, are fixed in the Canadian Copyright Act at a statutory rate and are not currently subject to review by a tribunal. The statutory royalty rate was set at two cents for each playing surface of each record or other contrivance. This rate, introduced in 1921 before the introduction of the long-playing album or tape, is no longer followed by the industry. The practice today is to pay two cents per side for singles and one and one-half to two cents for each selection on an album or tape.

Given that the system of compulsory licensing is now an integral part of the recording industry, some justification for its continuance must exist.

In this chapter, the basic rationale for compulsory licensing systems in general, and the specific rationale for the compulsory licensing of the mechanical reproduction of musical works in sound recordings will be explored.

General Rationale for Compulsory Licenses

Keyes and Brunet (1977) were of the opinion that all compulsory provisions constituted a diminution of the copyright-owner's rights: "Compulsory provisions are derogations

of exclusive rights and as such should be strictly construed" (p. 74).

Above and beyond any potential derogations of rights, there are a number of other difficulties associated with compulsory licensing systems. Initially, the difficulties of these systems will be explored, followed by a discussion of the benefits they provide.

The potential problems of compulsory licensing systems include the following:

a) inflexibility with regard to changes in price which will likely lead to the possibility that the market value of the rights in the work subject to the license will bear little relation to the price determined by the compulsory license; and

b) problems with determining equitable distribution; this occurs when the royalties are amassed collectively.[1]

These will be discussed in turn.

a) Inflexibility of rates: in a private market economy, consumers, through the price system, determine the value of goods and services. The more urgently a specific good or service is desired the higher will be the price of this item. Changes in preferences bring about changes in price. The price system functions as the signal for the economic participants to reduce or increase the amount of time and resources devoted to a particular activity. A system of compulsory licenses, with the rates either set by statute or determined by a tribunal, essentially blunts this reallocation function of the price system. It is extremely unlikely that a compulsory licensing system could ever be sensitive enough to perform this function as efficiently as the price system.

If, due to this inflexibility, the price set for the compulsory license is lower in general than the copyright

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[1] A third problem, sometimes argued, is that compulsory licenses force copyright owners to deal with unsavory characters who often do not pay royalties after acquisition of the license. It is not clear, however, that abolishment of a compulsory licensing system would rectify such a problem. If, after acquiring the compulsory license, a party chooses not to pay royalties, then he is acting illegally. It seems that even if the license was not available to him he might proceed and use the material in an illegal manner. In either case, an effective remedy is needed.

owners would achieve in a free-bargaining situation, then it is likely that the number of people engaging in the production of creative works would be lower as well. Similarly, if the compulsory license payment is set above what a competitive market would dictate, (i.e., copyright owners were earning rents) then copyright owners would gain at the expense of users. It is likely that such rents would induce new entrants. The end result would be overcommitment of resources (relative to a negotiated outcome) to the creation of copyrighted works.

In summary, a system of compulsory licensing is unlikely to be flexible enough to allow consumers or intermediate users to signal their preferences explicitly, and this is likely to lead to misallocative effects and a non-optimal output of copyrighted works.

b) Equitable distribution: the other alleged problem associated with a system of compulsory licensing is that methods for the disbursement of the funds are required.[2] As indicated, these difficulties are most prevalent when the rights of copyright holders are administered in a collective fashion. The most striking example of an association having to deal with this problem is again given by the existing performing-rights societies, which have developed intricate systems to monitor and distribute the royalties of their members. The major hurdle to be overcome in any distribution system is matching the relative value of a work with the compensation to be paid to the owner. Liebowitz discussed the difficulties that the holders of copyright in musical works would have in proving the extent to which their song was responsible for the success of a long-playing album or tape. He argued that inequities in the distribution of funds are likely to result. A system of strict copyright liability would presumably ameliorate these inequities by providing for a bargaining situation.

Balanced against these disadvantages are certain strong advantages which must be noted.

First, there is the reduction in transaction and administrative costs that compulsory licensing systems permit. The need to contact, negotiate with and receive the approval to use copyrighted works from all owners is often laborious, time-consuming and expensive. Lengthy searches and drawn-out negotiations in ascertaining ownership of the goods and determining equitable royalty rates result. That these costs are significant was explained to the department in several of the

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[2] For a somewhat similar discussion of the problems of compulsory licensing schemes see Liebowitz, 1979, pp. 19 and 20.

copyright briefs received in response to the Keyes and Brunet paper. A particularly revealing quotation comes from the brief prepared by F. Hébert of the CNIB:

> Most agencies which produce materials for the exclusive use of blind or handicapped readers, are required to obtain permission to do so from the copyright owners. In many cases, permissions are speedily given, in a spirit of generosity and understanding. But in a growing number of cases, the obtaining of permissions is a procedure fraught with delays and frustrations. Extreme delays can result in tracing the copyright owner. An initial letter may be forwarded to three or four different locations before an agency handling the specific permission requested is found. In each location contracts must be searched. ... In the case of books being produced for the recreational reader, this delay is unfortunate. But in the case of books required by a blind student delays can have tragic results. (CNIB, 1978, p. 10)

Further confirmation of the need for immediate access to the use of copyrighted material for educational purposes is given below:

> Modern teaching methodologies and the variety in curriculum content have led to a resource-based approach to education. It is essential that a broad base of materials useful to education be available at all levels. The problem becomes particularly acute when excerpts from such materials are used as elements of the teaching process within an educational institution. It must be recognized that any alteration in the way copyright is applied will have financial implications and will influence the selection, quality and quantity of materials used in education. (Council of Ministers of Education of Canada, 1978, p. 5)

Given the ever-increasing immediacy of the needs of research, professional, commercial, educational and many other types and classes of users, the advantage of compulsory licensing systems in speeding up access to the use of material should not be underestimated.

With respect to administrative and transactions expenses above and beyond the time delays, the following passage from Johnson regarding the compulsory licensing provisions of

the new U.S. Copyright Act as they apply to cable systems is instructive:

> Not only would fees paid to copyright owners constitute an added cost to CATV operations, but CATV operators assert that the sheer mechanics of the clearance process would be formidable,... Clearance on a continuous basis for several channels allegedly would require massive paperwork...a potentially serious problem. (Johnson, 1970, p. 17)

Any reduction in these transaction expenditures is unquestionably a desirable result as this has the effect of making the provision to the ultimate users of copyright material less costly. A decrease in these costs conceivably could make more funds available to the copyright owners when their works are used.

In addition, the decreased transaction costs may have the effect of increasing output. With records, for example, it is quite likely that wider distribution[3] of some less popular works has resulted from the decreased transaction costs brought about by the compulsory licensing provisions.

The second major benefit ascribed to compulsory copyright licensing systems is that they prevent the abuse of the exclusive economic rights arising from the copyright. This becomes especially important when the owners of copyright band together to exercise their rights collectively. Under these circumstances the probability is much higher that, at least for the short term, rights owners, by controlling the entire class of copyrightable material, could secure monopolistic prices and rents far above a competitive level.[4] To prevent these misallocative effects from occurring it is argued that compulsory licenses guaranteeing access at non-punitive prices for all

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[3] A compulsory licensing system providing certainty for users may, to some extent, facilitate long-range planning and this may increase the use of the copyright material as well.

[4] The informed reader will, of course, recognize that the owners of copyright in musical works have not, in Canada in the past, exercised their mechanical reproduction rights in a collective manner. This section of the general discussion of the benefits of a system of compulsory licensing schemes does not, therefore, directly reflect on the introduction of this system. It should be noted, however, that with the establishment in 1976 of the Canadian Mechanical Reproduction Rights Agreement (CMRRA), the collective exercising of this right is increasing.

users should sometimes be introduced. The most obvious and highly visible collective societies have been the performing-rights groups which administer the composer's performing right in his music. The operations of these associations are governed by specific provisions in the present Canadian Copyright Act. The level of royalties that these groups can charge is determined by the Copyright Appeal Board, which attempts to determine "fair" prices for users. Most other countries with comparable performing-rights groups have also instituted checks and balances on their monopoly power.

The main advantages of compulsory licensing systems, therefore, are first, the decreased transaction costs in terms of both time and actual monetary outlays and second, the reduction of monopolistic inefficiencies.

In summary, whether or not a compulsory licensing system is to be favoured over strict copyright protection depends upon whether or not the advantage in diminished transaction and monopoly costs outweigh the disadvantages of misallocated resources arising from inflexibilities in the payment mechanism. In view of the ever-increasing urgency with which users require the copyright material, adherence to compulsory licensing systems is likely to arise more frequently.

With this general framework of the costs and benefits of compulsory licensing systems in mind, an examination of the rationale for the Canadian system of compulsory licensing for the mechanical reproduction of musical works will be undertaken.

History of Compulsory Mechanical Reproduction Licenses

The compulsory licensing provisions with respect to the mechanical reproduction of musical works, detailed in the Canadian Copyright Act in 1921, remain in place today. The origins of these provisions in Canada, as in the case of much of the Copyright Act, are to be found in the U.K. Imperial Act of 1911. The primary concern in the United Kingdom, and in the United States, which introduced the system in 1909, was over the possibility that a monopoly in the music-recording industry could develop if a mechanical reproduction right was provided. Prior to this time there had been no explicit need for a mechanical reproduction right, as the necessary technology to economically create such devices did not exist. The compulsory licensing provisions were introduced to assure free access to musical works of all record companies in order to ensure a competitive industry. The U.S. legislators were especially apprehensive that one record company would acquire all the

recording rights in popular music. The following passage is illustrative of these concerns:

> Congress was not satisfied simply to grant the mechanical reproduction right in music to copyright owners. While the new copyright bill was under consideration, information came to light that the Aeolian Company, the largest by far of all the piano roll manufacturers, had entered into long-term contracts with 80 leading music publishers for the exclusive piano roll rights in their entire catalogues of copyrighted compositions. Fears were expressed about the creation of gigantic music monopolies in the piano roll and phonograph record industries, with the leading manufacturers tying up the sources of musical material and thus making it impossible for others to exist in the recording field. To meet these fears, Congress devised the so-called compulsory license clause, ... (Diamond, 1962, p. 421)

Provisions in Other Major Record-Producing Countries

The mechanical royalty in the United States was set at 2 cents per work in 1909, and remained at that rate until the recent revision to the copyright law increased the rate to $2\frac{3}{4}$ cents per work or $\frac{1}{2}$ cent per minute of playing time, whichever is larger. In the United Kingdom the rate set in 1911 was $2\frac{1}{2}$ per cent of the retail selling price for the first two years and five per cent thereafter. A new statutory rate of $6\frac{1}{4}$ per cent of the ordinary retail selling price of an individual record was fixed in 1928. It remains at this level today. The British Act, like the American and Canadian Acts, provides that the compulsory provisions come into effect only after the owner of copyright in a musical work has authorized the mechanical reproduction of that work for the first time.

Other major developed countries such as Japan, Australia, India, New Zealand, South Africa and the Republic of Ireland have similar provisions. From the available literature, however, it appears that most western European countries do not have similar provisions for compulsory licensing in their copyright acts. The payment of mechanical royalties in countries such as France, Holland and West Germany is negotiated between BIEM (Bureau international des sociétés gérant les droits d'enregistrement et de reproduction mécanique) representing composers and lyricists and IFPI

(International Federation of Producers of Phonograms and Videograms) representing record producers.[5]

According to the Francis Report, copyright owners in these countries are, in practice, obliged to collect their mechanical royalties through collecting agencies. In these countries conditions for mechanical reproduction are governed largely by a standard contract between producer and composer groups. Thus, even though most of the continental European countries do not have, in their copyright acts, compulsory licensing provisions that set statutory rates, their systems ensure that:

> throughout the western world manufacturers of records enjoy rights to reproduce copyright works either under compulsory license provisions or by virtue of the terms of the BIEM standard contract. (Spicer Report, 1959, p. 35)

Consideration of Present-Day Rationale for System

As stated above, the original intent of the compulsory licensing provisions in Canada, the United Kingdom and the United States was to ensure competitive conditions in the creation of records. In Canada, the law appears to have been successful. Statistics Canada reported that in 1977 52 record companies in Canada released records that they themselves had produced (Statistics Canada, 1979). It is because of the fixed compulsory mechanical licensing fee that copyrighted works have been made available to almost all companies under the same non-discriminating terms.

Thus, it appears the Act has been successful in ensuring competitive access to any and all once-recorded musical works. The fear, however, continues today that major record companies, in the absence of compulsory licensing, could acquire control of large blocks of music.

> It has been suggested that, in the absence of compulsory license, the large and financially powerful recording companies which largely control the leading recording artists would purchase recording options to entire catalogs or entire repertoires of musical publishing firms, with the result that they would assume a strategic control of the entire record business, to

[5] For further details see Francis, 1956.

> the detriment of smaller and less powerful record producers. (Blaidsell, 1963, p. 955)

It should be remembered as well that for Canada 11 of the 13 companies listed in RPM magazine (the major record trade paper in Canada) as the major record manufacturers and distributors are foreign owned. In 1976 these major foreign-controlled companies accounted for 90.1 per cent of record sales through their distribution services in Canada (Keon, 1979, p. 45). In addition, in the present-day Canadian recording industry, most of the major record companies have established publishing company subsidiaries. Given the market power that the major record companies already possess, and given that they already have entered the publishing business, it is not inconceivable that potential abuses could still arise in the absence of compulsory licenses.

