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**HOW TO SLICE THE PIE: REGULATING THE DISTRIBUTION OF
COPYRIGHT REVENUE IN THE MUSIC INDUSTRY**

**Submitted for LAWS529: The
Opportunities and Pitfalls of Regulatory Reform**

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Abstract

This paper argues that the different bargaining strengths between music creators and music companies results in inefficient and unfair copyright revenue distribution. On that basis it suggests two forms of regulatory intervention. Fair Trade Music is a voluntary certification scheme which would set a standard of 'fair remuneration'. The second option is mandatory regulation of the distribution of copyright revenue to ensure a minimum proportion goes to the music creator. Both schemes are considered against the benefits and obstacles in their practical implementation, ability to achieve the regulatory goal, political reactions and international obligations. Ultimately, this paper does not recommend adoption of a mandatory regulation and advises a cautionary approach to Fair Trade Music. Ostensibly it is unlikely the government will pursue either regulatory response without some political impetus.

Key words: copyright; regulation; contract; Fair Trade Music; revenue

I Introduction

The internet era has heard the cries of the music industry hailing the end of music as we know it due to copyright infringement. “The artists will not be paid” they lament, and then request strengthening of copyright laws. Rather than focusing on copyright infringement, which is where much of the debate has been focused, this paper will scrutinise the music industry itself. The extent to which piracy is affecting the music industry in general, and music creators specifically is not a question this paper seeks to answer. Instead, it argues that the structure of the music industry is leading many music creators to receive unfair remuneration for their work. Many economists and policy makers have acted on the assumption that the interests of creators and distributors are aligned, but there is evidence that this is not the case. Copyright is premised on creators having exclusive rights to their work which they can exploit, usually to earn money. Different jurisdictions and different individuals offer various rationales for why this right exists: some state that it is to provide an incentive for artists to create work which benefits society, others claim that artists deserve compensation for their hard work, and there are other rationales besides. This paper proceeds on the basis of a financial incentive rationale for copyright, regardless, the fundamental point that this paper and the various rationales for copyright share is the idea that the author *should* be paid for their work. On that basis the exploitation of music creators by the music industry, often for little to no remuneration, presents a problem.

A possible solution to this problem is regulation. This paper proposes two possible regulations and discusses the benefits and concerns regarding their implementation in New Zealand. A brief note, the discussion of copyright and market failure that creates the basis for the regulations is a general discussion, not specific to the New Zealand jurisdiction except where noted, though the analysis of the regulations put forward by this paper is from the perspective of New Zealand implementation.

The first part of this paper will outline the legal framework for copyright in New Zealand and then enter a general discussion about its rationales, referring mainly to the financial incentive justification. The second part will then discuss the market failure resulting from the unequal bargaining positions between music creators and the music industry, before moving away from economics to discuss regulating that relationship as a substantive political goal. The third part of the paper will introduce Fair Trade Music, a voluntary certification scheme. It will discuss some of the difficulties in implementing such a scheme and outline prerequisites for implementation. A mandatory regulatory scheme setting a minimum proportion of revenue to be given to the music creator is discussed in the fourth section of this paper. Again, the benefits of such a scheme will be highlighted as well as issues with

implementation, including the legitimacy of effectively regulating foreign contracts. Finally, I will briefly conclude on the overall desirability of these regulatory responses.

II Copyright

A Legal Framework

The purpose of copyright is to prevent others from exploiting a work without permission.¹ Historically, this meant preventing others from copying the work without authorisation.² This remains at the core of copyright, but has been added to a list of other restricted acts which only the copyright holder is permitted to do. Copyright infringement will occur whenever one of these acts is done by anyone else without a licence.³

Copyright law in New Zealand is largely governed by the Copyright Act 1994. The Act holds that something will be copyrighted if it falls within a category of ‘works’ listed in s 14. It must be original;⁴ be a form of expression, not simply an idea; be recorded (for certain works); and meet other qualifications.⁵ A list of restricted acts is given in s 16 of the Act and largely covers unauthorised copying, disseminating of copies, or making available the work to the public. A copyright will usually endure for 50 years after the author dies.⁶ It is also worth noting that as a property right, copyrights can be licenced.⁷

B The Justifications of Copyright

The justifications and goals given for copyright are varied and are often highlighted or ignored depending on the law under debate or the argument that an academic, policy maker, copyright owner or any other interested party is making.⁸ One widely accepted justification of copyright law in common law countries is the utilitarian model or the incentive-access paradigm.⁹ This justification treats copyright as “a device for balancing incentives for creators against public access”.¹⁰

Broadly put, the idea is that the cost of creating an original work is high, both in time and effort, whereas the cost of copying the work is comparatively low. Once copies are available

¹ Paul Sumpter *Intellectual Property Law: Principles in Practice* (2nd ed, CCH, Auckland, 2013) at 68.

² Sumpter, above n 1 at 68.

³ Sumpter, above n 1 at 68.

⁴ Copyright Act 1994, s 14.

⁵ Copyright Act, s 18 and Sumpter, above n 1 at 5.

⁶ Copyright Act, s 22(6).

⁷ Copyright Act, s 111 and Sumpter, above n 1 at 53.

⁸ See for example various justifications which have been espoused in Canada: Daniel Gervais “A Canadian Copyright Narrative” (2009) 11 J. World Intell. Prop. 432.

⁹ Katie Sykes “Towards a Public Justification of Copyright” (2003) 61(1) U. Toronto. Fac. L. Rev. 1 at 2, 5, and 24.

¹⁰ Sykes, above n 9 at 2.

it is often inexpensive to create more copies, or to disseminate them. If the author prices their work at close to the cost of producing one additional copy (marginal cost) then they may compete in the market, but they may not recoup the value of the resources spent creating the work.¹¹ If the author prices their work at higher than marginal cost, people may not buy it because cheaper copies are available to them from copiers who price near marginal cost. The result is a market failure, which is what copyright aims to remedy.

This widely accepted justification for copyright law as a remedy to market failure, rests on the idea that original artistic works are in the public interest.¹² Society, or academics and governments at least, consider original artistic works to be in the public interest. For example, the United States' Constitution states that copyright law may be enacted "to promote the Progress of Science and useful Arts",¹³ Barbara Friedman describes a thriving culture as one where as many original works as possible are available,¹⁴ and Judge Leval writes that copyright "embodies a recognition that creative intellectual activity is vital to the well being of society".¹⁵ Robert Merges notes that "countless judges begin their intellectual property decisions with...[a] 'stage-setter' about how intellectual property protection exists to serve the public interest."¹⁶

While these statements all originate in the United States they are indicative of a general attitude towards copyright.

Thus the goal of copyright law within this paradigm is to provide the public with the highest level of access to artistic works, by balancing the incentive to produce the work with public access to the work. The optimum balance is where the public has access to the highest level of original works.¹⁷

It is worth acknowledging that this justification has faced criticisms, predominantly that the balance between the competing interests has never been adequately identified, and possibly cannot be precisely delineated, and that our copyright law does not embody this paradigm.¹⁸ It has also faced accusations of being created at the behest of certain interest groups, rather

¹¹ William M. Landes and Richard A. Posner "An Economic Analysis of Copyright Law" (1989) 18 J. Leg. Stud. 325 at 325.

¹² Landes and Posner, above n 11 at 325 and Sykes above n 9 at 24.

¹³ Constitution of the United States of America, Article I, section 8.

¹⁴ Barbara Friedman "From Deontology to Dialogue: The Cultural Consequences of Copyright" (1994) 13 Cardozo Arts & Ent. L.J. 157 at 158.

¹⁵ Pierre Leval "Fair Use or Foul? The Nineteenth Donald C. Brance Memorial Lecture" (1989) 36 J. Copyright Soc'y 167 at 169.

¹⁶ Robert Merges *Justifying Intellectual Property* (Harvard University Press, Cambridge (Mass), 2011) at 3.

¹⁷ Merges above n 16 at 2.

¹⁸ Glynn Lunney Jr. "Reexamining Copyright's Incentives-Access Paradigm" (1996) 49 Vand. L. Rev. 483 at 487 and Merges above n 16 at 3

than as an attempt to secure the production of a public good.¹⁹ Regarding the first of these, I will merely point out that simply because a goal is not being optimally achieved, or is difficult to optimally achieve, does not necessarily make it any less desirable. In response to the second, Katie Sykes makes the argument that the law understands itself as a justificatory enterprise:²⁰

Even if as a matter of historical fact copyright emerged at the instigation of certain interest groups, as *law* it presents itself as normatively grounded in values that transcend its historical origins.

These responses, while brief, are all that are required for a paper of this nature, which deals with the justifications of copyright only peripherally.

III Regulation

One of the central issues around which modern copyright debates revolve is the balance of power which comes from copyright law and regulation.²¹ This paper argues that the distribution of remuneration between music creators and music companies is imbalanced in favour of music companies, which undermines the incentive aspect of copyright. This situation creates a case for regulatory intervention.

The discussion below will outline the reasons for the imbalance and why it justifies a regulatory response. It will do this by reference to welfare economics and political substantive goal theories. The issues underlying the imbalance in distribution of copyright revenue will be discussed generally, as the exploitation of music by copyright contracts is a global feature of the music industry, however the specific regulatory responses are discussed from the perspective of New Zealand implementation.

A Justification for the regulation

Regulation is not the appropriate mechanism for government intervention in all instances. Instead, the necessity for regulation should be justified before a government takes legislative action. The welfare economics approach focuses on market failure, and has been described by Ogus as: “regulation is justified because the regulatory regime can do what the market cannot”.²² Substantive political approaches can be used complementarily to a welfare

¹⁹ Sykes, above n 9 at 14.

²⁰ Sykes, above n 9 at 14 and Merges above n 16 at 9 and 14. Merges also notes that changing the foundation of intellectual property would not affect its day-to-day operation (9), and suggests normative foundations (14).

²¹ Bethany Klein, Giles Moss and Lee Edwards *Understanding Copyright* (Sage Publications, London, 2015) at 20.

²² Anthony Ogus extract in Bronwen Morgan and Karen Yeung *An Introduction to Law and Regulation: Text and Materials* (Cambridge University Press, New York, 2007) at 18.

economics approach, and use non-economic substantive goals to justify regulatory intervention.²³ I argue that both of these approaches may be relied upon to justify regulatory intervention in the music industry.

1 Welfare economics

At a high level, welfare economics can be understood as being concerned with allocative efficiency, that is, putting resources to their most valuable use.²⁴ Theoretically, an ideal market will generate allocative efficiency, but this often does not occur in reality.²⁵

Alonso and Watt describe an efficient distribution of copyright income as one where neither party (creator and distributor) to the contract can benefit from a change without making the other party worse off.²⁶ This is called Pareto efficiency. The level of risk aversion between the parties will affect the efficient sharing of the revenue. For example, in music contracts, the creator is often more risk averse than the distributor.²⁷ In this situation it is more efficient for the creator to have a higher proportion of revenue when low revenue is earned, and a lower proportion when a high revenue is earned.²⁸ This ensures a somewhat steady income for the risk averse creator, and means the less risk averse distributor has the chance to obtain a greater benefit. However, many real world copyright contracts provide for royalties to grow alongside revenue.²⁹ This is almost always inefficient.³⁰

The optimally efficient share of revenue is difficult to establish in practice, so the Nash Bargaining Solution has been suggested as an easier way to calculate efficient revenue distribution.³¹ According to the Solution, the most efficient royalty contract is one that awards each party a proportion of revenue equal to their relative bargaining power.³² However, music creators often have very weak bargaining positions relative to music distributors.³³ This is due to differences in the “independent wealth and outside opportunities for each party (that is, the relative need of each for the distribution contract to exist)”.³⁴ More

²³ Morgan and Yeung, above n 22 at 27.

²⁴ Ogus in Morgan and Yeung, above n 22 at 18.

²⁵ Ogus in Morgan and Yeung, above n 22 at 18.

²⁶ Jorge Alonso and Richard Watt “Efficient distribution of copyright income” in Wendy Gordon and Richard Watt (eds) *The Economics of Copyright* (Edward Elgar Publishing, Northampton (Mass), 2003) 81 at 82 and Ruth Towse “Copyright policy, cultural policy and support for artists” in Wendy Gordon and Richard Watt (eds) *The Economics of Copyright* (Edward Elgar Publishing, Northampton (Mass), 2003) 66 at 69. The reasons for this are further discussed below.

²⁷ Alonso and Watt, above n 26 at 88.

²⁸ Alonso and Watt, above n 26 at 88.

