THE "NEW PAYOLA" AND THE AMERICAN RECORD INDUSTRY: TRANSACTIONS COSTS AND PRECAUTIONARY IGNORANCE IN CONTRACTS FOR ILLICIT SERVICES

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Payola is the practice of making undisclosed payments or other inducements to radio (or television) broadcast personnel in consideration for the inclusion of material in radio (or television) programming. The origin and economic function of payola were first analyzed in 1979 by Professor Ronald Coase.[1] He argued three fundamental propositions. First, every time a radio station plays a song, it in effect advertises a specific product (namely, a phonograph record) that a record company has for sale. Payola is a price mechanism for efficiently allocating this scarce but otherwise unpriced on-the-air advertising of popular music. There is no reason to believe that a record company that dispenses payola will spend its finite advertising resources promoting "bad" music rather than "good" music. Second, long before the commercial development of radio, a similar pricing system was commonplace in the United States with respect to the inclusion of songs in live performances by popular singers and musicians. At that time, the implicit advertisement was for sheet music sold by music publishers. Third, since at least the 1890s, movements to prohibit payola have been used as competitive weapons by record and music publishing firms. Those firms have acted, sometimes in concert, not only to reduce their own advertising costs, but also to restrict the advertising alternatives by which new entrants could

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1. Coase, *Payola in Radio and Television Broadcasting*, 22 J.L. & ECON. 269 (1979).

expose to the public their sound recordings and copyrighted compositions.

Unaware that payola is a price mechanism that can enhance allocative efficiency, Congress in 1960 condemned the practice[2] and subjected it to criminal penalties under section 508 of the Federal Communications Act.[3] Viewed in isolation, however, section 508 addresses itself to a narrow agency problem between the owner of a radio station and the station's employees. In relevant part, section 508 provides that

> any employee of a radio station who accepts or agrees to accept from any person (other than such station), or any person (other than such station) who pays or agrees to pay such employee, any money, service, . . . or other valuable consideration for the broadcast of any matter over such station shall, in advance of such broadcast, disclose the fact of such acceptance or agreement to such station.[4]

Read literally, therefore, section 508 envisions a naive radio station owner victimized by secret payments from a record company to the station's employees. It makes this one variety of an employee's usurpation of his employer's business opportunity a federal crime punishable by a maximum jail term of one year, a maximum fine of $10,000, or both.[5]

The significant constraint on payola lies in section 317 of the Communications Act, which requires that, if a radio station has received consideration for broadcasting certain material, it disclose that fact and identify the person furnishing such consideration at the time of broadcast.[6] In the case of legitimate advertisements, the identity and commercial interest of the sponsor are apparent from, and revealed in, the contents of the advertisement itself. Section 317 is concerned with material, such as an otherwise innocuous sound recording, that communicates no apparent or ostensible advertising message when broadcast.

A further requirement of section 317 is that any disclosure

2. *See Responsibilities of Broadcasting Licensees and Station Personnel Hearings Before a Subcomm. of the House Comm on Interstate and Foreign Commerce*, 86th Cong., 2d Sess. (1960); *Communications Act Amendments: Hearings Before a Subcomm of the House Comm. on Interstate and Foreign Commerce*, 86th Cong., 2d Sess. (1960).

3. Communications Act Amendments, Pub. L. No. 86-752, § 8(b), 74 Stat. 889, 896 (1960) (codified at 47 U.S.C. § 508 (1982)).

4 47 U.S.C. § 508(a) (1982).

5. *Id* at § 508(g).

6. *Id* at § 317(a)(1).

that a station employee would be required to make to a station owner under section 508 (namely, that the station employee had received pay for play) must be relayed to the public through "an appropriate announcement . . . made by such radio station."[7] Although the statute does not expressly require that such "appropriate announcement" be made at the time the affected material is broadcast, the Federal Communications Commission has promulgated the detailed sponsorship identification rules, which contain many examples of circumstances requiring disclosure.[8] As we shall show, it has become increasingly important for a record company to navigate the intricacies of the payola statutes and the accompanying FCC rules since Professor Coase published his article in 1979.

Professor Coase addressed the origin of payola and the recurring efforts to regulate the practice, which culminated in the 1960 legislation making payola a crime. The 1970s brought several more payola scandals, only briefly mentioned by Professor Coase, which displayed familiar economic motives. By the 1980s, however, this market for the on-the-air advertising of pop music had acquired a structure quite different from the one that Professor Coase had described only a few years earlier.