The other major benefit ascribed above to compulsory licensing systems was that they effected reductions in administrative and transaction costs. Undoubtedly these costs are of importance in the record industry as well. With respect to a long-playing album or tape the need to negotiate with, and receive the approval of, perhaps several different copyright owners is eliminated.

The compulsory license ensures that all record companies have access to material for the same price and under the same conditions. It obviates the need to bargain individually over the terms and conditions of the license.[6]

The administrative costs, in terms of accounting for and distributing the royalty payments, will be present with either strict copyright liability or compulsory licensing. The major administrative saving, therefore, would appear to be in the area of negotiating or bargaining time.

In light of the fact that the compulsory licensing provisions have been successful in encouraging competition in the recording of musical compositions, and given that its abolition is not strongly recommended by either record producers or composer/publisher interests, the arguments presented in the following passages from the Whitford Committee Report would appear to be well suited to the Canadian situation:

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[6] The informed reader will realize that not all mechanical licenses stipulate the two-cent-per-tune rate. Record clubs and discount record companies such a K-Tel and TeeVee Records often obtain licenses at lower than normal rates. This does not, however, suppress the case that for the vast majority of record releases the elimination of the bargaining process is a real cost saving.

> Without exception the submissions received on this subject were in favour of the compulsory recording license being continued. It is clear that the record industry finds the provisions, which now have a history of 64 years, helpful. The British Phonographic Industry Copyright Association commented that "this is not an old provision which has little practical application; it is very much the stuff of everyday life in the recording industry and, it is strongly submitted, it has and continues to have significance and relevance for the interested parties in conducting and regulating their day-to-day affairs". Also it may not be without significance that the three major territories in which the recording industry has developed to the most substantial extent - the United Kingdom, United States of America and Japan - all have legislative provisions for compulsory recording license. (Whitford Report, 1977, p. 86)

In addition, it should be noted that if Canada were to remove the compulsory licensing provisions, Canadian record companies could be placed at a serious disadvantage vis-à-vis foreign competitors. Under their own domestic legislation these companies would have the right to record all once-recorded works. Canadian companies would be required to obtain permission to record. It is submitted that this would impose serious hardship not only on the major multinational record companies operating in Canada but more especially on the smaller independent Canadian companies who are often lacking in market power.[7]

For all these reasons it is recommended that the compulsory licensing provisions, as they pertain to the mechanical reproduction of musical works, should be maintained in the Canadian Copyright Act. This is not meant to imply that some of the difficulties inherent in compulsory licensing schemes, and discussed above, are not present. Obviously the problem of price inflexibility, which can lead to license fees that do not reflect true market value, is present. The provisions of the Canadian Act have been the same since 1921. The difficulty of matching the value of a particular musical work with a proper royalty fee remains as well. It is argued, however, that to

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[7] This concern over loss of competitive position if the compulsory licensing provisions were removed was also voiced in the Spicer Report, (1959), p. 35.

some extent, these problems can be ameliorated by effecting changes in the mechanics of the compulsory licensing provisions. It is also maintained that they are not of such magnitude as to cause the dismantling of provisions around which an entire industry has grown and prospered.

CHAPTER III

THE SCOPE OF COMPULSORY LICENSING

Having determined, in general, that the continued existence of compulsory licensing, vis-à-vis the mechanical reproduction right, is justified, it is incumbent upon us now to examine any problems or inconsistencies in the present system, with a view to eliminating or resolving them. This chapter will thus deal with the scope of compulsory licensing.

Musical Works and "Songs"

Subsection 19(1) of the Copyright Act provides that the making, by someone other than the owner of the copyright within Canada, of records, perforated rolls or other contrivances that may mechanically reproduce musical, literary or dramatic works shall not be deemed to be an infringement of copyright in such works under certain circumstances. Two associated issues are evident: first, the definition of "musical works" presents some problems, and second, it is unclear whether the compulsory licensing applies equally to published and unpublished works.

We deal first with the problem of definition; "musical works" is defined in section 2 of the Copyright Act as: "Any combination of melody and harmony or either of them,printed, reduced to writing or otherwise graphically produced or reproduced."

At first glance this would appear to be a straightforward and apt definition lacking obvious problems. Further, it is not surprising to find this definition in the Copyright Act, given that the Canadian law has its roots in its British counterpart, and given the fact that an identically worded definition appeared in British Law in the Musical (Summary Proceedings) Copyright Act of 1902 (2 Edward 7, C. 15, s. 3). However, upon reflection, the definition does present some problems and incongruities.

The words "printed, reduced to writing or otherwise graphically produced or reproduced" are problematic since they limit musical works to those that have been written or printed for visual perception. This would seem to be an anachronistic limitation in that the advent of sound recording has provided an alternative means for the fixation of a musical work, other than visual notation. Furthermore, it would seem illogical to demand as a condition of protection of an aural work, that it be given a visual representation. It would appear, therefore,

that a musical work that has not been reduced to some form of visual notation (for instance, many of our modern spontaneous musical compositions, which are merely captured or "fixed" in sound recordings) technically does not constitute a "musical work" and could conceivably not be subject to compulsory licensing (Perry, 1972, p. 256 et. seq.).

One incongruity with respect to the definition of "musical works" arises from the fact that the United Kingdom repealed the Musical (Summary Proceedings) Copyright Act, including its definition of "musical works", in 1956, without substituting a new definition (Copinger and Skone James, 1971, p. 77). The apparent reason was that, among other things, the words "graphically produced or reproduced" were inappropriate to modern circumstances. Australia adopted a similar approach, based on the same observations as to requirements for visual notation, and chose similarly not to define "musical works" in its 1968 Copyright Act (Lahore, 1977, p. 48). Nor does the American Copyright Act define "musical works," apparently because it has a "fairly settled" meaning (Nimmer, 1978, pp. 2-53). In view of the foregoing, it would seem illogical to retain an anachronistic and problematic definition of musical works. On the other hand, it would be remiss not to provide some statutory guidance as to the meaning of "musical works," in that Canadian case law is insufficient in this regard in comparison with the case law of the above-noted countries. Therefore, a general redefinition of musical work is suggested to include the notion that it is an arrangement of sounds into patterns involving relative pitch, melody, harmony and rhythm or any combination of these, howsoever fixed. Such a definition: (a) should provide sufficient guidance to enable a court to determine whether an entity is a musical work, without compelling the court to pass judgment on the "musicality" of the thing, and (b) would obviate any requirement of a particular type of fixation.

The other problem perceived in the application of subsection 19(1) is the apparent lack of clarity as to whether publication of a recorded work is a necessary precondition for the application of compulsory licensing (Keyes and Brunet, 1977, p. 93). This apprehension seems to stem in part from the historic distinction between the treatment of published and unpublished works, prior to the 1924 Canadian Copyright Act, and the fact that, to a limited extent, some distinctions were continued in certain provisions of the Act.[1]

Prior to 1924, unpublished works were protected by so-called common law copyright, whereas published work could ob-

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[1] See for examples, sections 3(5), 4(1), 6, 7(1) and 19(9).

tain statutory copyright protection under the then prevailing law (Copyright Act, R.S.C., 1906, C. 32, s. 6). Subsequent to January 1, 1924, the effective date of the present Canadian Copyright Act, both published and unpublished works were entitled only to statutory copyright protection (Fox, 1967, p. 60); common law copyright ceased to exist and the Copyright Act, in section 42, substituted statutory copyright for whatever common law protection might previously have existed. Thus, all works, unpublished or published, pre-1924 or post-1924, are completely dealt with under the present Copyright Act. Presumably, therefore, any distinctions intended to be carried on in the treatment of published and unpublished works would have been explicitly delineated in the Act. Inasmuch as subsection 19(1) does not explicitly delineate any such distinctions, it is suggested that compulsory licensing does indeed apply equally to published and unpublished works without distinction. Moreover, the only compulsory license limitation related to publication is the specific subject of a transitional provision in subsection 19(9), which deals with musical, literary and dramatic works published before 1924. Since this is the only explicit distinction relating to the application of compulsory licensing with regard to publication, this would support the contention that the compulsory license of subsection 19(1) does apply to any and all works whether published or unpublished. Finally, it is not necessary to know whether a work is published or unpublished to determine whether it is a "musical work," a "literary work" or a "dramatic work." Insofar as the compulsory licensing provisions of subsection 19(1) apply to musical, literary or dramatic works, irrespective of whether they are published or unpublished, the question of publication is not material and need not be addressed.

Songs

It is common knowledge that a significant proportion of popular works that are recorded are compositions consisting of two principal elements: music and lyrics.[2] As noted earlier, the definition of "musical works" in section 2 of the Copyright Act is that they consist of "any combination of melody and harmony or either of them,printed, reduced to writing, or otherwise graphically produced or reproduced."

Nowhere in this definition is there any reference to lyrics. It could well be that the draftsmen of the 1924 Act had in mind the lyrics of a song when they extended the application of the compulsory license in subsection 19(1) to

[2] Hereafter such compositions will be referred to as "songs."

literary and dramatic works. However, this extension may have inadvertently created latent problems, since purely literary or dramatic works unaccompanied by, or disassociated from, music are ostensibly subject to the same compulsory licensing as musical works (Fox, 1967, p. 141). This state of affairs diverges from that of the British Copyright Act of 1911 in which Canada's copyright law has its roots. The British Act limited compulsory licensing to a musical work only, with the proviso that "it shall be deemed to include any words so closely associated therewith as to form part of the same work" (British Copyright Act, 1911, s. 19(2)). Therefore, in Britain, the lyrics of a song are subject to the compulsory license, along with the music, without purely literary or dramatic works also being subject to such a license.[3]

The Canadian approach exhibits similar inconsistencies with the Berne Convention. First, Article 13 of the Rome Text of the Convention, to which Canada adheres, merely establishes the mechanical reproduction right for musical works, while the Canadian Copyright Act extends its application to literary or dramatic works. The Convention, therefore, only deals with reservations (i.e., compulsory licenses) concerning musical works, and does not advert to such reservations vis-à-vis literary or dramatic works, while the Canadian Act stipulates that the compulsory license provision also applies to literary and dramatic works. Canada's extension of a mechanical reproduction right to literary and dramatic works does not appear to contravene the Convention, as determined earlier,[4] but the inconsistency does present some perplexing questions as to its origin.

Another interesting distinction between the Canadian approach and the Berne Convention, relates to the Paris text of the latter, which is its most recent revision, and to which Canada has not acceded. The revised Article 13 specifically extends the permitted compulsory license reservation to apply to words that accompany a musical work, but still does not provide for compulsory licensing of purely literary or dramatic works.

The American approach to compulsory licensing, vis-à-vis the mechanical reproduction right, in their 1976 Copyright Act might be instructive. In section 115 of the U.S. Act, the exclusive rights to make and distribute phonorecords of non-

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[3] It will be argued later that purely literary or dramatic works ought not to be subject of compulsory licensing in section 19.

[4] See Chapter 1.

dramatic musical works provided in section 106 are subject to a compulsory license similar to that in Canada. The expression "musical works" is specified in subsection 102(a)(2) to include "any accompanying words." Apparently, it was thought unnecessary to further delineate "musical works" because it had a "fairly settled" meaning (Nimmer, 1978, pp. 2-53). It is also thought that there is no substantive difference between the expression "nondramatic musical work" in section 115 and "musical work" in subsection 102(a)(2) (Nimmer, footnote 4, pp. 8-53). Thus, while the U.S. Copyright Act confers, among other rights, a mechanical reproduction right, with respect to literary, dramatic and musical works, the compulsory license of section 115 is limited to nondramatic musical works and is inapplicable to literary or dramatic works (Nimmer, 1978, footnote 4, pp. 8-53).

The American approach goes one step beyond Britain and Berne, and somewhat parallels Canadian law in that literary and dramatic works may enjoy an explicit mechanical reproduction right similar to that applying to musical works. However, in the United States, lyrics of songs are as equally subject to compulsory licensing as the music, not by reason of being a literary or dramatic work in their own right, but because they form an integral part of a nondramatic musical work; this, however, does not preclude the lyrics from also being separately and independently protected as a literary work (Nimmer, 1978, pp. 2-55). This situation of overlap with respect to lyrics engenders a prickly problem: equally persuasive arguments can be structured to show, on the one hand, that lyrics, even though they may constitute a literary work, are subject to compulsory licensing if they are part of a "nondramatic musical work," and on the other hand, that because a song may amount to a collective work (being a collection of two distinct elements: the music and the lyrics) the lyrics, being a separate literary work, are not subject to compulsory licensing in section 115 (Nimmer, 1978, pp. 2-56).

If such a contradiction is to be avoided in Canada's Copyright Act, and if lyrics are to be subject to compulsory licensing, as is the music of a song, it will have to be explicitly stated in any compulsory license provision that it applies to musical works and also to any associated words or lyrics, irrespective of whether such works or lyrics are independently eligible for protection as a literary or dramatic work.

It has been suggested that musical works already include compositions with or without words by virtue of the section 2 definition of the expression "every original literary, dramatic, musical and artistic work" which reads: "every original literary, dramatic, musical and artistic work includes

musical works or compositions with or without words ..." (Fox, 1967, p. 146).