²⁹ Alonso and Watt, above n 26 at 88.

³⁰ Alonso and Watt, above n 26 at 89.

³¹ Alonso and Watt, above n 26 at 91, see also John Nash “The Bargaining Problem” (1950) 18(2) *Econometrica* 155.

³² Alonso and Watt, above n 26 at 91.

³³ Towse, above n 26 at 69.

³⁴ Alonso and Watt, above n 26 at 92.

specifically, because individual artists often have poor access to the capital market and rely on companies to distribute their work, they do not usually have surplus money and must sell their work quickly.³⁵ Additionally they have considerably less experience in the market.³⁶ This weak bargaining position leads to standard royalty contracts with 10-15% of sales revenue reserved for creators.³⁷

Alonso and Watt specifically state that they have not considered the desire to ensure a sufficient incentive for artists to produce original works,³⁸ and even they find it economically difficult “to defend cases where the creator ends up with a share that may be as low as 10% of total revenue”.³⁹ Once one considers the view that creative works are beneficial to the public, and the finding that artists respond to increased earnings by devoting more time to artistic work, it becomes even harder to justify such low royalties as economically efficient.⁴⁰

Regarding creator responses to increased earnings, there is debate about the extent to which, or indeed whether, financial rewards play an incentivising role in the production of creative works.⁴¹ There are many examples of creative production without economic reward.⁴² Some music creators may well produce music, or produce more or higher quality music, as a result of financial incentives, but this assumption does not speak to the values of all music creators.⁴³ This paper will rely on the assumption that financial incentive does play a role in the production of musical works. This is partly because copyright is premised on the idea that creators ought to be paid, whether to incentivise the production of creative works or because they deserve to be remunerated if a market for their work exists,⁴⁴ and partly because the true motivations for creating music remain somewhat ambiguous even to scholars of cultural economics.⁴⁵

The ideal distribution of revenue between music creators and other parties (mainly music companies) to achieve the optimal production of music in the public interest is outside the scope of this paper, which is focused on regulation rather than an economic analysis.

³⁵ Towse, above n 26 at 69.

³⁶ Towse, above n 26 at 69.

³⁷ Towse, above n 26 at 69 and Alonso and Watt above n 26 at 92. Also see Sara Karubian “360° Deals: An Industry Reaction to the Devaluation of Recorded Music” (2009) 18. S. Cal. Interdisc. L. J. 395 at 440 which states the traditional royalty contract for newcomers gives 13-16% of revenue.

³⁸ Alonso and Watt, above n 26 at 82.

³⁹ Alonso and Watt, above n 26 at 93.

⁴⁰ Towse, above n 26 at 68 and Ruth Towse “Partly for the Money: Rewards and Incentives to Artists” (2001) 54 KYKLOS 473 at 482.

⁴¹ Towse, above n 26 at 69 and William Patry *How To Fix Copyright* (Oxford University Press, New York, 2011) at 14.

⁴² Patry above n 41 at 14.

⁴³ Klein, Moss and Edwards, above n 21 at 69.

⁴⁴ Merges, above n 16 at 2-3.

⁴⁵ Klein, Moss and Edwards, above n 21 at 70.

Nonetheless, there is a strong argument that there is an imbalance between the music businesses and music creators, in terms of financial reward, in favour of businesses, which is allocatively inefficient and makes a prima facie case for a regulatory response. I will outline that argument now.

2 *Application of welfare economics to the music industry*

Copyright allows creators to hold the exclusive rights in their work, which they may then exploit or trade as they see fit. This trading is done via contracts, so it follows that those contracts are central to the consideration of allocative efficiency.⁴⁶ Towse points out that Anglo-Saxon copyright law, and many economists, have assumed that the interests of creators and distributors are in harmony and are equally served by copyright.⁴⁷ This is true in the sense that both wish to profit from the exploitation of artistic works but those interests conflict when it comes to the distribution of that revenue.⁴⁸

As discussed above, music distributors have a stronger bargaining position than music creators. This unequal bargaining position occurs because of “an oversupply of creative ambitions and winner-takes-all demand patterns”, which have had two main effects on copyright contracting: First,⁴⁹

since many more products want to enter the market than can be consumed, there is an important role for the commercial intermediary, acting as selector or gatekeeper. Publishers [and] record companies ... will play this role for different markets. The bargaining power of artists early in their career is therefore weak.

This position is made worse because the majority of creators competing in a large labour pool for which there is relatively low demand have a lower capacity to take financial risks compared to music distributors and, relatedly, their low capital reserves often force them to sell their work shortly after creating it.⁵⁰

Secondly,⁵¹

⁴⁶ Niva Elkin-Koren and Eli Salzberger *The Law and Economics of Intellectual Property in the Digital Age* (Routledge, New York, 2013) at 149 and Ruth Towse “Copyright and Economics Incentives: An Application to Performers’ Rights in the Music Industry” (1999) 52 *KYKLOS* 369 at 372.

⁴⁷ Towse, above n 26 at 70-71 and Towse, above n 46 at 371.

⁴⁸ Towse, above n 26 at 71.

⁴⁹ Towse, above n 26 at 69 and Martin Kretchmer and others *The Relationship Between Copyright and Contract Law* (study commissioned by the Strategic Advisory Board for Intellectual Property, UK, 2010) at 66.

⁵⁰ Towse, above n 26 at 69.

⁵¹ Kretchmer, above n 49 at 66.

despite ever more sophisticated marketing efforts, commercial intermediaries have been unable to predict demand patterns in winner-take-all markets. Nobody knows the next hit. Only a small percentage of releases will repay their initial investment. Market intermediaries tend to favour known artists with a track record. The bargaining power of consistently successful artists is therefore high.

Thus the demand for music creators is not distributed evenly; it tends to concentrate on already established and popular ‘superstar’ creators.⁵² The result is that the few elite creators have a stronger bargaining position vis-a-vis music companies, compared to less established creators, so tend to receive better contractual terms including higher royalty entitlements.⁵³ Moreover “a severe lack of transparency makes it difficult for rights holders to evaluate the compensation they receive or take action to change it”.⁵⁴

None of this is particularly new. Artists have long had limited bargaining power due to the structure of the music industry and restrictive contracts have existed for some time.⁵⁵ It is even economically justified to some extent. Copyright contracts are a way of sharing risk between the contracting parties, and financially a music company can take on higher risks than a music creator.⁵⁶ It follows that they should be able to gain higher rewards than a music creator. However, the disparity between the revenue that music companies and music creators are entitled to under these contracts is too high in many cases. Watt concluded, after creating an analytical model of the optimal royalty contract, that typical contracts are linear and inefficient at maximising creator utility.⁵⁷ The revenue derived from copyrights in music often either does not reach music creators, or reaches them only minimally.⁵⁸ This is due both to the increase in work-for-hire contracts, in which copyright and royalties attaching to it are transferred to company employing the musician, and traditional contracts which reduce the economic reward for music creators attaching to their copyrights by distributing a large share of it to the music company.⁵⁹

The issue of insufficient revenue for music creators has been exacerbated by the rise of music piracy. The record industry has responded to the threatened loss of profits by shifting to

⁵² Towse, above n 26 at 69.

⁵³ Ruth Towse “Copyright and Artists: A View from Cultural Economics” (2006) 20(4) J. Econ. Surv. 567 at 578

⁵⁴ Pierre-É. Lalonde *Study Concerning Fair Compensation for Music Creators in the Digital Age* (Commissioned by International Council of Creators of Music, Nashville, 2014) at 28.

⁵⁵ Klein, Moss and Edwards, above n 21 at 22.

⁵⁶ Towse, above n 46 at 370 and 375.

⁵⁷ Richard Watt *Copyright and Economic Theory: Friends or Foes?* (Edward Elgar Publishing, Cheltenham (UK), 2000) in Alonso and Watt above n 26 at 70 and Richard Watt “Licensing and Royalty Contracts for Copyright” (2006) 3(1) Rev. Econ. Research Copyright Issues 1 at 10.

⁵⁸ Klein, Moss and Edwards, above n 21 at 63-64 and 70.

⁵⁹ Klein, Moss and Edwards, above n 21 at 64 and 70.

contracts with creators that control more revenue sources.⁶⁰ These are known as ‘360 deals’ and include not just the rights to revenue from recordings, but also associated activities like touring and merchandising.⁶¹ While the distribution of revenue under these deals appears, at first blush, to be more favourable to artists, including newcomers,⁶² in reality they bring a previously independent source of creator earnings within the control of the music company.⁶³ Many artists make very little money from their records, and non-recording activities may be an important source of income.⁶⁴ Allowing music companies to obtain a share of these revenues, often a majority share in the case of creators who signed contracts as newcomers, is likely to perpetuate or worsen the distributive inefficiency in many copyright contracts.⁶⁵

There has been discussion about whether the internet might provide a mechanism through which music creators could circumvent music companies altogether.⁶⁶ For example, in 2007 Radiohead released the album *In Rainbows* independently of a record company and simply asked consumers to pay what they wished as well as contracting with iTunes to distribute the album.⁶⁷ The album was a financial success and conservative estimates predict that Radiohead made more than \$6.5 million from the pay-what-you-want model alone.⁶⁸ However, most music creators, and especially newcomers to the industry, could not have implemented this strategy. The band’s frontman, Thom Yorke, stated in an interview that:⁶⁹

the only reason we could even get away with this, the only reason anyone even gives a shit, is the fact that we’ve gone through the whole mill of the business in the first place. It’s not supposed to be a model for anything else. It was simply a response to a situation. We’re out of contract. We have our own studio. We have this new server...But it only works for us because of where we are.

⁶⁰ Klein, Moss and Edwards, above n 21 at 22; Gail Mitchell “Jay-Z talks Exit Rumours, Grammys, 360 Deals” BILLBOARD (USA online ed, 14 December 2007) in Karubian, above n 37 at 434; Karubian above n 37 at 423; and Matt Stahl and Leslie Meier “The Frim Foundation of Organizational Flexibility: The 360 Contract in the Digitalizing Music Industry” (2012) 37 CJC 441 at 442.

⁶¹ Karubian, above n 37 at 399 and 427.

⁶² Karubian, above n 37 at 331 Paramore received 30% of profits which is double the 13-16% available under the traditional model.

⁶³ Karubian, above n 37 at 434.

⁶⁴ Karubian, above n 37 at 434 and Matt Stahl “From Seven Years to 360 Degrees: Primitive Accumulation, Recording Contracts, and the Means of Making a (Musical Living)” (2011) 9(2) TripleC (Cognition, Communication, Co-Operation): Open Access Journal for a Global Sustainable Information Society 668 at 674.

⁶⁵ Karubian, above n 37 at 428-431: majority share of 70% in Paramore’s case

⁶⁶ See for example Towse, above n 46 at 377 and Karubian, above n 37 at 396

⁶⁷ Karubian, above n 37 at 395.

⁶⁸ Karubian, above n 37 at 395 and David Downs “Radiohead’s *In Rainbows* Leads to Digital Pot of Gold” *SF Weekly* (San Francisco, USA, 10 October 2007).

⁶⁹ Interview with Thom Yorke, Radiohead frontman (David Byrne, Wired Magazine, 18 December 2007) transcript at <www.wired.com> “David Byrne and Thom Yorke on the real Value of Music”.

This quote recognises the high costs of recording and the massive advantage afforded by an established fan base, which mitigates the financial risks of creating music.⁷⁰ “The popular music side of the record industry...is inherently risky, as consumers’ tastes are fickle and, in the case of new performers, unformed.”⁷¹ The only creators who are likely to be able to circumvent recording companies by using the internet are successful, already established creators, and they are unlikely to suffer the same poor contractual terms offered to newcomers in weak bargaining positions.⁷²

Alternatively, the internet via direct distribution platforms such as YouTube, Spotify and SoundCloud could be used by creators to establish themselves and to show that there is a market for their music which may improve their bargaining positions, as that creator now presents a smaller risk of financial failure. This strategy would avoid the issue of music creators having to go through the record company ‘gatekeepers’ for access to the public; while record companies remain to some extent gatekeepers of traditional media, their intermediary role is reduced online.⁷³ However, using the internet as an exposure or direct distribution tool has its own problems. As the internet has practically no barriers to entry for music creators competition for an audience is high and many musicians will never be heard. For example, there are approximately 4 million songs on Spotify which have never been listened to,⁷⁴ leading to the creation of “Forgotify” which gives access to those songs.⁷⁵ Even Justin Bieber and Adele, who were discovered online and signed contracts with music companies, as examples, this is unlikely to be a strategy guaranteed to secure substantial exposure.⁷⁶ Even the music creators who do find exposure this way may only slightly mitigate their poor bargaining positions. Thus, while some music creators may be able to utilise the internet to improve their bargaining positions or circumvent music companies altogether, these benefits will not be obtained by the majority of musicians, leaving the question of revenue distribution in a place of central importance.