In early 1986, separate grand juries in Los Angeles, New York, and Newark were convened to investigate charges of corruption in the recording industry, including charges that rec-

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7. *Id.* at § 317(b).

8. 47 C.F.R. § 73.1212 (1985). "At the very least, an audio announcement must be made which states, in essence, that the performer or an identified person acting on his behalf has paid the program producer in order to appear on the program." *In re* Application of Sections 317 and 508 of the Communications Act to "Kickbacks" of Fees Paid to Performers, 23 F.C.C.2d 588, 589 (1970). The FCC has emphasized that this requirement is not satisfied by "an audio . . . announcement at the conclusion of a broadcast, which merely mentions the receipt of 'promotional assistance' or 'promotional consideration,' " *id.* at 589, and that the following types of announcements in particular do not suffice: "Miss *X* appeared through the courtesy of *Y* Recording Co.," or "Miss *X*'s appearance was by arrangement with ————," or "Miss *X* was brought to you through the cooperation of *Y*." *Id.* at 589 n.1. *See also In re* RKO Gen'l, 25 F.C.C.2d 633, 651 (1970).

Evidently, record companies and radio stations did not find it mutually beneficial to contract for legitimate paid airplay accompanied by a pay-for-play disclosure at the time of broadcast. *See infra* text accompanying notes 196-98. Perhaps radio stations thought that such disclosures would destroy continuity in music programming and generate too much uninteresting chatter by disc jockies, thus causing listeners to switch to a radio station with less talk. In contrast, it was common by the mid-1980s for a toy manufacturer introducing a new character to spend $12 million to $15 million to produce a television cartoon series featuring that character. Wall St. J., Sept. 12, 1986, at 35, col. 4. *See also* Wall St. J., May 12, 1987, at 37, col. 4.

ord companies had distributed payola through independent contractors known as "independent promoters" who were allegedly linked to organized crime.[9] In April 1986, Senator Albert Gore, Jr., of Tennessee announced that he would conduct a closed-door investigation into the "new payola," which he said "is much more extensive than past practices, involves more money and [has] a greater connection between a network of promoters who allegedly have carved up the country into 'fiefdoms.' "[10] He alleged that this form of payola, particularly prevalent in the promotion of "Top 40" singles, "corrupts the way music gets on the airwaves" and prevents the songs that listeners demand most from "rising to the top of the charts."[11] Echoing the congressional hearings of 1960, Senator Gore stated that payola "should be stamped out,"[12] and that a congressional investigation into independent promotion was necessary to "determine whether the present payola law is working or if changes in the law are needed."[13] By late August 1986, three more grand juries—in Cleveland, Miami, and Philadelphia—had been convened to investigate corruption in the record industry.[14]

Apart from expressing indignation over payola, Senator Gore's remarks suggest that the transactions costs of using payola as a price mechanism for allocating scarce on-the-air exposure to pop music increased between the time that Professor Coase published his article in 1979 and the advent of the "new payola." In this Article, we examine how such a degradation in transactional efficiency could have occurred. Of necessity, our analysis is largely anecdotal because of the paucity of public data on the recording industry.[15]

In Part I, we analyze the law and economics of record promo-

9. *See* Rolling Stone, May 22, 1986, at 13, col. 1.

10. United Press Int'l Release (Apr. 2, 1986). *See also* Billboard, Apr. 12, 1986, at 1; L.A. Times, Apr. 3, 1986, § 1, at 1, col. 2.

11. Wall St. J., Apr. 3, 1986, at 52, col. 2.

12. United Press Int'l Release, *supra* note 10.

13. Billboard, *supra* note 10, at 1.

14. Daily Variety, Aug. 27, 1986, at 1.

15. Reflecting on the research for his 1979 article, *supra* note 1, Professor Coase has observed in personal correspondence:

> One problem in dealing with this industry is that it is very difficult to get reliable information. I have never before made an investigation in which the information given to me was so unreliable. In the end, I don't think I made any reference to information given to me in personal interviews. It soon became apparent that much of what I was told consisted of lies

Letter from Ronald Coase to J. Gregory Sidak (Sept. 16, 1986).