However, there is a slight inconsistency between this general inclusive definition of "every original literary, ... work" and the more particular and restrictive definition of "musical works."[5] In addition, the fact that the expression "any musical, literary or dramatic work" is utilized in subsection 19(1) implies that the general inclusive definition of "every original literary, dramatic, musical and artistic work" (which is a different expression) is not apt for the interpretation of subsection 19(1). Thus one is left with the more particular restrictive definition to interpret subsection 19(1). Since this last definition does not address the possibility of lyrics in a song, and since it will be argued that compulsory licensing ought not extend to purely literary or dramatic works not associated with musical works, it is imperative to explicitly state that the compulsory license applies to words or lyrics associated with a musical work, as noted above. The benefits of such a move would be to avoid the inconsistency problems outlined, and to harmonize the Canadian approach with those of Berne, Britain and the United States. In addition, it would obviate the need for agile reasoning and perhaps forced interpretation as to whether or not the compulsory license applies to lyrics in a song, such as occurred in the case of Ludlow Music Inc. v. Canint. Music Corp. et al.[6]

A further issue alluded to earlier, and raised in obiter dicta in the Ludlow case, arises from the Canadian definition of "collective work." Under the Canadian Act, a song may be a collective work in that it contains a musical work as well as a literary work, the lyrics. However, for the reasons set out below, under certain circumstances, a "song" may not be a collective work, nor, indeed, possess any status for the purposes of the Act, independent of its component parts. It is suggested that problems arise under the Canadian Copyright Act, which provides that in order to constitute a collective work, there must be distinct parts by different authors.[7] This re-

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[5] Noted earlier, see p. 21.

[6] (1967) 51 C.P.R. 278, at 297 et seq. In that case the court was compelled to be adroit in arriving at the conclusion that the compulsory license applies to the lyrics of a song as well as to the music. It was also decided therefore that subsection 19(2) precludes unwarranted modifications to lyrics a well as to the music of the song.

[7] See definition of "collective work" in section 2 of the Copyright Act.

quirement appears to be both anomalous and unjustifiable as it would deny the status of collective work to a collection of one author's work. Similarly, if one person both composed the music and authored the lyrics of a song, the resulting work would not appear to be a collective work at present; nor would either of the preceding types of works qualify as joint works, insofar as the parts are not inseparable. This inconsistency suggests that the definitions of "collective works" and "joint works" may require re-examination.

We now return to compulsory licensing. It has been suggested that there are two ways of ensuring that the compulsory licensing system covers lyrics:

a) by specifically extending the compulsory license to lyrics accompanying music; or
b) by defining musical works to include words intended by their author to be performed therewith;[8]

and that there is no strong advantage or disadvantage in either except that the latter would supposedly be more consistent. This suggestion is partly in error since it ignores the fact that restructuring the definition of musical works to include words intended by the author(s) to be performed with the music might be interpreted as precluding separate protection of the lyrics as a literary work independent of the music.[9] Furthermore, it might also be difficult to establish the author's intention. What if the author changes his intention? What if there is an author of lyrics, A, and a different composer of music, B, and they disagree as to whether their works are to be merged into a song? What if the lyrics and music come into existence at different points in time? Does the intention that words are to be performed with the music imply that there is also an intention that they should also be recorded together? If not, ought the compulsory license to apply?

Also ignored is the fact that extending the compulsory license to encompass specifically words or lyrics accompanying music would harmonize with the approaches in Britain and in the

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[8] Copyright in Canada, op. cit., p. 93. Note that there is a third way: by retaining the words "literary or dramatic" in subsection 19(1), but this may be undesirable from a policy point of view since it would also subject purely literary or dramatic works to the said compulsory license.

[9] There is authority that words of a song are protected independently of the music as a literary work. Rubens v. Pathé Frères Pathéphone Ltd. (1912) Macg. Cop. Cas. 58; Francis v. Olivier (1907) Macg. Cop. Cas. 86.

Berne Convention. Furthermore, it would obviate the need to establish intention and would succinctly clarify that the compulsory license does apply to lyrics, irrespective of their independent protection as a literary or dramatic work. Thus, in summary, it would be better to extend compulsory licensing specifically to lyrics or words accompanying music.

Compulsory Licensing and Literary or Dramatic Works

It was noted earlier that the fact that the subsection 19(1) compulsory license extends to purely literary or dramatic works in addition to musical works seems to be illogical and anomalous when compared with the Berne Convention approach (see Chapter I). While a view different from that in Keyes and Brunet (1977, p. 93) is adopted here, in that the broader scope of the Canadian compulsory license is not seen as a contravention of the Berne Convention, there is general agreement with an implicit aspect of Keyes and Brunet, that so long as lyrics or words associated with a musical work fall within the purview of the license, there is no need to also subordinate purely literary or dramatic works to the compulsory license. Indeed, the whole focus of discussion in the early movement to control the mechanical reproduction right, which resulted in the Berlin text of the Berne Convention, was on musical works and their reproduction in "instruments de musique mécaniques" (Le Droit d'Auteur, 1908, p. 107). Any mention of literary or dramatic works in the pre-Berlin discussion of a mechanical reproduction right addressed such works only insofar as they formed part of a composite entity in which a musical work figured as the most prominent element. Thus, purely literary or dramatic works, in the sense that they were not associated with a musical work, were not considered significant in the controversy of the mechanical reproduction right. Indeed, in 1921, when the Minister of Justice was discussing the mechanical right in debates preliminary to the enactment of the present Canadian Copyright Act, he explained that the mechanical right would apply "mostly to musical publications, and to the right of the author when copies of his work are made by means of the production of discs to be used in phonographs and other mechanical contrivances whereby songs are reproduced" (House of Commons Debates, 1921, Volume V, p. 3833).

This is not surprising because literary or dramatic works already enjoyed an easy method of wide dissemination in the printed word. In contrast, not many people could simply read sheet music to enjoy the product. This fact made the phonorecord a unique and ideal medium for the popular marketing of musical works. In essence then, it was the aggressive manner in which phonorecords and other mechanical contrivances

were utilized to market musical works which spurred the need for, and the creation of, the mechanical reproduction right and its concomitant reservations to prevent possible monopolies in musical works from arising.

The difference in marketing methods between literary and dramatic works on the one hand and musical works on the other is perhaps the most persuasive reason to treat them differently as far as compulsory licensing is concerned. This difference still exists today. While print is the primary marketing domain of literary and dramatic works, generally speaking, phonorecords and similar contrivances remain the primary marketing domain for musical works. There are special compulsory licensing provisions with respect to printed matter in sections 13, 14 and 15 of the Act which, by reason of print being the primary domain of literary and dramatic works, affect them most directly, and affect musical works only secondarily. Since the mechanical reproduction right is primarily the marketing domain for musical works, if control of this market is sought by the establishment of reservations such as compulsory licensing, such reservations ought not to extend beyond musical works for fear of adversely affecting purely literary and dramatic works which merely employ phonorecords as a secondary marketing medium. Thus, the compulsory licensing of subsection 19(1) should not be applicable to works that are purely literary or dramatic. However, a corollary to this conclusion is that if a literary or dramatic work takes the form of lyrics or words that are associated with a musical work, then the compulsory license ought to apply to the collective entity formed by the lyrics or words together with the music.

The implementation of the above conclusion would also harmonize the Canadian compulsory license provision with those of the United States and Britain, and would more closely reflect the language of the Berne Convention. While such harmony is not the determining factor in the revision of the Canadian law, it is somewhat persuasive in recognition of Canada's close ties with these nations.

Modifications Permissible Pursuant to a Compulsory License

At present, subsection 19(2) authorizes alterations to, or omissions from, works compulsorily licensed under subsection 19(1) only if necessary in order to adapt the work to a particular mechanical contrivance, or if similar modifications have been made in previous contrivances by or with the consent or acquiescence of the copyright owner. This provision seems to have generated little controversy in that the Ilsley Commission (1957, p. 70) recommended that it be maintained, as did Keyes

and Brunet, with the subsequent support of the Canadian Recording Industry Association, the Association of Canadian Television and Radio Artists and the Canadian Copyright Institute. In addition, no objections were voiced against the retention of subsection 19(2). Inasmuch as there does not appear to be any difficulty in the application of subsection 19(2) (e.g., the Ludlow case referred to earlier), it is submitted that this section ought to be maintained.

Cinematographic Sound Tracks

The present Copyright Act was enacted in the era of the silent film, and it is not surprising, therefore, that in its treatment of the relatively new technology of the cinematograph, it merely addressed the extant process. Section 2 of the Act defines cinematograph rather loosely as including any work produced by any process analogous to cinematography and makes no reference to a possible sound track. The dictionary defines cinematography as a means or practice whereby a series of instantaneous photographs of moving objects is projected on a screen so as to produce the effect of a single motion scene.[10] This leaves one with the impression, accurate perhaps in 1921, that a cinematograph was solely a visual experience.

Similarly, in 1921 the drafters of the present Copyright Act had in mind only phonorecord discs, piano rolls and music boxes when they referred to mechanical contrivances that reproduced sound, since such was the state of technology at the time (House of Commons Debates, 1921, Volume IV, p. 3831). By accident, or by design, they so broadly categorized such contrivances that most technological advances in sound recording, such as audio tapes and cassettes, automatically came within the ambit of mechanical contrivances that reproduced sound. What was not adverted to, however, was the merging of audio and visual elements into a hybrid contrivance that reproduced both simultaneously. Thus, with the advent of talking movies, videotape and other such audiovisual wizardry, there occurred a lacuna in the legislation as to how these were to be dealt with.

The main complication that arises from audiovisual entities such as cinematographs with sound tracks and analogous media is that due to the broad language of section 19 they can be characterized as mechanical contrivances for the reproduction of sound, within the ambit of subsection 19(1), notwith-

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10 Shorter Oxford English Dictionary, 3rd ed. (London, England: Oxford University Press, 1973) p. 336.

standing their hybrid nature (Fox, 1967, p. 191 and Perry, 1972). The result is that any literary, dramatic or musical work captured in an audiovisual product is subject to the compulsory licensing of sub-section 19(1). Thus, the dialogue, music and songs in a "movie" or videotape could be reproduced under a compulsory license.[11] This seems incongruous when one realizes that audiovisual hybrids were unknown at the time of the enactment of the present Copyright Act and are commercially different from sound recordings.

It is submitted that this problem in subsection 19(1) can be cured by realigning the statutory language in recognition of technological advances that have occurred since its enactment. It is suggested that the most appropriate way of eliminating this problem with respect to audiovisual devices would be to stipulate that only those mechanical contrivances that record aural phenomena (i.e., sounds only) are to be known as "phonorecords" and are to be subject to the compulsory license in section 19. This would not only accord with the situation as it was perceived in 1921 by the legislators of the present section 19, but it would also reflect present marketing differences between phonorecords and audiovisual entities. It is common knowledge that phonorecords are mass marketed by multitudinous individual sales of facsimiles of the recorded work, while audiovisual products are, generally speaking, mass marketed by a system whereby the consumer purchases merely an opportunity to view a performance. The effect of the marketing differences between phonorecords and audiovisual products is that the mechanical royalties payable under section 19 would be extremely small for audiovisual entities when compared to phonorecords, because of the relative differences in sales volume of each.

This is not to say, however, that marketing methodology for audiovisual entities will not change. There is reason to believe that one day videotapes and videocassettes may be used to market audiovisuals in much the same way as phonorecords of musical works are now marketed. Indeed when this situation arises, it may then be necessary to consider appropriate changes to the Copyright Act should market anomalies present themselves, such as spurred creation of the compulsory license in section 19.

The overall effect of the suggestion above would be to exclude from the compulsory licensing of section 19 any contrivances whereby sounds can be recorded as an adjunct to or coincident with visual representation. Therefore the capturing of

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[11] In practice video producers do not attempt to rely on section 19 for a compulsory license but rather negotiate on a more reasonable basis.

a work in an audiovisual could neither trigger the compulsory license, nor could it present or affect the operation of the license with respect to a work already captured in a phonorecord. What is meant by this is that, if a musical work was first recorded in an audiovisual format, since the audiovisual would not be a contrivance to which the section 19 compulsory license would apply, one could not invoke the section 19 compulsory license to justify making any reproduction of the musical work embodied in the audiovisual, even if such reproduction were to be in the form of a phonorecord. Corollary to this, if a musical work was first recorded in a phonorecord, the section 19 compulsory license could be invoked only to make a phonorecord reproduction of the work in an audiovisual. The paramount precept is that phonorecords and audiovisuals are mutually exclusive, even though elements of the former are to be found in the latter. This would return the effect of section 19 to what it was in 1921 prior to the technological advances that engendered the overlap problem vis-à-vis audiovisuals.