As acknowledged, there are winners in this system; the incredibly successful musicians also tend to receive better contractual terms, such as higher royalty entitlements.⁷⁷ However, most musicians do not belong to this incredibly successful elite and “while a small number of

⁷⁰ Karubian, above n 37 at 396.

⁷¹ Towse, above n 46 at 378.

⁷² Towse, above n 46 at 388 and Klein, Moss and Edwards, above n 21 at 64.

⁷³ Kretchmer and others, above n 49 at 66 and Karubian, above n 37 at 396.

⁷⁴ Spotify “It’s Spotify’s 5th Birthday Today!” (7 October 2013) Spotify <www.news.spotify.com>

⁷⁵ <www.forgotify.com>

⁷⁶ Michael Keshen “9 musicians who got discovered on the internet” (4 December 2014) Hover <www.hover.com> and Desiree Adib “Pop star Justin Bieber is on the brink of superstardom” (14 November 2014) ABC news <www.abcnews.go.com>

⁷⁷ Towse, above n 26 at 69.

creators are multi-millionaires, most are not making a living through creative work”.⁷⁸ Additionally, not all copyright contracts necessarily contain an inefficient distribution of revenue. But the weak bargaining position of newcomer music creators is not altered by the existence of some fair or efficient contracts and, as noted above, an economic analysis of *typical* royalty distributions in copyright contracts has suggested that they are inefficient.⁷⁹ The inefficient allocation of music revenue, while not absolute, is sufficiently prevalent to call for a consideration of regulatory intervention.

All of this does not lead to the conclusion that all music creators deserve payment by virtue of being music creators (although that is a conclusion that some may wish to draw). If the music that they create unpopular and is not purchased by consumers then this paper is not arguing that the state should provide them with income. Instead, it argues that within the context of copyright law, music creators who produce music which is popular and therefore purchased by consumers should be entitled to fair remuneration for their creation. As it stands, that remuneration is often not provided. This is due to the weak bargaining positions of most music creators compared to music companies, which is premised on the difficulty of entering the music industry as a newcomer.⁸⁰ As a result, the incentive, or even the ability, to produce music is diminished as potential music creators may choose more financially rewarding careers, or simply not have time to create music and support themselves. Consequently, there is an allocative inefficiency and a *prima facie* case for the state to intervene.

From the discussion above it is apparent that even from a strictly economic perspective it is doubtful that many of the current copyright contracts which distribute the revenues are efficient. Moreover, once the substantive aim of incentivising the production of music in the public interest is considered alongside the purely economic allocative efficiency approach it becomes clear that the distribution of revenue between music creators and companies should be considered from a regulatory standpoint.

If this approach is doubted, I engage in an alternative, yet complementary, justification based on the substantive fairness of regulated remuneration for music creators below.

3 *Substantive political approach*

The substantive political approach to the public interest theory of regulation goes further than welfare economics analyses. It incorporates substantive values, such as social justice, redistribution and paternalism into the assessment of what justifies regulation.⁸¹ It is argued

⁷⁸ Klein, Moss and Edwards, above n 21 at 71.

⁷⁹ Watt (2006), above n 57 at 10.

⁸⁰ Klein, Moss and Edwards, above n 21 at 70 and Towse, above n 26 at 69.

⁸¹ Morgan and Yeung, above n 21 at 26.

that these non-economic goals are sufficient basis for regulatory intervention.⁸² Public-interested redistribution and collective desires and aspirations are particularly relevant when considering the music industry.⁸³

Public-interested redistribution is, somewhat self-explanatorily, the redistribution of resources from one group to another, by the state, in the public interest.⁸⁴ The state has the power to do this by virtue of being the state, so long as Parliament has passed laws accordingly. However, the ability to do something does not justify doing it. Thus, the ‘public interest’ aspect of the regulation must be defensible. I argue that in the case of the music industry, music creators are in an analogous position to labourers prior to minimum wage laws, a group which is easily defended as having a legitimate claim to the resources.⁸⁵

Sunstein describes statutory protection of workers as an effort to overcome “the difficulties of organisation of many people in the employment market”.⁸⁶ He describes a situation where workers prefer 9 hour days to 12 hour days, but prefer 12 hour days to no work at all. In an unregulated market the workers will compete to their collective disadvantage: due to fear that if they refuse to work 12 hour days, other workers (who are willing to work such long days) will be hired to do the work and they will be unemployed.⁸⁷ This is analogous to music creators who are competing to enter contracts with record companies and so are in a poor bargaining position regarding payment. While this situation would not arise if labour was scarce, there are many more musicians trying to become successful than there are record labels willing to sign them and so there is a power imbalance in favour of the companies.⁸⁸

Simply giving music creators copyright in their works is not enough, because they may trade or licence the copyright which simply causes the collective action problem, described above, to rematerialise. Sunstein says the same of labourers, explaining that rights conferred by regulatory statutes must be inalienable, otherwise they will simply be traded and the problem will not be resolved.⁸⁹ He goes on to say that this kind of analysis helps to justify minimum wage and fair labour legislation generally, though he notes that the distributional consequences are complex and there will be many losers even within the group which is the target of the regulatory aid.⁹⁰

⁸² Morgan and Yeung, above n 21 at 27.

⁸³ Morgan and Yeung, above n 21 at 27.

⁸⁴ Cass Sunstein extract in Morgan and Yeung, above n 21 at 27.

⁸⁵ Cass Sunstein extract in Morgan and Yeung, above n 21 at 27.

⁸⁶ Cass Sunstein extract in Morgan and Yeung, above n 21 at 27.

⁸⁷ Cass Sunstein extract in Morgan and Yeung, above n 21 at 27.

⁸⁸ Klein, Moss and Edwards, above n 21 at 70.

⁸⁹ Cass Sunstein extract in Morgan and Yeung, above n 21 at 28.

⁹⁰ Cass Sunstein extract in Morgan and Yeung, above n 21 at 28.

Public-interested redistribution can therefore be used as a rationale for regulating to provide music creators with fair remuneration, on the basis that as a group they are unable to obtain it without regulatory intervention due to their individually weak bargaining positions and internal competition. Collective desires and aspirations are also relevant in this discussion. The basic premise of this rationale is that the choices that people make as consumers are sometimes different from those they make as political participants; “democracy thus calls for an intrusion on markets”.⁹¹ For example, a consumer may wish to buy the cheapest T-shirt available, but may also be politically opposed to child labour and sweatshops. Regulating against the latter will cause the price of the T-shirt to increase, in opposition to the individual’s consumer preferences, but consistently with their political ideals.

Sunstein offers, in explanation for the difference in preferences, the fact that there are a variety of influences distinct to politics which do not have an effect on consumer choices.⁹² These include seeking to fulfil aspirations in political behaviour, but not in consumption; attempting to satisfy altruistic desires, which diverge from self-interested market preferences; acting on meta-preferences, or “wishes about their wishes”, and; using political choice as a way to pre-commit themselves to a course of action they consider to be in the general interest.⁹³ It must be noted that it would go too far to make a generalisation about political preferences and consumer preferences always being identical or always being distinct.⁹⁴ Instead, they are best viewed as two arenas in which preferences may overlap, but which have considerations and influences on the individual unique to them.

Under this analysis, government action to ensure fair remuneration for music creators may be viewed as the expression of collective desires regarding fairness, the need to provide an incentive for music creation, a dislike of the power imbalance that favours record companies or really any individual reasoning that supports fair remuneration. A criticism here is that, despite the government having a democratic mandate, the public may not actually be in support of this particular regulatory response. They may prefer affordable music and may fear that the price will increase, or they may simply feel that it is not required. The response to this is that the government is democratically accountable, and will face consequences for their action at the ballot box.

B Goals of Regulation

Following from the justifications for regulatory action outlined above, the goal of any regulation suggested by this paper is to ensure fair remuneration for music creators. This is derived from the justifications of copyright, which understands itself as providing a financial

⁹¹ Cass Sunstein extract in Morgan and Yeung, above n 21 at 29.

⁹² Cass Sunstein extract in Morgan and Yeung, above n 21 at 29.

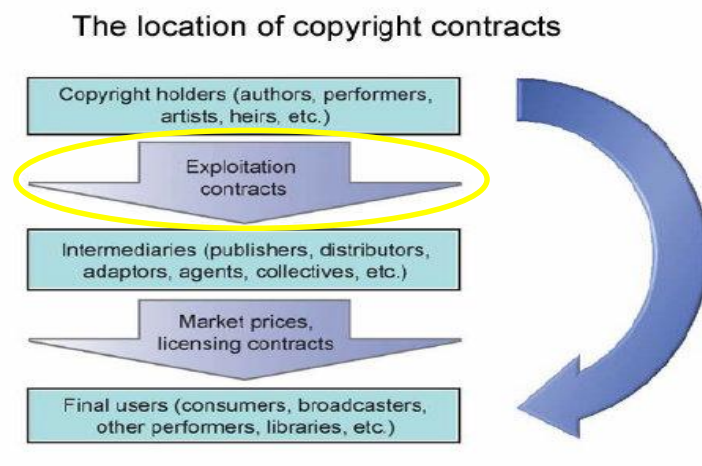
⁹³ Cass Sunstein extract in Morgan and Yeung, above n 21 at 29.

⁹⁴ Cass Sunstein extract in Morgan and Yeung, above n 21 at 29.

incentive for creators, and the market failure inherent in the current relationships between creators and the music industry, and the substantive political goal of ‘fairness’.

Many of the groups which support the strengthening of copyright law, do so purportedly on the same basis that I have just outlined, increasing artist remuneration. They believe that creators would be paid more ‘if the pie was bigger’. This paper instead focuses on ‘how the pie is cut’ (distribution of revenue) as that issue is more practically open to regulation than the issue of online copyright infringement. This is because detection is difficult in the anonymous realm of the internet and the widespread and often small scale nature of infringement makes enforcement mechanisms costly and slow.⁹⁵ Any regulation in this area would have to be ‘future-proofed’ to remain functional in the wake of constant technological advancements. In contrast, regulating contractual relationships between music businesses and creators is more feasible as businesses are not anonymous and retain copies of contracts and financial records. Additionally, while increased revenue from copyrights generally would result in creators having a higher total income, they would still be proportionately disadvantaged to music companies. Thus the allocative inefficiency and substantive unfairness would still exist, and the financial incentive to the creator would be smaller than was either fair or efficient.

The image below illustrates the various contracts by which copyrights can be governed. The regulatory target in this paper is the ‘exploitation contracts’ between the copyright holders and intermediaries.



(Martin Kretschmer and others *The Relationship Between Copyright and Contract Law* (2010) at 1)

⁹⁵ David Choi and Arturo Perez “Online piracy, innovation, and legitimate business models” (2007) 27 *Technovation* 168 at 168-170.

C *Evidence Based regulating*

One of the more recent criticisms about copyright reform has been the lack of evidence based legislation. The recording industry has repeatedly called for stronger copyright laws, warning that musicians are suffering as a result of piracy and increased protections will help.⁹⁶ The extent to which this is true is questionable, largely because very little evidence has been offered to support the argument, nor the laws that are enacted in reliance upon it.⁹⁷

There have been various recent reports about the necessity of evidence as an integral part of the copyright reform process. The Gowers review in 2006 relied strongly on evidence to analyse policy judgements,⁹⁸ the Social Science Research Council noted in 2011 that they saw “a serious and increasingly sophisticated industry research enterprise embedded in a lobbying effort with a historically very loose relationship to evidence”,⁹⁹ and the Hargreaves review in the United Kingdom urged the Government “to ensure that in future, policy on Intellectual Property issues is constructed on the basis of evidence, rather than the weight of lobbying”.¹⁰⁰ Thus this paper proceeds on the basis that evidence is at the minimum desirable, if not strictly required as a matter of law, in the regulation process, and that where possible it should be referred to by policymakers.

IV *Analysis of regulatory solutions*

This paper now turns to the potential regulation of the problems with the relationship between music creators and music businesses described above. Shleifer describes different strategies for control of businesses, each of which demonstrates the “ever growing powers of the state vis-à-vis private individuals”.¹⁰¹ They are: market discipline, private litigation, public enforcement via regulation, and state ownership.¹⁰² The Fair Trade Music scheme arguably falls within market discipline, helped by state facilitation, as it regulates via social norms and the market. The suggested regulation of copyright contracts falls within public enforcement via regulation.

⁹⁶ Klein, Moss and Edwards, above n 21 at 65.

⁹⁷ Patry, above n 41 at 11 and 50.

⁹⁸ Andrew Gowers *Gowers Review of Intellectual Property* (Her Majesty's Stationery Office, London, 2006) at 5.

⁹⁹ Social Science Research Council *Media Piracy in Emerging Economies* (Social Science Research Council, USA, 2011) at 4.

¹⁰⁰ Ian Hargreaves *Digital Opportunity: A review of Intellectual Property and Growth* (Independent Report for the Government of the United Kingdom, May 2011) at 1.

¹⁰¹ Andrei Schleifer “Understanding Regulation” (2005) 11(4) *Europ. Finan. Manage.* 439 at 442.

¹⁰² Andrei Schleifer, above n 101 at 442.

A *Fair Trade Music*

1 *Introduction*

Voluntary disclosure regimes, such as Fairtrade certification, are becoming more prevalent.¹⁰³ Within a capitalist economy the rising consumer awareness about the ethical implications of production processes creates an incentive for producers to disclose information about ethical production in order to attract consumers.¹⁰⁴ Fair Trade Music (FTM) is modelled after the Fairtrade Coffee movement, and aims to give music consumers a clear choice between music which has been produced ensuring the fair compensation of all parties involved and music which has not.¹⁰⁵ It requires each link in the distribution chain to operate ethically, according to standards set by a certification body.¹⁰⁶ This would result in a clear indication of “which digital streaming and other music services operate in a fair, transparent and ethical way”.¹⁰⁷ A certification body would determine whether music distributors are FTM compliant.¹⁰⁸

Successful implementation of this regulatory certification scheme would require consumer belief that ethical music was more desirable; leading to increased purchases, which in turn creates a competitive incentive for music distribution businesses to become certified. In this way social norms regulate consumer behaviour which leads to the market regulating business behaviour.

Various obstacles must be overcome for this idealised model to become reality. This paper first argues that the social norms that would act on consumers need to be shown either to exist, or to be inducible, and any attitude-behaviour gap between those norms and actual consumer purchasing decisions would need to be addressed.¹⁰⁹ Administration of the scheme would need to be established; this paper discusses why government establishment of independent administration would be beneficial. Standards would need to be set via the selection of certification criteria, and would need to be clearly communicated to consumers. Businesses tend to be self-interested, so inducing initial members of the scheme to become certified may pose a challenge. A cost benefit analysis of the proposed regulation would be beneficial to assess effectiveness. Finally, the issues of monitoring compliance and enforcement are addressed, as are difficulties which may arise from the political context.

¹⁰³ Morgan and Yeung, above n 22 at 98.

¹⁰⁴ Morgan and Yeung, above n 22 at 98.

¹⁰⁵ “What is Fair Trade Music?” (2014) Fair Trade Music <www.fairtrademusic.info>

¹⁰⁶ “Frequently Asked Questions” (2014) Fair Trade Music <www.fairtrademusic.info>

¹⁰⁷ “What is Fair Trade Music”, above n 105.

¹⁰⁸ “Frequently Asked Questions”, above n 106.

¹⁰⁹ There are studies indicating that consumers would prefer to purchase music that was ethical or at a minimum prefer to know where their money was going. These are discussed further below.

2 *Social norms*

A preliminary question which must be satisfied is whether regulatory schemes which use social norms to influence consumer behaviour can be effective. The copyright industry already has a history of using social norms to attempt to influence consumer behaviour.¹¹⁰ They have done this by campaigns that cast infringement in harsh terms, as a criminal activity or as damaging to the cultural industries,¹¹¹ as well as a softer approach which emphasises a partnership between the producers and consumers, where the consumers are responsible for keeping the creative industries alive.¹¹²

The FTM scheme depends on positive attitudes toward music creators and consumer engagement with the concept in order to be successful. In general, ethical consumption, defined as “the purchase of a product that concerns a certain ethical issue and is chosen freely by an individual consumer”, is on the rise.¹¹³ More specifically, studies have indicated that the majority of consumers are willing to pay more for music that is licenced from the copyright holder (and thus legal), and that they prefer the extra revenue to go to songwriters and musicians.¹¹⁴ This indicates that consumers have a positive attitude towards fair compensation for music creators. Further support for such an attitude may come from the notoriety of the Fairtrade certification mark, the presence of which may have created fertile ground for the extension of a social norm about fair compensation for commodities producers to be extended to music creators.¹¹⁵ However, a study evaluating this empirically would be desirable before implementing an FTM scheme on the basis of this attitude.

One of the possible effects of having a certification scheme for ‘ethical’ music, particularly one which was government sanctioned, is it may take on a normative role and begin to shape consumer expectations concerning music production. This provides an alternative to the requirement of a positive social attitude towards fair compensation for music creators, and instead gives support to the idea that such an attitude could be formed *by* the regulation (in part at least) rather than being a prerequisite to it. This is further supported by the important role of marketing in any certification scheme.¹¹⁶

¹¹⁰ Klein, Moss and Edwards, above n 21 at 32.

¹¹¹ Klein, Moss and Edwards, above n 21 at 33.

¹¹² Klein, Moss and Edwards, above n 21 at 35.

¹¹³ Patrick De Palsmacker, Lisbeth Driesen and Glenn Rayp “Do Consumers Care about Ethics? Willingness to Pay for Fair-Trade Coffee” (2005) 39(2) *J. Consum. Aff.* 363 at 363.

¹¹⁴ Songwriters Association of Canada *Canadian Music Consumption Behaviours Research* (Preliminary Report, March 2011) at 64: 59% of participants were willing to pay more and 93% preferred the money to go to songwriters/musicians; and Theodore Giletti “Why pay if it’s free?” (MSc Dissertation, London School of Economics and Political Science, 2012).

¹¹⁵ See Peter Drahos and Susy Frankel (eds) *Indigenous Peoples’ Innovation* (ANU E Press, Canberra, 2012) at 108: “The [Fairtrade] mark is now the most widely recognised social and developmental label in the world”.

¹¹⁶ Drahos and Frankel, above n 115 at 107.

Companies which engage in ethical practices are not growing at a rate proportionate to the documented rise in ethical consumerism.¹¹⁷ Various studies have proposed that this is due to an ‘attitude-behaviour gap’ which is where attitudes towards something do not translate into the expected behaviour.¹¹⁸ This means that even if consumers do have a positive attitude towards fair compensation for artists, this may not lead to them choosing an FTM certified music provider over another option.

The main reason this disconnect between attitude and behaviour exists is that a positive attitude toward a more ethical product is only one factor considered when making a purchasing decision.¹¹⁹ Consumer purchasing decisions often incorporate a complex variety of motivations which may outweigh specific attitudes.¹²⁰ The most common of these motivations are convenience, habit, value for money and individual responses to social and institutional norms.¹²¹ These practices are likely to be resistant to change.¹²²

Therefore, prior to implementing an FTM certification scheme empirical studies showing that positive attitudes towards fair remuneration for artists will actually translate into consumers choosing FTM certified businesses over non-certified options would need to be undertaken. However, a contrary conclusion is not necessarily the nail in the coffin for FTM. Studies have indicated that targeted marketing strategies could help to improve the conversion rate from ‘attitude’ to ‘behaviour’.¹²³ For example, a study looking at attitudes and behavioural intention regarding sustainable food found that consumers with high personal involvement (those who were more aware of the benefits of sustainable consumption) were more likely to have a positive attitude towards, and to purchase, sustainable products.¹²⁴ The study also found that belief in their personal consumer effectiveness, the perceived availability of a product, and certainty about the sustainability claims made in relation to the product all contributed to an increased likelihood of purchasing the product,¹²⁵ and that these were able to be influenced by communication of relevant information.¹²⁶

¹¹⁷ De Palsmacker, Driesen and Rayp, above n 113 at 2: They often had market shares of less than 1% as at 2000.

¹¹⁸ Iris Vermeir and Wim Verbeke “Sustainable Food Consumption: Exploring the Consumer “Attitude-Behavioral Intention” Gap” (2006) 19 J. Agr. Environ. Ethic 169 at 170 and De Palsmacker, Driesen and Rayp, above n 113.

¹¹⁹ Vermier and Verbeke, above n 118 at 173.

¹²⁰ Vermier and Verbeke, above n 118 at 173.

¹²¹ Vermier and Verbeke, above n 118 at 170.

¹²² Vermier and Verbeke, above n 118 at 170.

¹²³ Vermier and Verbeke, above n 118 at 185-186.

¹²⁴ Vermier and Verbeke, above n 118 at 184.

¹²⁵ Vermier and Verbeke, above n 118 at 184-185: Personal consumer effectiveness is the belief that the individual consumer’s purchasing decisions can have an impact on the social issue.

¹²⁶ Vermier and Verbeke, above n 118 at 188.

Additionally, many music distribution services offer similar and expansive music catalogues. If the majority of a consumer's music preferences are available on two services then the ethics of those services may become the distinguishing factor. It is thus entirely plausible that even if an attitude-behaviour gap is found in consumer decision making regarding FTM-certified music, this could be overcome by a targeted marketing campaign.

There are other concerns regarding FTM that may affect consumer decision making, such as a price premium attaching to FTM-certified services or comparatively reduced availability of FTM certified music. The first of these concerns is due to the concern that meeting FTM standards of fair compensation for music creators is likely to increase the operating costs for a music distribution company, which may result in the costs being passed on to end consumers as a price premium.¹²⁷ The second concern arises from the difficulties in obtaining stakeholder participation. If the major stakeholders are not on board with the FTM certification scheme then music which is certified as 'ethical' may be predominantly non-mainstream, leading to a comparatively low quantity and variety in the music available to ethical consumers. As each of these possibilities is a constituent of a larger issue around the implementation of an FTM scheme, I will discuss them in that context below.

3 *Administration and structure*

The issue of who would actually implement an FTM scheme and fulfil the certification function also needs to be addressed. The FTM scheme proposed by Eddie Schwartz envisions an independent certification body which would administer the scheme, and which would include music creators among its constituents.¹²⁸ However, this paper's focus is on governmental establishment of regulatory standards, so it proposes implementation of an FTM scheme by the New Zealand Government, rather than a third party or industry-based body.

The Trade Marks Act 2002 requires that certification of goods is undertaken by an independent body which does not trade in the goods.¹²⁹ An independent government entity, such as the Copyright Tribunal, could undertake this role. The benefit of this is that the entity could be constituted of people who have expertise in the relevant areas, such as copyright and

¹²⁷ Jean Darian and others "An Analysis of Consumer Motivations for Purchasing Fair Trade Coffee" (2015) 27(4) JICM 318 at 325: For example, the price of Fairtrade coffee is often the reason consumers cite for not buying more.

¹²⁸ Eddie Schwartz "Coda: fair trade music: letting the light shine in" in Susy Frankel and Daniel Gervais (eds) *The Evolution and Equilibrium of Copyright in the Digital Age* (Cambridge University Press, Cambridge, 2014) 312 at 312.

¹²⁹ Trade Marks Act 2002, s 14(b)

economics.¹³⁰ The entity chosen or created would need to have sufficient resources available, so if the Copyright Tribunal were chosen it would need to be expanded.

Generally speaking, the New Zealand Government possesses certain competencies that would allow it to successfully establish and help resource an FTM scheme which could then be managed by an independent regulatory body. Abbott and Snidal identify five stages of regulatory standard setting and four competencies required to regulate.¹³¹ They outline the five stages as, chronologically, placing an issue on the political agenda, negotiating the standards, implementation, monitoring, and enforcement.¹³² The four essential competencies are independence, representativeness, expertise and operational capacity.¹³³ This paper proposes that the government places the regulation on the political agenda, but leaves the negotiation of standards, implementation, monitoring and enforcement to an independent regulatory body.

The regulatory body could rely on the state's "strong operational capacity, including [its] substantial resources, legal authority, and strong legislative and administrative procedures, inspection systems and enforcement processes" to ensure it is strong and well-resourced.¹³⁴ Regarding representativeness, democratic states like New Zealand implicitly represent a broad range of interests and are generally accountable via the electoral process.¹³⁵ Furthermore, a regulatory body would be advised to engage in a standard setting process that incorporated the relevant stakeholders, discussed further below. Finally, an independent public body could be subject to judicial review if its independence in decision-making was doubted.