Compulsory Licensing and Sound Recording Contrivances

Subsection 19(3) of the Copyright Act establishes that a "musical, literary or dramatic work" does not include a sound recording contrivance for purposes of compulsory licensing. The effect of this provision is to preclude the compulsory licensing provisions from applying to phonorecords. The reason for this provision is that, as discussed at the outset of this paper, there are two copyrightable entities present: the musical work and the sound recording of the version of the musical work contained in the record or tape. This latter copyright is established by subsection 4(3) which, in effect, states that sound recording contrivances are to be treated as if they were musical, literary or dramatic works insofar as copyright subsists in them. If subsection 19(3) did not preclude compulsory licensing from applying to such contrivances, this would permit direct copying of sound recordings, contrary to the principles of the Copyright Act. Thus, the effect of subsection 19(3) is well worth retaining though some improvement could be brought to it.

The problem of having sound recording contrivances treated as if they are "musical, literary or dramatic works" ought to be removed. Sound recording contrivances are merely media for recording sounds. Cinematograph films are merely media to record that which can be seen (ignoring for the moment motion picture sound tracks). Since cinematograph films are protected under the Copyright Act as a separate and independent class of works, so should sound recording contrivances be protected as an independent and separate class of works. At pre-

sent, cinematograph films may be copyrighted under several heads, most notably as photographs.[12] Therefore they possess a method of copyright protection independent of whether their character is musical, literary or dramatic. It is submitted that sound recording contrivances ought to be treated similarly, in that they should also be copyrightable as a separate class of works from musical, literary and dramatic works. This would simplify matters considerably. In addition, it would make the Copyright Act more symmetrical in its treatment of recording media. Finally, since sound recording contrivances would not be treated as if they were musical, literary or dramatic works, but would constitute a separate class of work, it would be abundantly clear that compulsory licensing does not apply to the sound recording contrivance itself, and there would be no need for explicitly stating this.

Factors Triggering a Compulsory License

It is not an original observation that subsection 19(1) leaves unclear whether the making of a contrivance that triggers a compulsory license must have taken place in Canada, or whether such making could have taken place anywhere in the world. This observation was made in the Ilsley Commission Report (1957, p. 67) in the following terms:

> (2) "The owner of the copyright" as used in (1)(a) means the owner of the copyright (that is the mechanical right) for the country in which the records previously made were made. If the records previously made were made in a country other than Canada and the making of them in that country, without authorization, would not be an infringement of copyright either because no mechanical right existed there or for any other reason, the making of the records there should not be taken as having been made with the copyright owner's consent or acquiescence. In our present Act the owner of the copyright, as used in this connection, means the owner of the Canadian copyright. We see no reason, however, why if a person who has an exclusive right to authorize the making of records of a work in any country authorized the making of records in that country a manufacturer in Canada should not have the right to make the records of that work in Canada. It is

12 See Fox, 1967, p. 174 for a more ample discussion.

true that the owner of the Canadian copyright may not be the same person as the owner of the copyright who authorizes the making of records abroad but the position is either that one is the author and the other is claiming under the author or both are claiming under the author. The purpose of requiring the consent of the owner of the copyright to the making of records is to protect an author who does not wish his work to be recorded at all. If he or someone claiming under him permits it to be recorded anywhere then he and those claiming under him can have no reasonable complaint, we think, if the work is recorded on a royalty basis in Canada. We suspect that the practice under our present Act has been to treat consent or acquiescence of the owner of the copyright in a foreign country as having the same effect as consent or acquiescence of the owner of the Canadian copyright. In a copyright handbook prepared by a prominent Canadian copyright counsel in 1924 which has been brought to our attention, he says:

> "'Owner of the copyright' as used in this section undoutedly means the owner in Canada of the copyright covering mechanical reproduction. Nevertheless the owner of the Canadian copyright cannot successfully refuse to allow records of a composition to be made in Canada if consent has been legally granted elsewhere. If a composer X sells United States copyright to A and Canadian copyright to B and A permits the making of records, B cannot prevent like action. Copyright is a monopoly but the Act clearly intends that the monopoly shall continue only while retained by the original owner, that is by the author. On these grounds it is contended that proof of legal making is not curtailed to Canada. Proof of legal making of records in any country where mechanical reproduction copyright subsists in the composition is all that is necessary."
>
> This is not cited as good law but as evidence of how the law was understood.

In contrast, Keyes and Brunet recommended a more restrictive approach, in that the compulsory license should be triggered only by the making of a recording in Canada, or the importation of same into Canada, for the purposes of retail sale, by or with the consent of the copyright owner of the

musical work.[13] This was in part based on the view that territorial divisibility of copyright ought to apply to the mechanical right, and that this would be best accomplished by establishing the above conditions.[14] Thus, consent to the making of a recording elsewhere than in Canada would not trigger a compulsory license in Canada. In addition, Keyes and Brunet stated that it should be necessary to establish the copyright owner's consent to the importation into Canada of mechanical contrivances for retail sale.

There is some question as to whether a reservation in a domestic Copyright Act may be triggered only by a domestic event. Such a restriction might be implied from Article 13(2) of the Berne Convention, which states that reservations to the mechanical right may be determined by the domestic legislation of each country, but that the effect of any such reservation must be strictly limited to the country that enacts such reservation. It could be argued that the Ilsley Commission's proposal to establish the making, anywhere in the world, of a record with the copyright owner's consent (that is, the owner of the mechanical right for the country in which the recording is made) as the criterion for triggering the license in Canada contravenes the Berne Convention. This would depend on whether predicating the license in Canada on an event which takes place outside Canada may properly be construed as having an extraterritorial "effect." It is submitted that, so long as the compulsory license reservation in Canada deals only with the mechanical right in Canada, it would not contravene the Berne Convention, notwithstanding the possible triggering of the license by an extraterritorial event, since only the mechanical right within Canada is affected by the Canadian license. Thus,

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13 Keyes and Brunet, 1977, p. 96. Note the absence of "acquiescence" of the copyright owner as a factor triggering the compulsory license in the Keyes and Brunet proposal; this would effect the Ilsley Commission's suggestion that explicit consent of the appropriate copyright owner to the contrivances may be necessary for the compulsory license to operate.

14 This appears inconsistent with an earlier section of their paper. On p. 72 they state:

> Concerns have been expressed that a copyright owner's exercise of "territorial limitations" might impose conditions limiting markets and hindering competition within Canada. Territorial division could lead to price discrimination within the country. A Copyright Act should not be used for such a purpose.

the Berne Convention does not preclude the Ilsley proposal that the triggering event may occur outside Canada.

The question of territorial divisibility has been seen as important in Australia as well. In 1959, the Spicer Committee, which was then considering the revision of the Australian Copyright Act, received representations from the Association of Australian Record Manufacturers urging the adoption of an Ilsley-type proposal (Spicer Report, 1959, p. 36). These representations were apparently rejected on the basis that:

> 179. We think an Australian Copyright Act should concern itself with the rights of the owner of the copyright in this country and that those rights should not be affected by the conduct of other owners of copyright in the world elsewhere. (Spicer Report, 1959, p. 37)

The Committee recommended that:

> ... a person should be authorized to make a record of a work only where the copyright owner has previously consented to the making of a record in, or its importation into, Australia. (Spicer Report, 1959, p. 37)

Despite this apparent rejection, the Ilsley-type proposal was in fact implemented in the Australian Copyright Act 1968-1976 in subsection 55(1)(a)(iii). Under this provision, a compulsory license may be triggered if a recording of a work has, at any time in the past, been made in, or imported for the purpose of retail sale into, any of the countries specified in the regulations by, or with the license of, the owner of the copyright in the work under the law of that country (Lahore, 1977, p. 332). In fact, the countries specified are all member countries of the Berne and Universal Copyright Conventions. An interesting sidelight to this is that although an Australian compulsory license may be triggered despite the lack of the Australian copyright owner's consent to the manufacture in, or import into, Australia of a record of the work, the owner of the Australian copyright is, by subsection 55(3), given a one-month lead time during which he may arrange for his own record release of the work before the licensee may release records made under the compulsory license.

The Australian about-face, vis-à-vis the Ilsley proposal, is significant from several viewpoints. First, it may be viewed as confirmation of the logic and practicality of the Ilsley proposal. Second, the Australian recording industry probably parallels the Canadian recording industry more closely than many others, in that the domestic market is dominated by

works owned and marketed by foreign-owned subsidiaries (Spicer Report, 1959, p. 38; Blomqvist, 1979, p. 12). Thus, the adoption of the Ilsley proposal would seem to be an equally appropriate step in Canada.

Perhaps the most controversial aspect involved in choosing between the Ilsley proposal and the Keyes and Brunet alternative consists of the conflict between the principle of "exhaustion," epitomized in the Ilsley proposal, and the principle of territorial divisibility, embodied in the Keyes and Brunet alternative. The doctrine of exhaustion involves the notion that once a party has placed goods for sale in any market his rights with respect to such goods (as distinct from his copyright embodied in the goods) should be exhausted. In contrast, a proponent of territorial divisibility would suggest that a copyright owner may divide the world into discrete markets and promote his work in some while suppressing it in others, as he wishes.

It is beyond the scope of this paper to embark on a detailed discussion of the merits and demerits of the two conflicting principles. However, some observations with respect to the likely effect of the application of these divergent principles, vis-à-vis the mechanical right and compulsory licensing, would be germane.

Under subsection 17(4), at present, it appears that a Canadian copyright holder can prevent the importation into Canada of competing authorized versions of his work. Adoption of the concept of exhaustion, as recommended in a recent study by Blomqvist and Lim on the effects of import provisions in the Copyright Act upon the trade in records and books, would allow the import of such versions. A compulsory licensing scheme that adopted the principle of territorial divisibility could in theory negate the impact of such a move.

A small example should prove instructive. Assume that a Canadian owner of copyright in a musical work (A) has licensed that work to be first recorded in the United States. The musical work is contained on an album (B) with nine other compositions. The recording company owning the copyright in the record does not (for whatever reason) acquire from the copyright owner the right to make the recording in Canada.

Now, under the U.S. compulsory licensing provisions another recording company records another version of work (A) and includes it in album (C) with nine different works. Under the principle of strict territorial divisibility embodied in the compulsory licensing scheme, the owner of copyright in recording (C) could be prevented by the copyright owner of (A) from having copies of the recording made in Canada. Therefore, there would be a conflict between the two copyright owners.

Under the exhaustion concept the record company that created album (C) could import either the master tape or the final product (i.e., manufactured records or tapes). Under the concept of territorial divisibility[15] with respect to compulsory licensing he could import the master tape, but he could not, without the consent of the copyright owner of (A), have records manufactured here.

Approximately 90 per cent of the recordings sold in Canada are manufactured in Canada from foreign master tapes. Thus, the example provided here has the potential of being re-enacted in the real world. Such an occurrence is unjustifiable, since the copyright owners of the other nine musical compositions embodied in record (C) would, in effect, be prevented from selling their copyrighted product in the markets they choose. The territorial divisibility of rights embodied in a compulsory licensing system could thus result in a conflict of interest among the various copyright owners. Such a situation should be avoided if possible.

Furthermore, in the Blomqvist and Lim study (1979, p. 5) it was stated that:

> In the present context, it appears likely to us that the major part of the gains from the principle of territorial divisibility would in fact accrue to foreign composers possibly at the expense of Canadian artists and recording studios. Hence, if the principle of exhaustion is applied with respect to the import of sound recordings themselves,it would seem logical, and probably also in Canada's interest, to apply it to the issue of compulsory licensing as well, i.e., to abandon the principle of territorial divisibility.

On the basis of the foregoing arguments it is concluded that the Ilsley proposal, which reflects the present accepted practice in the Canadian recording industry, is most appropriate for Canada. There are no cogent reasons to depart from present industry practice; rather, there are persuasive reasons to avoid the principle of territorial divisibility with respect to sound recordings as demonstrated in the Blomqvist and Lim

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15 It should be noted that under the Keyes and Brunet scheme the importation into Canada, with the copyright owner's consent, of a recording embodying his musical work would, unlike our example, trigger the compulsory licensing provisions.

study. Furthermore, based on the market similarities between Canada and Australia, and the fact that Australia implemented legislation that reflects the position adopted in the Ilsley proposal, it would seem to be the more appropriate direction to follow in clarifying the factors that trigger the compulsory license in subsection 19(1).

CHAPTER IV

ROYALTY RATE PAYMENTS

The major issues to be addressed in the first section of this chapter will be: a) the determination of the basis upon which the mechanical royalty should be calculated; and b) the determination of the level of royalty payments. Related factors to be determined include: 1) whether the royalty payments should be paid on all records made or only on records sold; 2) how to apportion royalties between various copyright owners on a long-playing album or tape; and 3) the frequency with which royalty payments should be made.

Per-Composition or Percentage Royalty Payments

While the method of calculating royalty payments might, at first glance, appear to be nothing more than an administrative detail, it is in fact of considerable import. In reality, whether one is paid a fixed sum for each recorded musical work or a percentage of the selling price of the record embodying such works should not matter. What should and does matter is the total level of the payments. Twenty cents paid for the use of ten works on an album can just as easily be expressed as a percentage of an album's price, if one so desires. Conversely, a percentage rate can be converted into a per-work rate.