Apart from the requirement in the Trade Mark Act for independence of certificatory bodies, mentioned above, the consequences of insufficient independence were highlighted in Graber and Lai's analysis of the Australian Authenticity label. Lack of independence in the certification body, which also owned the mark and set the standards, was found to have contributed to the scheme's early failure.¹³⁶ As a comparison, the Fairtrade Labelling Organisation International (FLO) sets the standards collaboratively with producers, but an independent body called FLOCERT actually carries out the audit and certification

¹³⁰ Mark Thatcher "Delegation to Independent Regulatory Agencies: Pressures, Functions and Contextual Mediation" (2002) 25(1) West. Eur. Polit. 125 at 125.

¹³¹ Kenneth Abbott and Duncan Snidal "The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State" in Walter Mattli and Ngaire Woods (eds) *The Politics of Global Regulation* (Princeton University Press, New Jersey, 2009) 44 at 46-47.

¹³² Abbott and Snidal, above n 131 at 46.

¹³³ Abbott and Snidal, above n 131 at 46.

¹³⁴ Abbott and Snidal, above n 131 at 66.

¹³⁵ Abbott and Snidal, above n 131 at 67.

¹³⁶ Drahos and Frankel, above n 115 at 104 and 117.

functions.¹³⁷ While a Crown entity-type regulatory body would be independent of the industry it regulated, it should be considered whether, within government resource constraints, the certificatory and standard-setting functions of the body could operate independently.

Additionally, lack of financial sustainability and accountability has been attributed to the failure of the Australian Authenticity label. Adequate finances allow for marketing and consumer education which is crucial to the success of ethical certification schemes.¹³⁸ The importance of marketing has already been discussed in the social norm section above, however, this analysis of other certification schemes emphasises the need for sufficient resources to successfully implement the scheme. These could be obtained from the state if it made FTM an important regulatory goal, and the certification body could contribute by charging its auditing and certification processes to the applicants, as FLOCERT does.¹³⁹

The New Zealand Government can learn from international examples of successful certification systems. Through the establishment of an independent regulatory body which negotiates with stakeholders it is capable of creating a competent and successful system. Additionally, New Zealand does not have a strong domestic lobbying presence and so the state may be more willing to regulate the music creator-music distributor relationship than its counterparts in the United States, for example.

4 *Certification criteria and labelling*

The proposed FTM certification scheme is a form of standard-setting regulation. The FTM principles that have been suggested by the Global Advocacy Network of music creators are: fair compensation for music creators, transparent management of rights and revenues, an option for music creators to recapture their rights after a period of time, independent music creator organisations which advocate for, educate and provide support to members of the music creator community, and freedom of speech.¹⁴⁰

While it is outside the scope of this paper to propose specific criteria of an FTM certification scheme, as those should be negotiated by stakeholders, I will discuss the process of selecting the criteria. The certification criteria must be formulated with interests of consumers, music creators and the music industry in mind. In order to be effective they must balance the interests of the record industry in making a profit with the regulatory goal of fair compensation for music creators, while meeting consumer expectations of fair compensation.

¹³⁷ Fairtrade International “Certifying Fairtrade” <www.fairtrade.net> and Fairtrade International “Who we are” <www.fairtrade.net> and Drahos and Frankel, above n 115 at 105 and 107.

¹³⁸ Drahos and Frankel, above n 115 at 108.

¹³⁹ Drahos and Frankel, above n 115 at 107.

¹⁴⁰ Maureen Russell “Announcing the “Fair Trade Music” Initiative” (6 June 2013) <www.ethnomusicologyreview.ucla.edu>

Failing to achieve this balance could result in music company refusal to participate in the scheme, failure to achieve the goal of fair compensation for music creators, or lack of public engagement in the scheme which may exacerbate either of the other risks.

As the analysis of the failure of the Australian Authenticity label scheme points out, “stakeholder involvement is an important element of Fairtrade standards”.¹⁴¹ A similar standard setting process to the Fairtrade model, which is open and involves all major stakeholders, would be desirable in the FTM scheme.¹⁴² It would also be in line with the ISEAL Code of Good Practice for Setting Social and Environmental Standards.¹⁴³ Major stakeholder involvement in the construction of FTM standards would act to ameliorate stakeholder reluctance.

The label adopted by an FTM certification scheme to signify compliance with its standards should be chosen by the administering body. Certification marks are available in New Zealand under the Trade Marks Act, which is consistent with the TRIPS Agreement.¹⁴⁴ Using some version of ‘Fair Trade Music’ as a certification mark may pose a problem due to the similarity to the FAIRTRADE certification mark owned by FLO. This issue arises because s 25 of the Trade Marks Act prevents registration of marks which are either identical or confusingly similar to already registered marks, where the marks in question relate to the same or similar goods or services. This similarity may not be fatal to ‘Fair Trade Music’ as a certification mark however, because the ‘device’ or visual image that accompanies the FTM mark could be made quite distinct from the one accompanying the FAIRTRADE mark, lessening consumer confusion. Additionally, regarding the goods and services to which the marks relate, the certification of commodities which is undertaken by FLO is different to the certification of music proposed under the FTM system. Ultimately, the ‘Fair Trade Music’ certification mark may be registered where the Examiner is satisfied that there is “no real likelihood of confusion or deception resulting from the registration and use of the mark”.¹⁴⁵

An application for use of the FAIRTRADE certification mark owned by FLO for certifying music is unlikely to be successful. FLO aims to help farmers in developing countries

¹⁴¹ Drahos and Frankel, above n 115 at 106.

¹⁴² Drahos and Frankel, above n 115 at 106.

¹⁴³ Drahos and Frankel, above n 115 at 106 and ISEAL “Setting Social and Environmental Standards” ISEAL Code of Good Practice (version 6.0, December 2014) in particular clauses 4.1, 5.2 and 5.4

¹⁴⁴ Agreement on Trade-Related Aspects of Intellectual Property Rights (Annex 1c to the Agreement Establishing the World Trade Organisation, opened for signature 15 April 1994, entered into force 1 January 1995) Article 15.1 provides a broad definition of trademarks which covers all distinctive signs, and while certification marks and not specifically mentioned, Art 1.1 authorises WTO members to implement more extensive protection in their domestic laws than is required by the Agreement.

¹⁴⁵ Trade Marks Act, s 17(1)(a) and s 66(1)(e) allows for revocation of registration on the grounds of deception or confusion.

exclusively, and the system is intended for commodities.¹⁴⁶ Extending the FLO certification system to music would be inappropriate due to both the majority of the potential stakeholders being located in developed countries and the intangible and non-commodity nature of produced music.

Once a certification mark is chosen, there are other requirements that it must meet under the Trade Marks Act. These include a clear indication to consumers that it is a certification mark, and evidence of the competency of the applicant to certify only goods which possess the required characteristics and to prevent to misuse of the mark.¹⁴⁷ Additionally, the significance of the FTM mark must be communicated to consumers. If 'Fair Trade Music' is adopted as the mark, then public familiarity with the principles of the Fair Trade movement may go some way to achieve this. Indeed, the goodwill garnered by the FAIRTRADE mark may help to engender a positive perception of the mark among consumers. Conversely, there is a risk that the comparison of the FLO system which supports exploited farmers in developing countries with the FTM system which is designed to ensure sufficient pay of musicians primarily in developed countries might lead consumers to view the FTM arrangement negatively, as less virtuous than 'Fairtrade'. Nonetheless, the specific characteristics denoted by the FTM mark will need to be conveyed via marketing campaigns to raise awareness of the label among consumers. A marketing campaign of this sort will be costly but it will allow the system to accrue goodwill which will contribute to its overall success,¹⁴⁸ and will allow consumers to have confidence that the music, or music service, they are purchasing is consistent with their values.¹⁴⁹

5 *Initial stakeholder participation*

A key obstacle to be overcome for the success of an FTM certification scheme is stakeholder participation. Consumer engagement with the scheme, while necessary, is not sufficient for a successful operation. I propose two possible forms of stakeholder involvement to achieve a successful regulatory scheme.

In the first instance, stakeholders with a large market share or who provide a large variety of music to consumers may choose not to become involved in an FTM scheme. This may be due to a sense of security in the current business model and undertaking the kind of major changes that may be required to become FTM compliant could be viewed as risky. This is an even greater concern for businesses which provide a large variety of music to consumers, as they would be required to negotiate with all of the relevant rights holders in order to ensure FTM compliance; a process which may be time consuming and ultimately fruitless. Firms are

¹⁴⁶ Drahos and Frankel, above n 115 at 108.

¹⁴⁷ Trade Marks Act, s 55.

¹⁴⁸ Drahos and Frankel, above n 115 at 104.

¹⁴⁹ Drahos and Frankel, above n 115 at 107.

“by law and culture focused on profits”.¹⁵⁰ If this scenario occurs, the success of the scheme will depend on smaller stakeholders becoming certified and raising awareness of FTM among consumers. In turn, this will shine a spotlight on larger businesses and pressure them to become compliant. This occurred to some extent with Starbucks initial refusal to offer Fairtrade coffee in its American stores: Starbucks eventually participated in the certification scheme after it faced pressure from consumer advocacy groups.¹⁵¹ Firms which provide branded products, which includes most music services distributing music to end consumers, are more vulnerable to non-government organisation and public pressure than those producing intermediate goods.¹⁵² This is because they are more visible to end users and so can be targeted by publicity campaigns. Thus participation in an FTM certification scheme would grow gradually.

In the second possible scenario, larger stakeholders participate in the scheme from its inception. Due to concerns described above, these stakeholders may be hesitant to engage with an unproven scheme. Consequently, including key stakeholders in the formulation of the regulation, particularly in standard setting, may be essential to attaining initial participation of larger stakeholders.¹⁵³ Businesses are not inherently opposed to all regulation, in fact, businesses in the creative industries depend on copyright laws which allow them to exploit property.¹⁵⁴ Instead, businesses are concerned with the specific content of regulation.¹⁵⁵ Allowing companies to help formulate standards allows them, inter alia, to ensure more business-friendly rules and to minimise compliance costs.¹⁵⁶ Ultimately, businesses exist in a competitive environment which shapes their attitudes and concerns. They will avoid costs unless there is a visible competitive benefit associated with them.¹⁵⁷ All firms will be more open to standard setting regulation when their competitors also participate, which is why including them in the regulatory process is important.¹⁵⁸ A particular assistance to obtaining industry-wide stakeholder participation would be key businesses or industry associations which play a leadership role becoming involved in the FTM system.¹⁵⁹ This could create an industry norm around FTM participation. Another relevant consideration is that businesses may actually prefer to comply with voluntary standards because they feel it discourages

¹⁵⁰ Abbott and Snidal, above n 131 at 58.

¹⁵¹ Dan Welch “Fairtrade beans do not mean a cup of coffee is entirely ethical” *The Guardian* (United Kingdom, 28 February 2011): the group was the Organic Consumers’ Association.

¹⁵² Abbott and Snidal, above n 131 at 58.

¹⁵³ Drahos and Frankel, above n 115 at 117: for example, stakeholder involvement is an important element of all decision making processes of FLO, including standard setting.

¹⁵⁴ Abbott and Snidal, above n 131 at 58.

¹⁵⁵ Abbott and Snidal, above n 131 at 58.

¹⁵⁶ Abbott and Snidal, above n 131 at 58.

¹⁵⁷ Abbott and Snidal, above n 131 at 59.

¹⁵⁸ Abbott and Snidal, above n 131 at 59.

¹⁵⁹ Abbott and Snidal, above n 131 at 59.

governments from mandatory standards, such as regulation of the business-creator relationship discussed later in this paper.¹⁶⁰

To achieve an effective regulatory scheme, eventually key stakeholders will need to participate. This is because they represent the largest number of music creators and so without their involvement the regulatory goal will be frustrated.

An ancillary effect of a functional FTM system is that in order for music businesses to become certified in New Zealand, they may by proxy also comply with FTM standards in their global operations. This is because global businesses such as Spotify or Apple Music provide the same music internationally and if that music is made FTM compliant for New Zealand, it will likely remain FTM compliant in all other countries where it is distributed. The extensiveness of the required changes to international businesses may create an incentive not to engage with FTM, particularly as New Zealand is a comparatively small market within the global sphere, providing little incentive in the form of a consumer increase.