There are, however, certain undeniable benefits associated with each system, and the choice of a per-composition or percentage payment scheme continues to be a matter of some controversy in Canada.[1]

Keyes and Brunet, in recommending that Canada adopt a percentage payment system, argued that:

> The main advantage of a percentage basis for computing royalties is that it provides an automatic adjustment for inflation. But it can also adequately reflect other factors such as

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[1] For the varying and contrasting industry viewpoints on this subject see the briefs submitted by the following organizations in response to the Keyes and Brunet Report: Board of Trade Metro Toronto, Canadian Songwriters Association, Canadian Music Publishers Association, Morning Music Limited, Canadian Recording Industry Association and the Association of Canadian Television and Radio Artists.

> changes in the types of mechanical contrivances used. The licensing system would not be so drastically outmoded today had the royalty been calculated on a percentage of the retail selling price, for new techniques would have given rise to equitable royalties.(1977, p. 102)

Thus in the view of Keyes and Brunet, movement to a percentage system would help to ensure that the basis of calculation for royalty payments remained fair and reasonable.[2]

Undoubtedly the most desirable feature of the percentage system is that it provides an automatic adjustment factor for inflation. Copyright holders are quick to point out the inequity of a flat rate of two cents per work remaining in effect while the prices of record albums and tapes continue to rise. Royalty payments based on a percentage of retail price would guarantee that as the price of an album rose so also would the payments to copyright holders. In Chapter II, it was argued that one difficulty inherent in a compulsory licensing scheme was the inflexibility of the royalty payments. A percentage rate, while still not allowing differences in the value of individual works to be reflected, does at least allow the

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[2] In addition to these market-adjustment benefits, the authors were of the opinion that Canada could reap further gains by switching to percentage payments.

> With the exception of the United States most countries have institutionalized the percentage system. ... It would thus appear that Canadian works might stand a better chance of being used abroad if the mechanical rights were calculated on the same basis internationally. (p. 103)

The rationale for these claims is not clear. The practice in the record industry, which is dictated by the copyright legislation of the affected countries, is that the determination of the relevant royalty payments is dependent upon the country in which the record is released. (i.e., where the discs are pressed or the tapes duplicated). Thus, Canadian works contained in records released in Europe are paid according to the European rate system. Changes in the Canadian rate would therefore, in no way affect the degree to which these Canadian works are used or paid in countries with a percentage system. If movement to a percentage system did have the suggested impact, then it would be equally true that Canadian works would stand a poorer chance of being used in the United States after the change. The United States is by far the largest market for such Canadian works.

amount of royalties paid to be adjusted in response to general price-level fluctuations. In this regard, it is superior to a fixed per-work rate, which by its nature is not capable of accommodating price variations.[3],[4]

A percentage-of-price royalty payment would also allow the copyright owner to be reimbursed directly in relation to the selling price of the record or tape. Advances in technology, not foreseen in 1921, have resulted in recorded music now being marketed on singles, long-playing record albums, tape cartridges and cassettes. The selling price of tape cartridges and cassettes is normally higher than that of an album, even when exactly the same recorded musical works are included. With a percentage-of-price payment scheme, the copyright owner would be rewarded in direct relation to the price of the contrivance being sold.[5]

Movement to a percentage system would, however, present certain very major difficulties if implemented in Canada. The suggestion is most often made that determination of the mechanical royalty fee should be fixed at a percentage of the retail selling price as it is in much of Europe. This, however, raises the question of the proper specification of the retail price which is to be used as the basis of calculation.

Initially, it might be suggested that the calculation of a royalty payment as a percentage of retail price would be a straightforward operation. The high degree of price uniformity among <u>suggested</u> list prices would appear to facilitate this

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[3] A fixed per-work rate does, of course, provide for increased revenue when the total number of units sold increases. In Canada, total royalty payments have increased dramatically even though the per-work rate has not changed. This point will be discussed in more detail later in this section.

[4] As will be argued below, however, it is probably not in Canada's best interests, given the high degree of usage of foreign compositions, that the mechanical royalty payments increase continually.

[5] Whether or not it is desirable to allow composers to reap higher royalty payments from the sale of cartridges or tapes is a point of contention. A strong case can be made for the argument that the intrinsic value of the musical composition is the same whether it is included on a tape or on a disc record. The differences in selling price therefore have nothing to do with the value of the song. For this reason it is argued that there is no basis for the owners of copyright to receive increased benefits from technological changes.

exercise even further. But proponents of the system, such as the authors of the Keyes and Brunet Report, are most often not clear on whether the rate should be based on suggested retail prices or on actual retail selling prices. The distinction, in practice, is of great import.

In the North American retail record market there are a very large number of retailers. In Canada, records, in addition to being sold in outlets specializing in record and tape sales, are available in almost all types of retail operations including drugstores and chain department stores. Record club sales account for approximately ten per cent of shipments (Korcheski, 1978, p. 17). With the ever-increasing competition at this level, discounts, price cuts and sales are regular features in the marketplace. The result of this activity is that the actual retail selling price and the suggested retail price may differ significantly. Attempts to monitor the actual retail selling price would be extremely costly given the large number of outlets and the proclivity of retailers to discount. An administrative expense of this magnitude would result in considerably less funds being available for distribution. If the royalty is to be based on retail price, therefore, it would be all but obligatory from an administrative viewpoint to have it based on suggested retail price, as determined by the record companies themselves.[6]

In Britain, which has a percentage system, there is at present some confusion over this point. The U.K. Act provides that the royalty shall be six and one-quarter per cent of the ordinary retail selling price. The practice of the industry, however, has been to calculate the royalty as a percentage of the manufacturer's recommended price. In the past this did not cause serious concern since, under the prevailing Resale Price Maintenance (RPM) legislation, there tended to be little

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[6] A system based on actual selling prices does, however, have certain undeniable benefits. While in practice it is extremely difficult to determine the degree to which a particular song, rather than the specific rendition of that song by the artist, accounts for the value of a record, a royalty rate paid in respect of the actual selling price, would come closest to allowing market forces to operate in determining the reimbursement to the copyright owners of the musical works embodied in the record. Musical works contributing to the success of popular records (i.e., records that retailers do not have to discount to sell) would provide their copyright owners with a higher return than that being paid to owners of copyright in works contained on less popular records. Their reimbursement would thus more closely match the value of their works.

difference between the recommended retail price and the price that consumers paid. In North America, however, where the practice of RPM is illegal, the degree of variation from list price is much greater. Indeed, with the recent abolition of RPM in Britain, the capacity of their present system to maintain its validity and viability is being called into question. As reported in the Whitford Report, both the British Copyright Council and the Songwriters Guild have called for changes in the system away from the manufacturer's recommended price to some other formula.[7]

The Songwriters Guild suggested that, since the abandonment of retail price maintenance, the practice of calculating the royalty as a percentage of the manufacturer's recommended price is devoid of legal authority, and that therefore a new statutory basis for the royalty calculation is urgently required. In fact, the Act refers not to any particular recommended price but to "the ordinary retail selling price of the record" and this is required by regulation to be calculated "at the marked or catalogued selling price of single records to the public, or if there is no such marked or catalogued selling price, at the highest price at which single records are ordinarily to be sold to the public, exclusive of purchase tax in either case" (Whitford Report, 1977, p. 87).

There are, in addition, certain other practical difficulties likely to arise if one legislated that the royalty be based on suggested list price. The possibility exists that the industry practice of assigning and publicizing suggested list prices could end. As indicated above, these suggested prices are not the actual selling prices to either wholesalers,[8] retailers or the general public. It would probably not, therefore, disturb trade excessively if the practice was discon-

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[7] The authors are also aware of dissatisfaction with the system in place in most of Europe and administered by BIEM.

[8] It should be noted that record-industry spokesmen are disturbed at the concept that the calculation of mechanical royalty payments should be based on suggested prices, since the actual prices that they receive are lower than the suggested ones.

tinued.[9] If this circumstance arose, the use of percentage of suggested retail price as basis for royalty calculation would become anachronistic.[10]

The other possibility is that record companies could adjust their suggested retail prices in order to minimize royalty payments. Given again that the suggested price is not the actual transaction price, such a scheme might be introduced with little or no impact on the actual selling prices.

A further problem involved with a percentage system arises when works in the public domain are included with copyrighted musical works on the same long-playing album or tape. Under a per-composition system, royalties are paid only for the use of copyrighted material. Under a simple percentage system the royalty payable by the record company is the same whether all the works are subject to copyright protection or if only one is.

If, for example, there were 12 musical works included on an album with a suggested retail price of $9.00, then under a percentage system with a rate of say 4 per cent, there would be 36 cents from the sale of each record to be distributed among the various copyright owners. If each of the works was the property of a different owner, then each owner would receive 36 $\div$ 12 = 3 cents from the sale of each album. If, however, 6 of the works were in the public domain, and not subject to copyright protection, then there would be only 6 owners left to split the royalty payments. In our example the copyright owners would now be eligible for 36 $\div$ 6 = 6 cents from the sale of each record.

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[9] Given that the suggested retail prices, while extremely uniform in nature, are seldom the actual transaction prices their significance and meaning are not readily apparent. One possible explanation for their continued use is that they facilitate the accounting process for the parties involved. Wholesalers, rack jobbers, retailers, etc., are able, if they know the suggested price, to simply apply their standard discounts from suggested price to the records on hand to determine their book value. For a further discussion of the relevance of list prices see Blomqvist and Lim, 1979.

[10] It should be noted that the Whitford Report was also concerned with the practical complications that would arise if the manufacturers' recommended price were abandoned. Indeed, it has been suggested to the authors that, in Canada, certain of the major recording companies are already contemplating such a move.

Copyright owners of compositions that are included on albums containing public-domain material would, therefore, be receiving higher returns than if the album contained strictly copyrighted music.

In such a case, the royalty rate could be reduced proportionately to the number or length of the public-domain material, but some specific detailed method would have to be constructed. This could prove to be somewhat difficult for the parties involved from an accounting perspective. Many performing artists, record producers and musicians are already being paid on a percentage basis so the calculation of mechanical royalties on the same basis should not be prohibitively expensive. The need, however, to determine percentage payments resulting from sales of singles, long-playing albums, tapes, etc. and the need to account for public-domain material would make a percentage system more difficult than a per-composition system, from an accounting and administration viewpoint. Substantiating, to copyright holders, that the payments were correct would thus involve more time and expense.

For all these reasons it is apparent that movement to a percentage-of-retail-price system would be fraught with difficulties. Given the high degree of vertical integration[11] in the recording industry a royalty rate based on either wholesale price or net revenues would also be intractable.

The determination of wholesale prices would be extremely difficult, especially in those cases in which the record was not transferred at arm's length (i.e., when a record company owns its own wholesaling operation). To determine precisely the wholesale price in these circumstances would be problematic at best. Even if this could be overcome, it would still be very cumbersome to verify the actual transaction price of each and every record.

Another possible approach would be to calculate the royalty as a percentage of revenue. Again, however, the problem of identifying the total revenue arising from the release of each individual record could be prohibitive. The system would likely be inequitable as well, since some record companies do their own wholesaling and retailing while others do not. The question arises as to whether the revenue from wholesaling and retailing operations should be included in the royalty assessment for some companies but not for others. Separation of revenues between these various functions for vertically integrated companies could be of dubious accuracy.

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[11] For a description of this phenomenon see Korcheski, 1978, pp. 16-22.

In summary then, it is maintained that, while on the surface a movement to a percentage royalty rate system could be seen as a panacea for many of the problems inherent in the Canadian system, the probability of effective implementation is extremely low. It is instructive to note that the Whitford Committee in reviewing the British situation (paragraph 346) called for a movement to a new rate formula. No precise formula was offered, but it was stated that an appealing basis would be "for the royalty to be linked to the playing time of the copyright works."[12] Presumably this would have to be a set fee per unit of playing time. It thus appears that these authors favored moving away from a percentage system and much closer to the North American per-tune basis.

The final and perhaps most telling argument against moving to a percentage system is that it provides for automatic increases in royalty payments when this may not be in Canada's best interest. As will be elaborated below, the bulk of these payments are made to foreign copyright holders. Much of Canada's trade in copyright material shows this same negative impact. Thus, it is not clear that the government should legislate a provision that, in essence, provides that the copyright trade balance will continue to worsen. It is maintained that it would be preferable to have an increase in these payments come about only after a conscious government decision to do so.

From the above discussion it is clear that there are many caveats that one must attach to a percentage system, some of which are already affecting the working of this system in the United Kingdom. For this reason, it is recommended that the optimum (albeit imperfect) system for calculation of the compulsory mechanical royalties in Canada should be, as is the present industry practice, on a per-work basis.

In the following subsections a determination of the optimum level of these payments will be attempted.

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[12] It could be argued that basing the royalty rate on playing time would encourage length but not necessarily quality. There appears, however, to be no completely equitable basis for determining the value of a particular work embodied in a recording. One could argue that as there is only so much time to be filled on each record or tape, the inclusion of a particularly long recording indicates that it is considered valuable. A movement to a payment-for-playing-time system is at least a recognition of this potentially increased value.