However, the competitive advantages that come from being branded an ‘ethical music provider’ in New Zealand will apply equally overseas. Companies certified in New Zealand could market themselves as ‘Fair Trade Music’ in other countries and so gain a competitive advantage with more than just New Zealand consumers in the New Zealand market. Whether this advantage would outweigh the costs associated in becoming compliant is unclear. Smaller companies may wish to distinguish themselves from larger companies in overseas markets this way. As most music distribution services have a similar selection of music available competition on the quality of the experience is key, FTM could be a deciding factor in attracting ethical consumers to a particular distributor. Additionally, a recording business would not need to change its entire system of revenue distribution to become FTM compliant, it would simply have to ensure that revenue from an FTM certified source was distributed according to FTM standards. This may lower initial barriers to entry and allow for gradual uptake of the scheme, making it more attractive to distribution companies wishing to avoid difficulties with record companies.

Music distributors are not the only stakeholders in a FTM certification scheme. The music creators themselves will also be impacted by the successful adoption of a certification system. Some music creators, such as the group championing the current non-governmental FTM proposal, may be pleased with an FTM option and join certified businesses with alacrity. But this attitude will not necessarily be true of all artists. A negative attitude towards the scheme could exist for a number of reasons. For example, music creators may feel that demanding higher remuneration, such as one specified by an FTM standard, makes them less likely to be

¹⁶⁰ John Braithwaite and Peter Drahos *Global Business Regulation* (Cambridge University Press, Cambridge, 2000) at 282.

signed by record labels, so less likely to be successful. They may be ideologically opposed to regulatory schemes being applied to the music industry, or a variety of other personal reasons. However, many music creators have spoken out and said they want fair remuneration so it appears that engaging music creators as stakeholders in an FTM system will not pose the same difficulties as music businesses.¹⁶¹

6 *Cost-benefit analysis*

Cost-benefit analyses (CBA) can be used to improve the quality of public policy decisions, such as whether to promulgate new regulations.¹⁶² A CBS should be undertaken as part of the decision making process regarding FTM. Benefits include transparency, increased accountability, comparison of different policies and highlighting inadequacies in information.¹⁶³ However, an inherent limitation is that they quantify everything in economic terms which may overlook substantive goals behind regulation.¹⁶⁴

A cost-benefit analysis of an FTM certification scheme would need to quantify and attach monetary values to, inter alia, the expected increase in income for music creators, including estimates of the likely consumer base of FTM-certified businesses and the number of business which would become certified. The cost of implementing and maintaining the scheme would also need to be considered, including promotion required to encourage consumers to use FTM-certified schemes.

A full discussion of cost-benefit analyses in this context is both outside the scope of this paper and the expertise of the author, so will not be undertaken. It should be noted that a cost-benefit analysis is only one aspect of regulatory decision making.

7 *Monitoring compliance and enforcement*

The enforcement of a certification scheme, as with any regulatory scheme, is paramount to its success. In the case of FTM the primary issue likely to arise is detecting or preventing improper use of the 'Fair Trade Music' label by a business which does not meet the certification criteria. If FTM certification proves to be a factor in consumer decision making, there will be an incentive for music distribution businesses to market themselves as FTM compliant. However, FTM certification will likely require changes at many rungs of the distributional ladder—changes which are under the control of other parties. For example, Spotify may wish to obtain the benefit of FTM certification but would need to ensure that not

¹⁶¹ See Courtney Love "Courtney Love does the math" *Salon* (United States, 15 June 2000) and the Fair Trade Music scheme envisaged by Eddie Schwartz and discussed elsewhere in the Fair Trade Music section.

¹⁶² Raymond Kopp, Alan Krupnick and Michael Toman "Cost-Benefit Analysis and Regulatory Reform: An Assessment of the Science and the Art" (1997) Discussion Paper 97-19 (Resources for the Future, Washington DC) at Executive Summary (ES) 1.

¹⁶³ Kopp, Krupnick and Toman, above n 162 at 7.

¹⁶⁴ Kopp, Krupnick and Toman, above n 162 at 11 and 13.

only does it fairly remunerate the rights holders, but that they fairly distribute that remuneration so that the music creator receives fair compensation for their work. This may be difficult, costly and time consuming, particularly as it would likely require renegotiation or creation of new contracts and only some key players may be on board. Aggregate distributors like Spotify, could overcome the latter issue by marketing only specific music as being FTM compliant, but this may open the door to gaming by aggregate distributors marketing themselves generally as FTM compliant despite having little music that is actually compliant. Alternatively, some businesses may simply decide to access the benefits of the FTM label without going through the trouble of getting certified. To ensure that the label is not fraudulently used it can be registered as a certification mark which is a sign that signifies a particular characteristic of the product to which it is attached.¹⁶⁵

This premise raises a few issues: detecting improper uses of FTM certification; creative labelling, and; how to enforce the scheme once improper use has been detected. Regarding the first of these, some sort of monitoring system would have to be effected by the agency in charge of FTM implementation. Businesses keep accounts of payments and revenue so theoretically information gathering should be simple, however, music companies may be reluctant to disclose financial information.

Creative labelling, the second concern, refers to companies claiming the benefits of consumers believing they are FTM-certified, without actually obtaining or explicitly claiming the certification. For example, Costa Coffee in the United Kingdom displayed “Fair Trade” prominently on its website in 2011, despite not being “Fairtrade” certified.¹⁶⁶ Creative labelling can be dealt with under the Fair Trading Act 1986, to the extent that it is deceptive or misleading.¹⁶⁷

The third concern, enforcement, has various possible solutions. If a company obtains certification and is then discovered to no longer be compliant, revocation of their FTM-certification is an obvious step. However, companies who falsely obtain the benefit of FTM-certification either through creative labelling or simply improperly claiming certification will require additional enforcement action, to discourage this kind of behaviour. A logical corollary of companies falsely claiming certification because of the competitive incentive is that publicly naming the company as falsely claiming the certification will damage its reputation, and consumers who chose that company because of its ethical status will cease their custom. The effectiveness of this enforcement technique will depend on whether consumers chose that company for its FTM-certification (if not, then the illegitimacy of the

¹⁶⁵ Trade Marks Act, s 5(1).

¹⁶⁶ Dan Welch, above n 151.

¹⁶⁷ Fair Trading Act 1986, s 9.

FTM claim is unlikely to affect their consumption habits) and whether the agency in charge of FTM is able to effectively communicate the deceit to consumers.

Companies that misrepresent their compliance with certification standards may also be able to be sued for false advertising. The Fair Trading Act generally prohibits misleading and deceptive conduct in trade,¹⁶⁸ and specifically states that false representations about the affiliation or endorsement of products are prohibited,¹⁶⁹ as is false use of a trademark (including certification marks).¹⁷⁰ Section 3 of the Act states that it applies to conduct that occurs outside of New Zealand to the extent that it relates to trade within New Zealand.

Fines may also be imposed as a sanction for falsely claiming compliance with the scheme. However, the inclusion of fines within the regulatory scheme may act as a deterrent to potential members. Companies may be concerned that they will be fined for failing to comply where their failure was in good faith, exposing themselves to pecuniary risk with no guarantee of a reward.

8 *Political context*

The proposed FTM certification scheme would be voluntary rather than mandatory which would go some way to averting political fallout. Though it would still involve the government publicly championing the interests of one group (music creators), however reasonably, in a context where there are various perspectives to consider. This is likely to cause opposition to the scheme, most likely from music industry incumbents. The most important political considerations in this context are likely to be international. This is partly because New Zealand is in the process of negotiating a trade deal which is predicted to result in more protective copyright laws,¹⁷¹ and partly because New Zealand is a small market in the global behemoth that is the music industry—an industry which is known for its protectionist lobbying.¹⁷² It follows that the government may face pressure to maintain the status quo with regards to music creator compensation.

9 *International obligations*

The World Trade Organisation has various treaties to which New Zealand is a party. The FTM scheme, while domestic regulation, could apply to both national and international businesses. Thus it would need to be consistent with New Zealand's international trade obligation, including the General Agreement on Trades and Tariffs (GATT) and the Agreement on Technical Barriers to Trade (TBT).

¹⁶⁸ Fair Trading Act, s 9.

¹⁶⁹ Fair Trading Act, s 13.

¹⁷⁰ Fair Trading Act, s 16.

¹⁷¹ Rick Shera "TPP could block copyright fair use" *National Business Review* (New Zealand, 1 September 2015).

¹⁷² See Patry, above n 41 at 6.

The GATT sets out requirements for non-discrimination in trade. Specifically, Most-Favoured-Nation Treatment and National Treatment. Most-Favoured Nation Treatment requires that any advantage granted by a contracting party to a product originating in, or destined for, another country shall be accorded to like products originating in, or destined for, all other contracting parties.¹⁷³ National Treatment requires that goods that have entered a market are treated no less favourably than like products of national origin.¹⁷⁴ There is no indication that a voluntary FTM certification scheme would not be consistent with either of these obligations as it does not distinguish music based on country of origin.¹⁷⁵

The TBT covers voluntary certification schemes. Such schemes are ‘standards’ under the Agreement.¹⁷⁶ While it require states to adopt international standards where they already exist, there is no evidence of an international standard regarding fair trade certification of music.¹⁷⁷ The initiative by the Global Advocacy Group of music creators is unlikely to be considered to have become an international standard. Labelling procedures should also follow Articles 5-9 of the TBT, one of the requirements of which is for a complaints process to exist.¹⁷⁸

To summarise, there is nothing to indicate that a voluntary certification scheme, such as FTM, would not be consistent with the GATT or TBT agreements.¹⁷⁹ The TBT may impose some obligations on the standard-setting body which should be complied with.

10 Conclusion on FTM certification

While there are many practical hurdles that need to be surpassed prior to implementation, there is a reasonable argument that FTM certification could be successfully adopted within New Zealand. Stakeholder involvement and strategic marketing to consumers are two of the most important factors to successful execution. Without engaging both groups, the scheme is unlikely to effectively achieve its goal of increased creator remuneration.

¹⁷³ General Agreement on Tariffs and Trade (Annex 1A to the Agreement Establishing the World Trade Organisation, opened for signature 15 April 1994, entered into force 1 January 1995), Article I.

¹⁷⁴ General Agreement on Tariffs and Trade, above n 173 at Article III.

¹⁷⁵ See Drahos and Frankel, above n 115 at 113.

¹⁷⁶ Agreement on Technical Barriers to Trade (opened for signature 15 April 1994, entered into force 1 January 1995), Annex 1(1).

¹⁷⁷ Agreement on Technical Barriers to Trade, above n 176 at Article 4.1 requires compliance with the Code of Good Practice for the Preparation, Adoption and Application of Standards in Annex 3(F). The Code of Good Practice requires states to adopt standards that already exist.

¹⁷⁸ Agreement on Technical Barriers to Trade, above n 176 at Articles 5-9. The complaints procedure requirement is found in Article 5.2.8.

¹⁷⁹ Drahos and Frankel, above n 115 at 117.

B Regulating contractual relationships within the music industry

1 Introduction

The second proposed regulatory intervention is one which regulates the contractual relationship between music creators and businesses. The practical action in this instance would be akin to the regulation of labour relationships, such as the introduction of minimum wage, as mentioned earlier.¹⁸⁰ In this scenario it could be a threshold percentage of royalties that could not be assigned away, an inability to assign future rights (i.e. rights in a work that had not yet been produced), or review by a regulatory or judicial body of the ‘fairness’ of the contract.

This paper proposes regulating the distribution of copyright revenue between creators and music companies to ensure a minimum proportion for music creators. The licensing, assigning, selling or transferring of copyrights is done through contract, so regulation of revenue distribution would target copyright contracts.¹⁸¹ Attempts have been made elsewhere to influence copyright contracts, for example by making rights unwaivable or only allowing assignment of them to copyright collectives.¹⁸² Towse explains that “[e]conomists would not recommend making rights unwaivable because that interferes with the transfer of rights to the most efficient owner” which is unlikely to be the music creator due to high transaction costs.¹⁸³ Thus legislating a minimum distribution of the copyright revenue acts to protect the music creators in weak bargaining positions without interfering with the efficient transfer of rights. It would be unlikely to significantly impact artists earning above the threshold because they are already in stronger bargaining positions and would continue to be able to negotiate higher revenue proportions.

This is not exactly a ‘minimum wage’ as the creator income would be variable dependent on total revenue, but it would work to ameliorate the imbalance of bargaining power between the contracting parties in the same way that the minimum wage intends to. “[T]he presumption that no coercion exists, a premise fundamental to contract law and the orthodox theory of exchange, must be suspended in the case where one party to the exchange can be thought to suffer from unmet economic needs”.¹⁸⁴ As described above, music creators are in a weaker bargaining position than music companies.¹⁸⁵ “The existence of a systemic inequality in

¹⁸⁰ See the ‘substantive political approach’ discussion above.

¹⁸¹ Towse, above n 46 at 372.

¹⁸² Towse, above n 26 at 70.

¹⁸³ Towse, above n 26 at 75.

¹⁸⁴ Robert Prasch “In Defense of the Minimum Wage” (1996) 30(2) *Journal of Economic Issues* 391 at 395.

¹⁸⁵ See the ‘Justification for the regulation’ section above.

bargaining power” is one of the key arguments for a justification of minimum wage, and applies equally to the proposed minimum proportion of revenue regulation in this section.¹⁸⁶

Benefits attributed to the minimum wage equally extend to the proposed minimum proportion of revenue regulation. Freeman describes four benefits particular to the minimum wage: it provides an incentive to work, it is administratively simple, it does not take money from government or the public sector and it takes wages and benefits out of competition at the bottom of the wage distribution.¹⁸⁷ The proposed regulation of copyright contracts also offers these benefits. The income that a music creator receives under the copyright contract is dependent on the total revenue. Thus the incentive to continue producing music for which there is demand remains. This differs from other schemes, such as the award of state grants to artists and arts organisations which occurs in the Netherlands, which has been criticised for creating “too many artists and not enough good art”.¹⁸⁸ The regulation is administratively simple as it is a single percentage standard, making compliance simple to determine, although issues with this approach will be discussed below.¹⁸⁹ Additionally, this kind of minimum remuneration standard has a “self-enforcing character: [music creators] paid less than the minimum can report violations, minimising the need for a sizeable enforcement agency”, although there are issues with this point which will be discussed below.¹⁹⁰ The effect of the regulation proposed by this paper is to redistribute revenue already being obtained from copyrights in the music creator’s favour. It will not remove money from the public sector, except to the extent required to implement the regulation. Again, this is in contrast to government grants which, for example, provide up to 85% of the income of high arts organisations in the Netherlands.¹⁹¹ Finally, establishing a minimum revenue distribution removes the collective disadvantage problem often faced by labourers.¹⁹²

The Copyright Board of Canada offers an example of a similar regulatory scheme to the one suggested in this paper. It is described as “an economic regulatory body empowered to establish, either mandatorily, or at the request of an interested party, the royalties to be paid for the use of copyrighted works”, when the copyrights are entrusted to a collective-administration society.¹⁹³ The Board has statutory and implicit powers, including the power to set royalties at a higher rate than has been requested by the collective-administration

¹⁸⁶ Prasch, above n 184 at 395.

¹⁸⁷ Richard Freeman “Minimum Wages – Again!” (1994) 15 *International Journal of Manpower* 8 at 9.

¹⁸⁸ Towse, above n 53 at 569 and Hans Abbing *Why Are Artists Poor? The Exceptional Economy of the Arts* (Amsterdam University Press, Amsterdam, 2002).

¹⁸⁹ Freeman, above n 187 at 9.

¹⁹⁰ Freeman, above n 187 at 9.

¹⁹¹ Towse, above n 53 at 569 and Abbing above n 188, at 39.

¹⁹² See the discussion of Sunstein’s theory of public interested redistribution in the ‘Substantive Political Approach’ section above.

¹⁹³ Copyright Board of Canada “Copyright Board of Canada” <www.cb-cda.gc.ca> .

society.¹⁹⁴ The suggested regulation goes further than the Canadian model by proposing mandatory minimum revenue distributions in all musical copyright contracts, not only those administered by collective management organisations. The goal of the regulation is to ensure the fair remuneration of music creators, including those not represented by collective management organisations.

Having discussed some of the benefits of regulating a minimum standard of revenue distribution in musical copyright contracts, I now turn to some of the issues inherent in such a proposition. Regulating contractual relationships in the music industry is likely to require a level of expertise which may be higher than is easily available within government. Thus an independent body should be considered for the administration of the regulation. A consequence of this regulatory response would be that both companies operating solely within New Zealand and those which operate internationally, including within New Zealand markets, would need to comply with the regulatory scheme. This raises concerns about the legitimacy of the New Zealand government effectively regulating foreign contracts. There are also practical issues regarding the potential responses from both the companies and the individual creators being regulated, as well as the international community.

2 Administration

In New Zealand the Copyright Tribunal is an independent body which is currently responsible for hearing disputes about licensing schemes and applications regarding file sharing infringements under the Copyright Act 1994.¹⁹⁵ Extending its jurisdiction to include setting the minimum revenue distribution required in musical copyright contracts, and the determination of compliance with this standard, would be more appropriate than direct government implement this regulatory scheme.¹⁹⁶ Independent regulatory agencies, such as the Copyright Tribunal, are more suited to dealing with complex, technical and industry-specific issues.¹⁹⁷

The Copyright Board of Canada offers an example of the administration of a regulatory function of this kind. One of the advantages of this model is the independent research undertaken by the Board and its willingness to consider evidence which is not directly relevant to the interests of the parties in the dispute, but may instead relate to the broader public interest and the operation of the particular market.¹⁹⁸ The foundation of the proposed

¹⁹⁴ Daniel Gervais "A Uniquely Canadian Institution: The Copyright Board of Canada" in Ysolde Gendreau (ed) *An Emerging Intellectual Property Paradigm: Perspective from Canada* (Edward Elgar Publishing, 2008) Vanderbilt Public Law Research Paper No. 09-02 at 212.

¹⁹⁵ Copyright Act, ss 205 (Constitution of the Copyright Tribunal), 122J, 149-160 (Jurisdiction).

¹⁹⁶ A brief note: expanding the Copyright Tribunal's jurisdiction in this way may lead to a name change, as it would have broader than tribunal jurisdiction.

¹⁹⁷ Thatcher above n 130, at 125.

¹⁹⁸ Gervais, above n 194 at 215.

regulatory goal is ensuring financial incentive to secure to creation of music in the public interest, thus this consideration of broad evidence would be particularly desirable. As the Copyright Tribunal would be setting a standard and then determining compliance, consideration of the broader public interest would be more relevant at the standard setting stage. Thus the consideration of broad evidence may not be as beneficial in the New Zealand case. The Canadian model has also faced criticisms, most of which highlight the delay to get a hearing date, and the costs and duration of the proceedings.¹⁹⁹ These delays are largely the result of inadequate staffing and the large number of parties wishing to be heard.²⁰⁰ Theoretically, the long hearing times would not be such an issue under the proposed New Zealand regulation because the Tribunal would do a simple assessment of a copyright contract against the standard set by regulation. However, issues in the setting of that standard may undermine the ‘simple’ assessment. I will now discuss these.

The role of the Copyright Tribunal in setting the minimum share of revenue due to a music creator under a copyright contract may pose problems which lengthen the hearing process and lead to similar criticisms to those applied to the Canadian model above. As discussed earlier, there are various types of copyright contracts which may govern greater or fewer of the revenue sources available to a music creator.²⁰¹ The so-called ‘360 contracts’ which have become more popular in recent years get their name from their inclusive nature, which encompasses more revenue sources than traditional copyright contracts.²⁰² In acknowledgement of the extended control of artist revenue that they impose, their terms appear to often set a higher percentage of royalties intended for the music creator.²⁰³ This poses a problem for the supposedly simple ‘one percentage’ approach proposed by this paper. A better approach may be to establish categories of copyright contracts, defined by the revenue streams that they govern, which attract different minimum percentages of revenue to be awarded to the music creator. This may lead to the problems encountered by the Canadian model, such as long durations of hearings, and delays to get a hearing, as parties may contest the category into which their contract has been placed. This problem would likely be exacerbated by the sheer number of international contracts that would need to be assessed to obtain access to the New Zealand market. This could be ameliorated by a forward looking rather than retrospective application to contracts and an appropriate level of resources and government support, although this may be limited by the comparatively small public sector in New Zealand, but in any case it should inform the design of the regulatory scheme were it to be adopted.

¹⁹⁹ Gervais, above n 194 at 218.

²⁰⁰ Gervais, above n 194 at 218.

²⁰¹ See above ‘Application of welfare economics to the music industry’.

²⁰² Karubian, above n 37 at 399.

²⁰³ Karubian, above n 37 at 431.

3 *Enforcement*

One of the biggest issues affecting the success of the proposed regulatory intervention is enforcement. The Canadian Copyright Board may mandatorily or by request exercise its jurisdiction to set royalties. The proposed regulation could be enforced in a similar way, with the Copyright Tribunal assessing contracts spontaneously as well as by request. It could also be enforced solely on the basis of complaints from one of the parties (presumably the usually creator) or solely on the initiative of the Copyright Tribunal, either by spontaneous ‘audits’ or methodical assessment of each contract.

Practically speaking, the most effective enforcement approach appears to be one similar to that of the Canadian Copyright Board. A methodical assessment of each contract would likely strain the capacity and resources of the Copyright Tribunal, resulting in long delays and ineffective regulation as companies had to wait to enter the New Zealand market, or operated here without the required certification of their contracts. On the other hand, assessment of contracts exclusively following the complaint of an interested party may encounter problems on the same basis as there are currently unfair contracts: imbalance of bargaining power due, in large part, to the oversupply of labour. Music creators may be reluctant to complain and risk not having their contract renewed, or obtaining a reputation as difficult and struggling to find work with other music companies. This is especially pertinent when it is remembered that the music creators in the worst bargaining positions, who need the statutory protection, are also those who are most disposable to the music companies as they have not yet ‘proven themselves’ financially successful.

The combination of both spontaneous audits and the reception of complaints by the Copyright Tribunal would put pressure on music companies to obey the regulation, particularly if there were strong sanctions available such as having to leave the New Zealand market or large fines, without straining the resources of the Copyright Tribunal beyond a functional state. Additionally, allowing anonymous complaints may alleviate the fear of repercussions and result in more hesitant music creators raising concerns, as music companies would not be able to distinguish with certainty a spontaneous audit from one initiated by a complaint.

4 *Legitimacy*

The concept of legitimacy can normatively refer to the validity of political decisions and political orders, or descriptively refer to the social acceptance of political decisions and whether the actors subject to the decision believe that it is legitimate.²⁰⁴ The proposed regulation of revenue distribution in copyright contracts will have the effect of regulating

²⁰⁴ Michael Zürn “Global Governance and Legitimacy Problems” (2004) 39(2) *Government and Opposition* 260 at 260.

foreign contracts, as it requires music distributed in the New Zealand market to be compliant with New Zealand law (including the proposed regulation). Parties who wish to sell music in New Zealand will have to ensure that contracts with music creators meet the specified standard of remuneration.

In 2002 Germany introduced a general entitlement to equitable remuneration in its copyright contract law, *Urhebervertragsrecht*.²⁰⁵ The amendment to the law entitles:²⁰⁶

authors who have received a non-equitable remuneration (or no remuneration at all) ... to a retrospective variation of their contracts up to a level that the courts regard as common and honest practice in the trade ... at the time the contract was concluded.

The German law does not go as far as the regulation proposed by this paper. It does not require any copyrighted content that enters the German market to have been produced compliantly with German law. However, it does give a domestic right to fair remuneration, which may in limited situations extend beyond the boundaries of the German state. According to the usual rules of conflict of laws, where there is a sufficient connection to Germany a case may be decided under German law.²⁰⁷ Section 32b of the German copyright law specifically states that the mandatory provisions in s 32 of the Act (providing for fair remuneration) cannot be set aside by a simple choice of the applicable law.²⁰⁸ This means that the application of the German right to equitable remuneration may extend to foreign entities or individuals if they are domiciled within Germany, or where an entity has a branch in Germany and the dispute relates to this branch.²⁰⁹ The German Civil Code of Procedure also allows for jurisdiction over producers not located in Germany where they have assets in Germany and minimum contacts with Germany.²¹⁰ Section 32b(2) of the copyright law goes further than simple conflict of laws provisions and states that where substantial use of the work takes place in Germany, the German law will apply even where the contract is not most closely connected to German law.²¹¹ This provides some support for the domestic regulation of foreign contracts where there is a connection to the domestic market, as is proposed by this paper, although admittedly this paper does go further than the German law as it would not be limited by conflict of laws rules on the appropriate forum.

²⁰⁵ Kretchmer and others, above n 49 at 74.

²⁰⁶ Kretchmer and others, above n 49 at 74 and *Urhebervertragsrecht* 2002, s 32 (translation from Kretchmer).

²⁰⁷ Reto Hilty and Alexander Peukert "'Equitable Remuneration' in Copyright Law: the Amended German Copyright Act as a Trap for the Entertainment Industry in the U.S?" (2004) 22 *Cardozo Arts & Ent. L. J.* 401 at 437.