Level of Payments

Present situation As stated earlier, the royalty rate prescribed in the Canadian Copyright Act is two cents per playing surface. Legally, therefore, recording companies are obliged to pay only two cents for each side of every long-playing album or tape under the compulsory license provisions. The provisions of the Act were established before the introduction of such long-playing contrivances. Recognizing the inherent unfairness (and perhaps fearing an amendment to the Act) of the original provision, when applied to long-playing contrivances, record companies have long since adopted the practice of paying two cents for each musical work included on a single, album or tape. It was, of course, in their best interests to do so since such an apparently low rate could have negatively impacted on the number of creative individuals in Canada willing and able to devote themselves to composing. This practice of paying two cents for each work is now apparently universally accepted. As explained earlier, the two-cent rate is normally paid for all records made for sale within Canada, except for certain budget line releases, TV advertised packages, record club sales and musical works within medleys.

The composer/lyricist and the agent having control of the copyright (i.e., the publisher) are entitled to mechanical royalties in respect of each copy of each recorded version of their work. Certain very popular works have been recorded many times over.

Additionally, it should be noted that the mechanical reproduction right is not the sole income-producing right of the composer/lyricist and publisher. Prior to the introduction of the mechanical reproduction right in 1921, the largest revenue-producing activity was the sale of sheet music. In 1925, the Composers, Authors and Publishers Association of Canada Limited (CAPAC), formerly known as the Canadian Performing Rights Society (CPRS), was founded.[13] This association collects and administers the royalties accruing to its members from the public performance of their works. These performing right royalties have become by far the largest source of funds for the holders of copyright in musical works. In Canada, in 1977 the combined performing right revenues of CAPAC and PROCAN, the two performing right societies in Canada, were 18.9 million dollars. Unfortunately, no precise Canada-wide figures exist on the total revenue generated by mechanical royalties.

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[13] For further details see Mills, 1972.

Estimates by Cyril Devereux, General Manager of the Canadian Musical Reproduction Rights Society, indicate that, at the minimum, the total performing right royalties are three times as high as mechanical reproduction right royalties in Canada.

The standard industry contract between composer/lyricists and publishers for newer, non-established composer/lyricists calls for the mechanical royalties to be split 50-50 between the publisher and composer/lyricist. Many well-established composers contract for higher percentages, or in some cases have established their own publishing companies, in order to exploit these royalties more fully.

Arguments For increased rate Composer/publisher interests are united in their belief that the present rate of royalties payable for the mechanical reproduction of musical works is unfairly low. The following is typical of their sentiments:

> The many problems inherent in the Canadian music publishing industry are manifest in horribly outdated copyright legislation and sporadic half-hearted attempts at revision. The result is that protection for creators in Canada is the worst in the developed world and the high profit potential of music publishing, with its small staff and low overheads, is going almost unrealized.
>
> ... Quite apart from this, there has been a dramatic decrease in 'real earnings' by creators in Canada due to the fact that the government has allowed the rate per playing surface to remain at two cents for the past 55 years, with absolutely no revision for dollar devaluation. (Chater and Monaco, 1979)

Music publishers argued that the rate in Canada should be raised for two primary reasons: a) the rate has not increased since 1921, though the prices of all other goods have; and b) the Canadian rates are, according to their estimates, the lowest of any major record market in the world.

The first point is undeniably true. It must be remembered, however, that, as stated above, industry practice has evolved to the point where the statutorily set rate is no longer followed. Thus, one is not presenting the entire picture when stating that the rates paid have not increased.

Still, on the surface, the two-cent rate does appear low. Certainly, the rate, as stipulated in the Canadian Copyright Act (i.e., two cents per playing surface) is anachronistic and in need of revision if it is to be at all meaningful.

The second point refers to the fact that Canadian rates are quite low by international standards. The Francis Report (Francis, 1977) in its deliberations regarding the level of the British rate was presented with the following information regarding the rates paid in Europe. The "effective" mechanical royalty rate in the United Kingdom was 6.25 per cent, in France 7.01 per cent, in Holland 6.96 per cent and in West Germany 7.18 per cent. For the United Kingdom, Holland and West Germany this rate was calculated on recommended selling price. In France the calculation was based on a percentage of the maximum retail price as determined by a system of "sondage" or survey.

Canada and the United States calculate their royalty rates on a per-composition basis. The U.S. rate is $2\frac{3}{4}$ cents or $\frac{1}{2}$ cent per minute, whichever is greater. The actual rate paid in Canada is 2 cents per composition. The U.S. rate for an album containing 12 musical works and listing for $7.98 would be 12 x $2\frac{3}{4}$ = 33 cents $\div$ $7.98 x 100 = 4.14 per cent. It should be remembered, however, that this is a percentage of suggested retail price. If, for instance, the record is sold on sale for, say, $4.98, then the mechanical royalties payable are actually 6.63 per cent of this price.

The corresponding Canadian rate, based on the 2-cent payment, would represent 3.01 per cent of the suggested list price for an album listing at $7.98 and containing 12 compositions. For a record retailed at $4.98, the effective rate would be 4.82 per cent.

From this short discussion, two factors become apparent: a) that one must be clear on whether the comparison of Canadian and U.S. rates with those paid in Europe is being made on the same basis (i.e., whether recommended or actual selling price is being used as the basis for comparison); and b) that, from either basis, it is apparent that the mechanical royalty rates being paid in Canada are somewhat low by international standards.

Arguments against increased rate Given that the mechanical royalty rate specified in the Canadian Act appears low both in terms of comparisons with the movement in domestic prices and in comparisons with the rates paid in other countries, there might appear to be a case for its upward revision. The

question to be answered at this juncture is, would it be in Canada's best interests to do this through an amendment to the Copyright Act?

As pointed out above, the per-composition mechanical royalty has not increased in nearly 60 years. However, to determine a true picture of the situation of composers and publishers it is necessary to look at their total revenues from all modes of exploitation of their copyright. The total of mechanical royalties payable is, of course, strictly dependent on sales. In Canada, for the period 1974-1977, the percentage increase in net shipments of units of records and pre-recorded tapes for each year is given below.[14]

	Records % Increase	Pre-Recorded Tapes % Increase
1974	5.7	31.4
1975	5.2	26.6
1976	15.7	35.1
1977	15.5	5.9

Total mechanical royalties paid, which are computed at two cents per composition for each record sold, would thus, in monetary terms, have increased proportionately.

It is not possible in Canada, to determine with precision the total level of payments made to all copyright holders. This is due to the fact that until 1976 there was no Canadian organization collectively representing publishers' interests. Studies undertaken in both the United Kingdom and the United States, however, indicate that the growth in mechanical royalties has been substantial. The inquiry documented in the Francis Report was presented with evidence that in the United Kingdom for the period 1956-1976 the growth in mechanical royalties had exceeded the rate of increase in the retail price index by over six times (Francis, 1977, p. 13). In the United States Copyright Law Revision Hearings (Gortikov, 1975, p. 1411) evidence was produced that indicated that for the period 1963-1973 the Consumer Price Index rose by 45 per cent while mechanical royalties increased by 105 per cent. What both these studies indicate is that the total amount of money paid in respect of mechanical royalties after accounting for inflation has, in real terms, increased. Thus, while the rate remained constant over the period covered by these studies, the

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14 Keon, 1979, p. 35. Net shipments are defined as gross shipments, less returns and exchange and exclude shipments to radio stations, reviewers samples, promotional records, pre-recorded tapes and transcription records. Inter-company reporting duplication has been eliminated.

actual amounts paid have risen dramatically due to the tremendous increases in sales.

The other major factor to be remembered in a discussion of the net incomes of composers and publishers in Canada is that, at present, the majority of their total income is derived, not from mechanical royalty payments, but from performing right royalties.[15] As indicated earlier, at least 75 per cent to 80 per cent of their total income is generated by performing right royalties.

The largest of the two performing right societies, CAPAC, disbursed 13.9 million dollars in 1977. The total disbursed by the two performing right societies in Canada for that year was 19.98 million dollars. The annual percentage growth in royalties for CAPAC for the period 1974-1977 is given below.

	% Increase
1974	9.45
1975	9.97
1976	25.5
1977	8.52

Comparable figures for PROCAN are not available, but they undoubtedly would show the same impressive growth. It is important to realize, therefore, that whatever hardship these groups may submit they are feeling as a result of outdated mechanical royalty payments, such hardship is ameliorated, to some extent, by the high level of performing right royalties.

A related argument, often presented to counter the claim of publishers for increased royalties, is that the functions and responsibilities of the publishers themselves have diminished. The traditional importance of the composer in providing the music to be recorded has, of course, not changed. Undoubtedly, however, the function of the publisher has changed.

> Publishers certainly cannot argue that they deserve more because they are doing more to make a recording a success. Once, music publishers performed many more creative, promotional, and marketing functions for their 2¢

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[15] We are not, at this point, arguing against the concept that there are separate rights and that each is entitled to be exploited separately. The figures on performing right royalties are presented merely to place the financial situation of the composer/lyricist and publisher in proper perspective.

> than most do today for their 20¢ or 24¢. Their function today is heavily administrative and clerical; they are largely service entities, conduits for the processing of income and paper transactions. They don't help create demand as they used to. They don't employ field representatives as they used to. These promotional functions necessarily have been taken over by recording companies. As the former president of the American Guild of Authors and Composers commented: "Years ago a publisher bought a song, plugged it, and got it performed, in eventual hopes of getting a record. Now a song is nothing without a record at the start." (Gortikov, 1975, p. 1400)

To a degree, it is still true that publishers promote songs to artists and producers, but at the same time the distinct roles and functions of the publisher have disappeared to a large extent. Indeed, many successful composers of music, who are often performers as well, have established their own publishing firms. In addition, all major record companies operate their own publishing subsidiaries.

The point being made here is simply that, in 1921, at the time of the enactment of the Copyright Act, the level of mechanical royalties was structured to reflect the fact that both composers and publishers were to be the beneficiaries of the royalties. The rate was set to reflect the extent of their respective contributions to the success of a musical work.

In today's music industry, the importance of the publisher, vis-à-vis promotion, has diminished significantly. To this extent the arguments presented by publishers' interests in support of increased mechanical royalties, of which they would generally receive 50 per cent, are considerably weakened.

Additionally, it should be noted that the successful composer and his associated publisher are already receiving large royalties from the sale of popular music. Thousands of dollars can be realized through the sale of recordings of a song. This is especially apparent when multiple recordings of the same work are made. For example, in the 1975 United States House of Representatives Hearings on Copyright Law Revision it was stated that:

> In addition, publishers and composers receive multiple income from the recordings of one composition. I am holding a list of the current recordings of a familiar hit song "By the Time I Get to Phoenix" which was made famous by Glen

> Campbell. This shows 81 separately produced records of that song from the United States alone, not foreign - 81 separate sources for that 2 cents to multiply. "Bridge Over Troubled Waters", made famous by Simon and Garfunkel's recording has 80 current separate recordings, and Paul McCartney's hit recording of "Yesterday" has 91 U.S. recorded renditions, 91 multiple sources of mechanical royalty income. (Gortikov, 1975, pp. 1399-1400)

This situation is in contrast to that of both the performing artist and the record company, who receive royalties only on the sale of copies of their own recorded version of the work. Undeniably there are composers who receive mechanical reproduction royalties that are by many standards insufficient. However, as pointed out in the conclusions of the Francis Report, this is not primarily a function of low royalty rates.

> No doubt, there are many unsuccessful composers whose rewards are modest, although they may receive a not insignificant income before the record company makes a penny. A small rise in the rate say to 8 per cent or even 10 per cent - would not make much difference in money terms to the unsuccessful composers. Their modest earnings are the result of low sales of their records, not of the level of royalty rate. (Francis, 1977, p. 18)

It is therefore important to note that the major beneficiary of any increase in rates will be the already-successful copyright owners. With respect to musical works (as with most copyrighted works in Canada, the vast majority of recordings sold embody foreign musical works. Klopchic in his study (1976, p. 17) of the Ontario recording industry reported that for 1974 only four per cent of the records sold in Canada had Canadian content.

From this it follows that the large majority of the revenues generated by the mechanical reproduction right, and which are dependent upon the sale of records, flow to foreign interests. In like manner, the large majority of any increased royalty payments would be distributed to foreign copyright holders.

A further matter that merits consideration is the impact that increased mechanical royalty payments would have on Canadian recording companies. The recording industry in Canada is, at present, healthy. However, increased mechanical royalties, which increase costs, could impact on the decision to

manufacture the more marginally profitable recordings. These more risky or marginal recordings are in many cases going to be those with Canadian content since they will not have had the benefit of extensive promotional activities in the United States.

Given that the majority of any increased payments will be made by resident Canadian companies to foreign resident composer/lyricists and publishers they again result in transfers out of the Canadian economy.[16]

Proposed rate The above discussion indicates that any claims of financial hardship expounded by publishers should be accepted with caution. The real increase in the total level of mechanical reproduction royalties as well as the growth in performing right royalties indicate that the financial returns to many publishers and composer/lyricists are generous. Clearly the rewards of some less popular Canadian composer/lyricists are small. This is not entirely due to low royalty rates. It is primarily a function of low sales levels. It thus follows that any increase in rates will go to the owners of copyright in musical works contained in the most successful recordings. As less than ten per cent of the recordings sold in Canada contain Canadian content the bulk of the increased royalties will leave the country.