²⁰⁸ Adolf Dietz "Copyright Contract Law according to the New German Legislation and Practice" (2005) 29(1) *ami-tijdschrift voor auteurs-, media- & informatierecht* 20 at 25.

²⁰⁹ Hilty and Peukert, above n 207 at 433.

²¹⁰ Hilty and Peukert, above n 207 at 434: s 23.

²¹¹ Hilty and Peukert, above n 207 at 437.

Regarding the legitimacy of a mandatory standard of creator remuneration, the German law also provides some support. The title of the 2002 Amendment is ‘Law on Strengthening the Contractual Position of Authors and Performers’ which clearly indicates the intention to strengthen the bargaining position of authors and performers.²¹² The legislative process involved controversial positions taken by a number of parties, but final adoption of the amendment was premised on compromises which interested groups, including creators and the businesses, were willing to accept.²¹³ This stakeholder participation in the formulation of the law likely helped it to achieve legitimacy in the descriptive sense; the actors subject to the law viewed it as legitimate.

5 *Company response*

The effects which result from this kind of ‘redistribution’ regulation tend to be very complex and can be difficult to predict.²¹⁴ Efforts by the regulatory state to redistribute resources “tend to hurt the least well-off, and in any case, to have complex effects, many of them unintended and perverse”.²¹⁵ For example, regulating for a minimum wage tends to result in higher unemployment in the low-wage sector, although the consensus among economists on this point has been challenged.²¹⁶ The analogy here is that creating a minimum revenue distribution, which targets the lowest paid music creators, will result in lower employment among that group as music companies attempt to manage costs. The regulation, therefore, may cause a chilling effect on the music industry.

Additionally, any legislation regulating labour standards is likely to evoke a negative or, at the minimum, hesitant response from the industry it is regulating. That negative response may translate into a mass exodus from New Zealand. This appears an extreme reaction, but it is necessary to remember that New Zealand is a comparatively small market (only 4.6 million) people and that these regulations may impact the operations of a company in the copyright industry significantly.²¹⁷ Companies that are operating internationally might find that it is more expensive to meet the statutory minimums of revenue distribution than to simply leave the New Zealand market. Alternatively, companies might choose not to leave

²¹² Dietz, above n 208 at 23.

²¹³ Dietz, above n 208 at 23.

²¹⁴ Sunstein in Morgan and Yeung, above n 22 at 28.

²¹⁵ Sunstein in Morgan and Yeung, above n 22 at 28.

²¹⁶ Sunstein in Morgan and Yeung, above n 22 at 28; Daniel Sharivo “The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy” (1997) 64(2) *University of Chicago Law Review* 405 at 406; David Card and Alan Krueger in *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton University Press, Princeton, 1997) argue that modest minimum wage increases can increase, or not affect, low-wage employment; Robert Prasch and Falguni Sheth “The Economics and Ethics of Minimum Wage Legislation” (1999) 57(4) *Review of Social Economy* 466 at 466 challenge the idea that the minimum wage leads to unemployment.

²¹⁷ Statistics New Zealand “Population Clock” <www.stats.govt.nz>

the New Zealand market even if remaining is the more expensive option, owing to concerns about their public image.

A likely corollary of withdrawal *en masse* from the New Zealand market is that music infringement levels in New Zealand would increase in response to the sudden unavailability of music preferences. Additionally, the use of proxy servers or other technological means of accessing legitimate content not available in New Zealand would likely be employed by members of the public. Both of these, as well as the initial exit from the New Zealand market, would cause the regulation to be ineffective, as music creators would not receive increased remuneration. In fact, removing access to legitimate music within New Zealand would result in less access to music for the New Zealand public, both failing to achieve the goal of this regulation and frustrating the stated aims of copyright.

It is also likely that music companies that wish to remain operating within the New Zealand market but do not wish to increase their operational costs will attempt to game the regulation. For example, they may try to alter their contracts so that they do not fall within the scope of the regulation as they are not ‘music copyright’ contracts. If the scope of the regulation was extended so that it covered all copyright contracts, this may reduce the ability of companies to avoid the regulation but it would be much broader than its intended application based on the regulatory justification discussed earlier. While many of the creative industries suffer from low remuneration, potentially unfair contracts, and weak bargaining power, the necessity and likely effects of such a broad regulatory scheme would need to be explored independently of this paper, prior to implementation.²¹⁸

6 Creator response

Almost all music creators would be likely to agree with the statement that musicians should be paid. The mechanics of achieving that goal may cause more debate. Music creators are a diverse group and have a broad range of opinions about copyright and the best way to implement it. A 2004 study into artists’ views on the internet and file-sharing revealed split opinions about whether file sharing was good or bad.²¹⁹ There will not be a single ‘creator response’ to the proposed regulations.

The Songwriters Association of Canada commissioned a study into fair compensation for musicians which found that the revenue split in the music industry was “grossly inequitable” which 94% of revenue going to labels and performing artists, while only 6% on average went to songwriters, composers and music publishers.²²⁰ It suggested that a 50/50 split between the

²¹⁸ See Kretchmer and others, above n 49.

²¹⁹ Mary Madden *Artists, Musicians and the Internet* (Pew Internet & American Life Project, Connecticut, 2004)

²²⁰ Lalonde, above n 54 at 27.

two groups would be preferable.²²¹ This provides some support for the regulation of music industry contracts. Additionally, the American Federation of Musicians sued various music labels this year for failing to make required payments from streaming revenue.²²² This provides evidence that some musicians are unhappy with the way that labels manage their finances. However, the study above also noted that Pandora, a music streaming service, adopted a payment model based on a previously regulated royalty rate, which acted as “a ceiling instead of a floor” of royalty levels.²²³ While this was an example of a streaming service paying the rights holders, the same concern may apply to the split of revenue between rights holders. Thus a regulated solution may not be in music creators’ interests.²²⁴

Rolling Stone magazine has written on the subject, describing the unequal revenue split between music creators and music labels. It mentions that Maynard James Keenan, the frontman for multiple bands one of which released a record independently of music labels in 2011, had “pulled out” of the relationship with music companies due to the unfair distribution of revenue.²²⁵ In the same article, Josh Grier, a music-business attorney notes that while the disparity in revenue between music companies and music creators is still a point of contention, “artists are far more likely to throw up their hands and say, ‘Who gives a crap? Let’s just make a pile from touring’”.²²⁶ Although under the ‘360 contracts’ described above, this response may no longer be an option.

It is not simply companies in the music industry that might have negative reactions towards the proposed regulation; music creators may also have negative responses. While creators may support the ideals underlying the regulation, they may find that protections afforded to them cause companies which continue to operate in New Zealand to be less willing to contract with music creators, particularly those without a record of success. This is because it is risky investing in music creators, no one can predict what will be popular with the public and so earn high revenues.²²⁷ Where music companies do not share that financial risk with music creators, as is the case in many copyright contracts where the music company initially pays for recording and marketing music, they may prefer to expose themselves to less risk overall.²²⁸ Requiring a higher share of revenue for music creators results in less money for

²²¹ Lalonde, above n 54 at 27.

²²² *American Federation of Musicians and Employers’ Pension Fund v Atlantic Recording Corporation and Ors 1:15-cv-06267* (filed 10 August 2015) and American Federation of Musicians “Companies Sued for Failing to Fund Pensions” (10 August 2015) <www.afm.org>

²²³ Lalonde, above n 54 at 20.

²²⁴ Lalonde, above n 54 at 20.

²²⁵ Steve Knopper “The New Economics of the Music Industry” *Rolling Stone Magazine* (United States, online ed, 25 October 2011).

²²⁶ Knopper, above n 225.

²²⁷ Kretchmer and others, above n 49 at 66.

²²⁸ Karubian, above n 37 at 430.

the music company, which translates to less money to rely on if some of the music contracted and marketed by the music company is unsuccessful. The overall consequence is that music creators in New Zealand may leave, and those overseas may be more likely to be employed by companies which do not comply with the 'fair distribution' regulation. Both of these responses undermine effective achievement of the goal of the regulation.

7 *Political response*

I do not pretend to possess the prescience to predict the responses of political actors, both globally and domestically, which are likely to be both complex and varied. However, this suggested regulatory scheme is radical as it allows domestic laws to regulate foreign contracts. It seems likely that it will engender some strong responses from political actors, both negative and positive. Some, like the various stakeholders in the Fair Trade Music scheme promulgated by Eddie Schwartz, may be supportive of this government intervention. The music industry itself, which lobbies strongly in many countries including the United States, is likely to be opposed to something which impacts its operation so much.²²⁹ This may result in domestic and international opposition to the regulation, by both industry groups and governments who represent their interests, or feel that their sovereignty is being interfered with. In an ideal world the regulation would be taken up by key legal systems, such as the United States and the European Union, after seeing the New Zealand model, which would contribute significantly to its legitimacy, political clout and overall success as the music industry could no longer 'opt out' by not operating in New Zealand. Consultation with other countries may ease some of the political backlash likely to come from a regulation of this kind, however, it is not likely to be internationally popular for the reasons above.

8 *International obligations*

There is no indication that this regulatory response would breach international obligations. As the regulation would apply to all music businesses it would be likely to be consistent with Most-Favoured-Nation Treatment, which requires that any advantage granted by a contracting party to a product originating in, or destined for, another country shall be accorded to like products originating in, or destined for, all other contracting parties.²³⁰ It would also be consistent with National Treatment which requires that once goods have entered a market they are treated no less favourably than like products of national origin.²³¹

²²⁹ Social Science Research Council above n 99, at 4 and Patry, above n 41 at 6.

²³⁰ General Agreement on Tariffs and Trade, above n 173 at Article I.

²³¹ General Agreement on Tariffs and Trade, above n 173 at Article III.

The Technical Barriers to Trade Agreement would not be an obstacle because it relates on to technical requirements about a product.²³² This regulation relates to contractual terms, not product specifications or labelling, so it would not fall under that agreement.

9 Conclusion on Regulating the Relationship

While this scheme has laudable regulatory goals, on balance I do not recommend that it is implemented. While it seems that it would achieve the regulatory goal of ensuring creators are paid more by the music businesses with which they contract, it is unclear whether it will have a net benefit on creators in general. Moreover, its implementation is likely to require a high level of government investment, at least in the short term, as the Copyright Tribunal will need to be extended and have additional resources to effectively manage the number of contracts and set an appropriate proportion of revenue distribution in such a complex field. Additionally, there is likely to be a strong negative response from the music industry, which is a powerful lobbyist in some foreign countries, and from other countries themselves, who may feel that New Zealand is interfering with their sovereignty by regulating foreign contracts. While Germany has passed a law which may have a similar effect, it only extends to foreign countries through conflict of laws provisions (albeit slightly modified conflict of laws provisions). Germany also has a large economy and is politically powerful so music distribution companies are less likely to leave the German market in response to that law than they are to leave the New Zealand market in response to this regulation.

V Conclusion

The foregoing discussions establish the market failure and inherent unfairness that results when music creators obtain only low proportions of revenue as a result of their weak bargaining positions. It then analyses two possible regulatory responses to this situation. FTM is a voluntary certification scheme which relies on marketing to ethical consumers, creating a competitive advantage among firms which are FTM compliant. Conversely, regulating the distribution of copyright revenue is a mandatory scheme which imposes conditions on revenue distribution in music creator-music company contracts if that music is distributed within the New Zealand market. Both are aimed at the music creator-music company relationship.

Both schemes are likely to encounter obstacles to successful implementation, not least of which are the resource costs associated with the implementation and operation of such

²³² Agreement on Technical Barriers to Trade, above n 176 at Article 1.3 (applies to products) and Annex 1(1) (definition of technical regulation is 'document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory').

schemes and the possible stakeholder reluctance to engage with a scheme which interferes so much with the ordering of business relationships.

On balance, this paper recommends against the adoption of mandatory regulation of the contractual relationship between music creators and music companies. On the other hand, a voluntary FTM certification scheme shows more promise as a successful regulatory response if implemented carefully and following a deeper investigation of issues highlighted above.

Finally, from a practical point it appears unlikely that the New Zealand Government *would* implement a regulation of this kind. There is no groundswell of public support for such a proposal and no international consensus that this is an appropriate step. Additionally, the Government is currently negotiating expansive trade agreements and adopting this proposal which may have a chilling effect on the music industry in New Zealand would likely be an unpopular move among other negotiating countries and, without support from key international countries, such as the United States, it may weaken New Zealand's negotiation position.

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