For all these reasons it is recommended that the Canadian mechanical royalty rate should not be statutorily increased beyond what is the practice of the industry today. That is, the rate should be amended in the Act to specify that the royalty rate shall be two cents per composition or one half

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16 It should be noted that while the majority of any increase in mechanical royalties will be paid by Canadian resident record companies, these companies are for the most part foreign-owned. It is significant, however, that these payments would be made by record companies resident in Canada to foreign-resident publishers. Depending on the degree of autonomy of the companies, some of their existing profits and revenues do find their way into the production and distribution of Canadian-content recordings. In addition, profits of record companies resident in Canada are taxed by the Canadian government. Copyright royalties, such as mechanical royalties, leave the country tax free. For these reasons it is correct to identify payments by Canadian resident companies to foreign copyright holders as an outflow of royalties.

cent per minute for works in excess of five minutes for each record sold.[17]

It is maintained that these are far less costly schemes, which can be constructed to provide less-established Canadian composers/lyricists with additional income. For a suggested format for this type of scheme see the Appendix.

Royalties Payable on Records Made or Records Sold

As stated in the present Canadian Copyright Act, subsection 19(1)(b) copyright holders receive royalties for all contrivances sold. Existing industry practice in the recording industry is such that record manufacturers send wholesalers and retailers records and tapes with full return privileges for unsold copies.[18] This leads to a situation under which the company manufacturing the records does not know for some time after parting with the record whether or not it has been finally and permanently sold.

This has led to the adoption of an industry-wide practice of maintaining "reserves" lest overpayment to the copyright holder be made for records that are later returned. The level of reserves, and the time for which they are held, is a subject of concern to copyright holders. While in general they are not against the concept of reserves, they argue that record companies are misusing these funds and in effect obtaining free use of money that rightfully belongs to the holder of copyright in the musical work.

In order to solve this problem Keyes and Brunet recommended that royalties should be payable on all records made, and payable at the time of manufacture. In terms of simplicity this is possibly the optimal solution. Its practical effects would nevertheless be negative.

Information provided to the authors indicated that, at present, mechanical royalties amounting to approximately 20 cents per album, are equivalent to slightly more than one-third of the 54-cent manufacturing cost of such an album.[19] A re-

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[17] The reasons why the royalty should be paid for records sold and not on all records manufactured is explained below.

[18] It should be noted that certain of the major record companies are contemplating introducing return limits.

[19] For a complete discussion of the cost structure of a record album see Department of Industry, Trade and Commerce, 1978, p. 37.

quirement to have mechanical royalties paid on all records made would thus undoubtedly induce recording companies to undertake more conservative manufacturing and distribution policies. As was succinctly stated in the CRIA brief in response to the Keyes and Brunet report:

> It should be noted that if this recommendation were to be adopted the practical effect would be that recording companies would henceforth be extremely careful about the number of contrivances made so as not to pay mechanical royalties in respect of goods manufactured but not sold. The result would be fewer contrivances manufactured and therefore fewer sold - certainly not in the interest of music publishers. In addition, such a recommendation would at one stroke increase substantially the existing inventory costs of recording companies at the moment of adoption. (Canadian Recording Industry Association, 1978, p. 23)

In addition it does not seem equitable to require a compulsory licensee to pay royalties on records that are returned and never sold and from which the licensee derives no economic benefit.

For these reasons it is recommended that royalties be paid only for records that are actually "sold." The United States, in its recent revision to the Copyright Act, provided that mechanical royalties should be paid for all records made and distributed. The term "made" was meant to include every possible manufacturing or other process capable of reproducing a sound recording in phonorecords and it would appear that Canada would be wise to adopt such an all-encompassing provision in order to prevent any disputes as to what constitutes "manufacturing."

The U.S. Act requires that the record be made and distributed before royalty payments are required. Difficulties arise in the interpretation of the word "distributed." The phonorecord is considered distributed only if the licensee has "voluntarily and permanently parted with its possession" (U.S. Copyright Act, s. 115(c)(2)). As noted earlier, the determination of when a phonorecord is <u>permanently</u> distributed is difficult.

In the regulations accompanying a new Canadian Copyright Act, it will be necessary to delineate clearly what constitutes permanent distribution. It is suggested that the U.S. Act again provides a useful model. Their interim regulations provide:

> ...that permanent distribution of phonorecords occurs one year from the date on which the compulsory licensee actually parts with possession, or at the time when a sale of the phonorecord is "recognized" in accordance with generally accepted accounting principles. ... The intent of this provision is to make the compulsory licensee's reporting requirements for copyright purposes consistent with its overall business reporting practices and requirements. (U.S. Federal Register, Vol. 42, No. 250, 1977, p. 64890)

This requirement would ensure that the holding of any reserves was limited to a one-year period. In some instances reserves are now being held for up to two and three years.

It should be noted that the present Canadian Act requires royalties to be paid on records sold. Movement to a system where royalties would be paid on all records distributed, such as is the case in the United States, would thus entail payment on so-called promotional copies sent to radio station personnel, etc. Imposition of this type of system could again lead to a more conservative promotional and distributional strategy by the record companies. As was argued above, it is not clear that such an approach is beneficial to the copyright owners. For this reason it is recommended that mechanical royalties should be payable on all records made and permanently distributed for <u>retail</u> sale to the public.

Apportionment of Royalties

As it is recommended that the present per-composition basis of the royalty rate should be retained, it is also recommended that there be no change in the method of apportioning the royalties - i.e., two cents for each work. The present Canadian Act in subsection 19(6) states that:

> Where any such contrivance is made reproducing on the same playing surface two or more different works in which copyright subsists, and the owners of the copyright therein are different persons, the sums payable by way of royalties under this section shall be apportioned among the several owners of the copyright <u>equally</u>.

It should be clarified in the new Act that the royalties will be apportioned not necessarily equally but on the

basis of the number of works that a copyright owner has contained on the contrivance.

It should be noted that the apportionment of royalties between the composer/lyricist and the publisher of an individual work is a matter of private contract and need not be set out in the Act.

Timing of Payments

The Keyes and Brunet report recommended that royalties be paid on a monthly basis. In briefs received in response to the Keyes and Brunet report both the Canadian Recording Industry Association and the Canadian Music Publishers Association suggested that the present method of quarterly payments is appropriate. Given that both the major participants in the marketplace are in agreement that the present practice is most appropriate the recommendation here is to retain the status quo and have payments made on a quarterly basis.

Chapter V

THE MECHANICS OF THE COMPULSORY LICENSING SYSTEM

This chapter deals with some of the mechanics associated with compulsory licensing in section 19.

Notice Required for a Compulsory License

One of the conditions for the application of the compulsory license currently set out in subsection 19(1)(b) is that a prescribed notice of intention to make a contrivance must be given. Regulation 21(2) specifically prescribes the required contents of the required notice. As pointed out by Keyes and Brunet, the recording industry is well acquainted with this notice and it would be of little advantage to depart from well-entrenched practice. There is a problem, however, with other notices and "inquiries" described in the regulations, and with some of the mechanics associated with answering the notices.

First, regulation 21(1) speaks of notices required where royalties are payable on contrivances made before 1924. In that this was then a measure of a transitional nature which now has become an anachronism, assuming that no such contrivances still exist, this regulation may be done away with.

Second, regulation 22 specifies that the notice of intention to make contrivances must be sent to the owner of the copyright at least ten days before any contrivances are delivered to a purchaser. This seems at first glance to be a reasonable provision, and the time between the sending of the notice and the expected delivery date appears to be a reasonable minimum. However, if the date for sending the notice of intention to make contrivances is predicated on a date ten days thereafter for delivery of such contrivances it would seem that the prospective licensee could make contrivances before sending the notice. If a notice of intention to make contrivances is to be true to its name, it ought to be stipulated that such notice must be given some time before the making of the contrivances begins. Where there is more than one copyright owner, that each one should be given a notice individually is merely logical since each will be entitled to share in the proceeds of the mechanical royalties. As to the delivery date of contrivances, in a manner similar to Australia's law, the copyright owner ought to have an equitable amount of lead time, say 30 days, to enable him to arrange for release of his own recording if he so wishes, in view of the recommended adoption of the Ilsley proposal.

Answering the Notice and Royalty Payment Arrangements (Regulation 23)

Regulation 23(1) deals with arrangements to be made for the payment of royalties and the mechanics of answering the notice of intention to make contrivances. The frequency of royalty payments is dealt with elsewhere in this paper. There is no doubt, however, that each royalty payment made, irrespective of frequency, and whether the notice of intention is answered or not, should be accompanied by a certified accounting of the number of contrivances manufactured and/or sold since the last payment and the amount of royalties thus to be paid as well as cumulative statements on both these matters. Keyes and Brunet were of the opinion that such accounting is now required only when royalties must be deposited to the credit of the Receiver General for lack of response to the notice of intention. In spite of the better view that regulation 23(1)(c) presently requires a certified statement even in the case where the notice of intention is answered correctly, the regulation should be made unambiguous in this respect as recommended above. The question of whether the royalty payment ought to be based on "records made" or "records sold" and the concomitant question of reserves is dealt with elsewhere in this paper.

Regulation 23(2) provides for the filing of a $5,000 bond payable to the Crown for the benefit of copyright owners, to secure payment of all royalties. The measure is vague in that it requires such filing by "every person proposing to manufacture contrivances under the provisions of section 19 of the Act and this rule." "Person" should include corporate entities, but this is not explicit. Further, the bond-filing requirement is currently ignored without consequence since there is no express penalty for non-filing in the Copyright Act. Industry practice is not to file a bond and copyright owners have not voiced any objection to this or taken action because of it. It is also noted that the amount of a bond, if too small, would be inadequate to compensate fully for lost royalties; and, if too large, would be too onerous for record companies, especially smaller wholly Canadian ones. The conclusion is that the level of the bond is a contentious issue which can be resolved only by setting an arbitrary figure that will in all likelihood be unsatisfactory to all interested parties.

The Canadian requirement of a bond also seems to be unique in that no similar provision is found in the Copyright Acts of Australia, the United Kingdom or the United States. In any case, insofar as alternative methods of ensuring compliance with the conditions and formalities of a compulsory license can

be structured, such as enabling the copyright owner to terminate the license for non-compliance as discussed later, and inasmuch as industry practice has rendered the present bond requirements of little effect and value, it is submitted that the bond requirement should be done away with as inappropriate to a compulsory license scheme.

Presumption of Consent

Subsection 19(7) of the Copyright Act provides that where mechanical contrivances reproducing a work have been made, the owner of the copyright will be presumed to have given his consent to the making of such contrivances if certain prescribed inquiries have been made by the person intending to make contrivances under the compulsory license, and if such inquiries remain unanswered. The form and details of the prescribed inquiries are set out in regulations 24 to 27.

Subsection 19(7) was designed to overcome difficulties in discovering whether or not the copyright owner actually consented to the making of contrivances that it is known have been made. The significance of course is that the copyright owner's consent to the making of such earlier-made contrivances would normally be a necessary precedent for triggering the compulsory license. Whatever the reason for the difficulty in ascertaining whether the consent was actually given, such difficulty should not be insurmountable if the record company seeking to avail itself of the compulsory license is fully, and in good faith, willing to comply otherwise with the compulsory license requirements. If this were not so, it is conceivable that an otherwise proper compulsory license would not issue, and that the copyright owner might be deprived of the full economic potential of his work.

Admittedly, there is some potential for abuse of the presumption in subsection 19(7) in that it could be used to circumvent the requirements of subsection 19(1). However, if the element of good faith is introduced, there is reason to believe that a flagrant abuse of the presumption could be actionable at the instance of the copyright owner. Moreover, on the balance of convenience, it is preferable to allow the bona fide exercise of a compulsory license, than to preclude it based on an uncertainty as to consent that cannot otherwise be resolved. Therefore, the general schema of the presumption in subsection 19(7) ought to be continued. Any changes necessary to streamline the forms and procedures for the inquiries, or to bring them into line with the eventual structure of the Copyright Act, may be accomplished by amendments to the regulations pursuant to subsection 19(8), which authorizes the making of such regulations.

Non-Compliance with Compulsory License Requirements

Generally speaking, the consequences of non-compliance with the conditions in the Copyright Act for obtaining a compulsory license, and with associated formalities in the regulations are not dealt with explicitly at present. Implicitly, however, it seems clear that non-compliance with the conditions laid down in subsection 19(1) would disentitle one to the compulsory license, and thus expose the "former" licensee to a successful suit for copyright infringement in respect of phonorecords made subsequent to non-compliance; for in order to avoid the infringement of a work by its reproduction in a mechanical contrivance, one must prove compliance with the two principal conditions in subsection 19(1):

1. that contrivances embodying the work have been previously made, with the consent of the owner of the copyright in that work; and

2. that the prescribed notice of intention to make contrivances has been given, and that the royalties have been paid to the copyright owner in the prescribed manner.

In that the regulations prescribe the formalities that are involved in complying with the conditions laid down in subsection 19(1), any non-compliance with the formalities in the regulations must be viewed as equivalent to non-compliance with the subsection 19(1) conditions. Thus, failure to pay royalties at a prescribed time, or with the prescribed certified statements of account for instance, would equally expose the "former" compulsory licensee to a likely successful suit for copyright infringement at the instance of the copyright owner.

This, however, would not resolve the copyright owner's problem with respect to the unpaid royalties since, at present, there is apparently no mechanism for deeming such royalties to be part of his damages flowing from the actions of the "former" licensee. To resolve this, the copyright owner must be able to advise the compulsory licensee of the defect in royalty payment or other prescribed formality, by a letter sent by registered mail. Such letter could advise the compulsory licensee that if the defect is not cured within 20 days of the date of sending the letter, then the license will be terminated automatically. If the Copyright Act or the regulations contained a measure whereby, upon termination of the license, the making of all contrivances for which a royalty remains unpaid will be considered as an infringement as if no compulsory license had ever arisen, then the copyright owner could obtain a judgment for

all copyright infringement damages including unpaid royalties. Furthermore, any making of contrivances subsequent to the termination of the license would constitute additional actionable infringements for which the "former" licensee could be pursued. Therefore, by allowing the copyright owner to effect a termination of the license, which would have retroactive effect, he will be enabled to enforce a remedy for non-compliance with respect to both the conditions laid down in subsection 19(1) and the formalities laid down in the regulations.

Such a regime would be similar to one found in subsection 115(c)(4) of the U.S. Copyright Act. In that Act it is additionally provided that acts that constitute infringement by reason of the termination of the compulsory license at the instance of the copyright owner would be subject to all remedies for infringement including injunction, impounding and disposition of contrivances that infringe, damages and profits, court costs and attorneys' fees, liability for criminal offense, and finally seizure and forfeiture of infringing contrivances. It is suggested that inasmuch as the compulsory license amounts to a special contract relationship imposed upon the copyright owner, that he should have all of the above-noted remedies at his disposal to ensure compliance with the conditions and formalities of the compulsory license.

Establishment and Review of the Royalty Rate

Currently, the rate for computing the royalty for the compulsorily licensed mechanical right is set in subsection 19(5) of the Copyright Act. Aside from the question of the level of the rate and the manner of its calculation, dealt with earlier in this paper, there is also the issue of how it should be set and what mechanism should be available for its review. Doubtless the fact that the present rate is set out in the Copyright Act is partly to blame for the lengthy delay in its review and adjustment. It is, perhaps, common knowledge that an amendment to a statute requires a terrific impetus just to get it before the legislature, let alone to have it passed and effected in a reasonable time interval. Because of this great inertia, which a measure in a statute seems to take on, it is submitted that the rate should not be set out in the Copyright Act itself, but rather should appear in the regulations to the Act. The power of the Governor in Council to make and amend regulations pursuant to subsection 19(8) and section 44 would ensure sufficient flexibility in adjusting the royalty rate to meet extant conditions.

The Ilsley Commission proposed that the royalty rate should be reviewed after a period of two years, upon the application of any interested person, by a committee appointed for that purpose. This proposal is commendable in that it would ensure the adjustment of the rate on an ongoing basis. While the adoption of the general theme of the proposal is recommended, in that there should be ongoing review of the rate, there are certain alterations that could improve it.

It is suggested that the rate review ought to be on a regular and continuous basis, and that its initiation ought not depend on the application of any interested person. Review ought not to be ad hoc. A certain and predictable review period would probably achieve better results than one initiated by an uncertain application of any interested person. It is suggested that a period of five years elapse between each review so as to allow a rate to be in place long enough to produce cogent reaction, but not so long as to work a major disadvantage due to lengthy time lag.

As far as responsibility for the review of the royalty rate is concerned, it is submitted that the Copyright Act already provides a body competent to deal with such questions, in the form of the Copyright Appeal Board. The Board already deals with the question of royalty rates for performing rights on an annual basis, and could be assigned the task of reviewing the mechanical right royalty rate every fifth year. The Board could receive evidence and submissions from all interested parties, then make a recommendation to the Governor in Council as to changes in the rate. The Governor in Council is already empowered to make and amend regulations and could therefore decide whether or not to implement the Board's recommendation.

In summary then, the regular review of the royalty rate, every fifth year, by the Copyright Appeal Board (or whatever body stands in its place) should, in theory, ensure that the rate reflects existing conditions in the marketplace and provides equitable remuneration for copyright owners based on the use of compulsory licensing with respect to their works.

CONCLUSION

The recommendations of this paper, if implemented, would, to an extent, codify what has evolved as standard recording industry practice in Canada, with respect to the operation of the compulsory license for the mechanical reproduction of musical works. Changes are suggested to certain administrative procedures such as the notices and penalties for non-compliance. Certain other recommendations are made with a view to clarifying matters such as the definition of a musical work and the issue of the application of the compulsory license to sound recordings. In addition, there is an important recommendation that the rate should not be set out in the Copyright Act itself, but rather should appear in the regulations to the Act.

With respect to the question of whether to retain the present compulsory licensing system, it is recommended that it should be maintained but limited to musical works exclusively and thus should not include literary or dramatic works. This position is a reflection of the fact that while sound recordings are the primary mechanism for exploiting musical works, this is not the case in respect of literary or dramatic works. The returns to the owners of copyright in literary and dramatic works that would be mechanically reproduced would be unfairly low when compared to the returns to copyright owners of musical works, due to the difference in sales volume.

It is maintained, as well, that Canadian recording companies would be seriously disadvantaged, vis-à-vis their competitors in other countries, if the Canadian compulsory licensing provisions were removed. It is further recommended that Canadian record companies should have the right to record any musical work, once it has been recorded anywhere in the world with the consent of the copyright owner. Failure to provide this right could result in conflict among the various owners of copyright in musical works contained on a long-playing album or tape, where certain owners wished to have the album reproduced in Canada while others did not. This recommendation would simply clearly establish in the Act, what has long been industry practice.

From a practical economic perspective the two major items to be determined were a) the method of calculation of the royalty rate, and b) its level. With respect to the former it is recommended that the status quo be maintained in that the calculation should remain on a per-composition basis. Administratively a percentage-of-retail-price system is more complex, but, in addition, and more importantly, it entails a system whereby as prices increased there would be a continued increase

in mechanical royalties - the majority of which would flow out of the country, when it is not at all clear that it is in Canada's best interest to have these royalties increase.

With respect to the rate, we recommend that it be increased from the two cents per side, as presently stated in the Act, to reflect the rate that existing market forces have produced. Despite strong suggestions by composer and publisher interests that the present industry rate is too low, there are a number of factors that support maintenance of the current situation.

First, the empirical evidence indicates that the level of both mechanical and performing right royalties being paid in Canada has consistently increased. Second, the diminished role of music publishers, who in the majority of cases share the royalties equally with the composers/lyricists, supports the equity of a comparable decrease in the publishers' relative returns from the sale of works embodying musical compositions. Third, and equally important, the vast majority of any increase in mechanical royalties would go to the most successful composers/lyricists, most of whom are non-Canadian, and to their accompanying publishers. In the present Canadian music industry the bulk - over 90 per cent of increased royalties - would go to foreign copyright holders.

For all these reasons it is recommended that the mechanical royalty rate should be specified to be two cents per composition plus one half cent per minute in excess of five minutes for each record sold, which reflects current industry practice.

It is provided, however, that the rate be subject to review by a tribunal at five-year intervals. This, in our opinion, is an important and necessary recommendation as it will provide greater flexibility in allowing the rate to be changed if and when the royalty payments are felt not to adequately reflect the existing market situation.

Finally it is maintained that, to the extent that it appears appropriate to direct more funds to less-established Canadian composers/lyricists, there are far more efficient means of providing for such transfers than by an increase in mechanical reproduction royalties. The authors are of the opinion that such measures could be introduced prior to, or coincident with, the introduction of new copyright legislation and should be given due consideration.

APPENDIX

FUNDING FOR CANADIAN COMPOSERS/LYRICISTS

The rationale for claiming that less costly systems (than an increase in mechanical royalty payments) are available for providing increased income to Canadian composers is simple. Approximately 90 cents out of every dollar generated by an increase in mechanical royalties would accrue to foreign composers/lyricists and publishers. A system of subsidies, either from government general revenue or supported by a specific tax on record companies, could be structured to ensure that the payments were directed solely to Canadian composers/lyricists.

The funds needed to support such a scheme (and ensure increased funds for Canadian composers/lyricists) would be far less than the total level of increased mechanical royalties required for the same purpose. Instead of generating ten dollars so that one dollar could be paid to Canadians, as with increased mechanical royalties, only one dollar would have to be so generated.

As stated above, funds for a transfer scheme to Canadian composers/lyricists could be raised by a tax on record companies in Canada. As is well known, in the micro-economics literature, a lump sum or profit tax is optimal in that it does not affect the price and output decisions of the firm (Henderson and Quandt, 1971, pp. 219-222). Excise or sales taxes, whether on a per-unit or an ad valorem basis (i.e., a fixed percentage of the price of a commodity), generally will result in increased prices and decreased output in either competitive or monopolistic industries. For the recording industry, however, as was argued in Chapter IV, payment on a per-composition basis is optimal from an administrative viewpoint. It is maintained here that a tax scheme computed on the basis of units of sales for transfer to Canadian composers/authors would likewise be optimal. The level of the tax required would be extremely small in comparison with the total record sales volume and revenue. The marginal tax rate would be minimal and it is very unlikely that it would have any direct impact on the pricing or output decisions of firms.

Some formal mechanism for the disbursement of these funds will be necessary. The derivation of such a mechanism will not be attempted here.

It should be noted, however, that the Department of the Secretary of State is at present chairing an Interdepartmental Cultural Industries Committee, the purpose of which is to determine optimal mechanisms for enhancing the viability of Canadian cultural interests. It is submitted that this would be the appropriate forum for consideration of such a transfer scheme.

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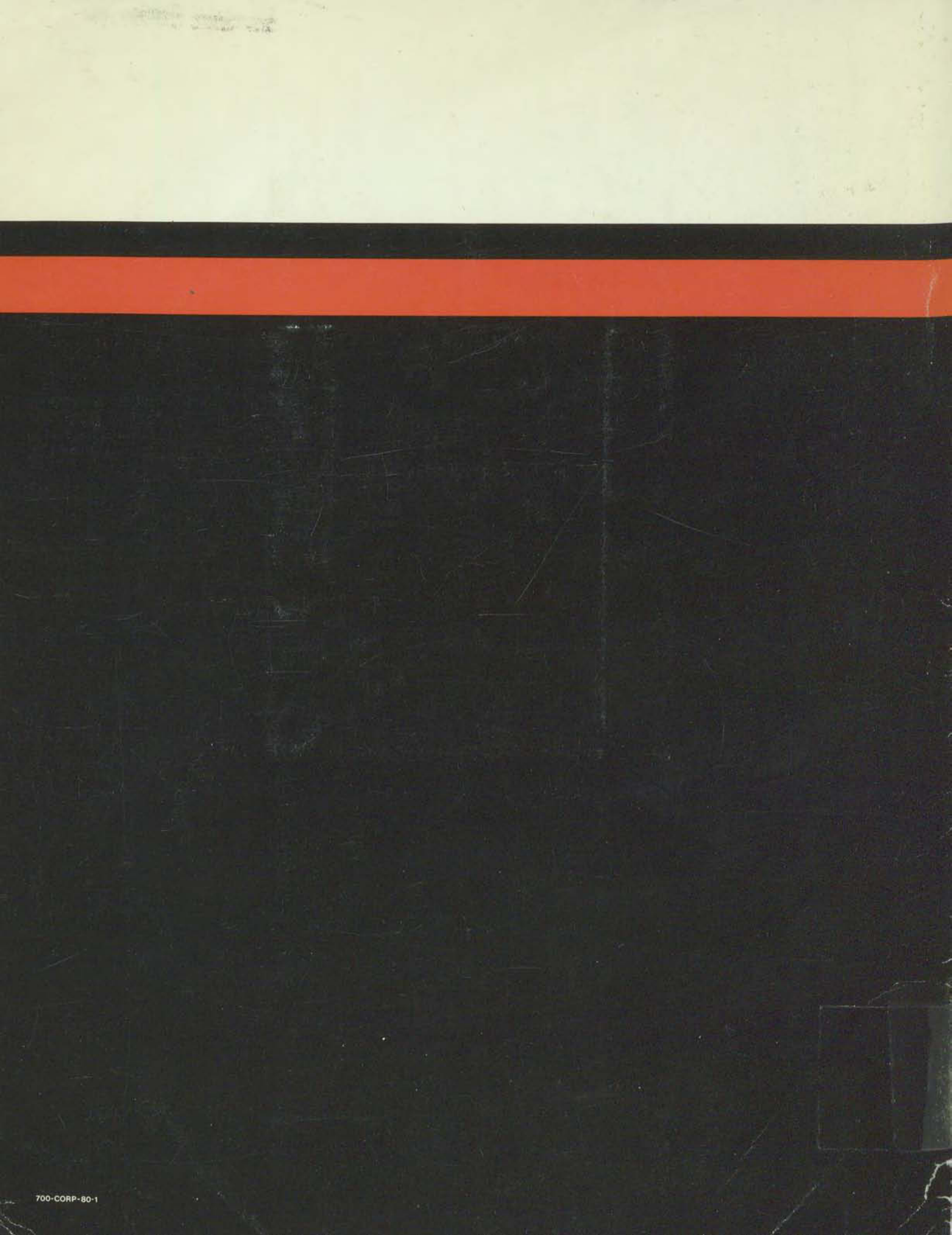

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