tion. We show why it was difficult for a record company to specify and monitor contractual performance by independent promoters, and how this difficulty enabled independent promoters to act opportunistically vis-a-vis the record company.[16] In Part II, we analyze the "new payola" scandal of 1986, which we argue resulted from transactional inefficiency in the contractual relationship between record companies and independent contractors for record promotion—inefficiency that manifested itself in opportunistic behavior by independent promoters. In Part III, we argue that the major record companies did not counteract this opportunism through vertical integration into radio broadcasting because FCC regulation effectively blocked such integration, thus causing the desired efficiency outcomes to be approximated more inexpensively through the advent of music video broadcasting and the growth of syndicated radio programming. Finally, in Part IV we propose that payola be deregulated in a manner that would eliminate the inefficiencies of opportunistic behavior by independent promoters while preserving certain efficiencies that they may have created. Specifically, we propose that the FCC amend its sponsorship identification rules so as to require the disclosure of certain information that would enable the market for hit records to function more like an organized exchange.

I. The Law and Economics of Record Promotion

Since 1978, the domestic record industry has consisted of six "major" companies: CBS, Warner Communications (WCI), RCA/Ariola, Capitol Industries-EMI, MCA, and Polygram. Each is a vertically integrated company capable of acquiring and developing talent through its various record "labels" and manufacturing and distributing prerecorded music software. In addition, three substantial "independent" record companies—A&M, Motown, and Chrysalis—acquire and develop talent but subcontract with RCA/Ariola, MCA, and CBS, respectively, for manufacturing and distribution.[17]

16. Our discussion of opportunistic behavior relies on the analysis in Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & Econ. 297 (1978). *See also* Alchian & Woodward, *Reflections on the Theory of the Firm*, 143 J. Institutional & Theoretical Econ. (Zeitschrift für die gesamte Staatswissenschaft) 29 (1987).

17. Kronemyer & Sidak, *The Structure and Performance of the U.S. Record Industry*, in 1986 Entertainment, Publishing and the Arts Handbook 263, 264-66, 270.

A. *The Market for Record Promotion*

In record industry parlance, "promotion" connotes the securing of radio airplay for new releases. Radio airplay is advertising for prerecorded music. It notifies the consumer of the availability of a new product and enables him to sample that product before purchase; it is generally believed to be the greatest stimulant to sales of a particular pop album.[18] Further, the report of radio airplay by highly rated radio stations may stimulate airplay at radio stations in other geographic markets and at lesser radio stations in the same geographic market. In this respect, radio airplay generates a market signal of the most profitable composition of a radio station's broadcast portfolio. Radio stations are competing providers of a public good—namely, the free broadcast of music, news, sports, and other entertainment. One of the most prevalent radio programming formats is "Contemporary Hit Radio" (or "CHR"), which is also called "Top 40" radio.[19] CHR stations compete for listeners on the basis of the attractiveness and predictability of their specialized and repetitive hit record portfolios, which consist of a relatively restricted playlist of records that are or have been ranked highly on the national hit records charts.

As frivolous as it may seem, a highly organized market exists for assessing the broadcast value of hit singles such as *Walk Like An Egyptian*[20] and *Rock Me Amadeus*.[21] Every Tuesday night, all CHR radio stations polled by the various trade publications submit their playlists for the week ending that day. Those lists, when aggregated, become the published national hit records charts. *Billboard* even offers an on-line service that reports the chart position of records and additions to radio station playlists immediately after the raw data are tabulated.

A highly organized market also exists for assessing the value to listeners (and hence to advertisers) of the overall portfolio of hit music programming offered by radio stations within a par-

18. *See, e.g.*, WARNER COMMUNICATIONS, INC , 1979 ANNUAL REPORT 29 (1980). *See also* Brief for Federal Trade Commission at 14, *In re* Warner Communications, Inc., FTC Dkt. No. 9174 (filed Aug 17, 1984) There appears to be no published study confirming this complementary demand relationship, let alone estimating its empirical magnitude.

19 Rolling Stone, Apr. 24, 1986, at 21, col. 1.

20 The Bangles, *Walk Like an Egyptian*, on DIFFERENT LIGHT (CBS Records, FC 40039, 1985).

21. Falco, *Rock Me Amadeus*, on FALCO 3 (A&M Records, SP-5105, 1985).

ticular geographic market. The ability of a radio station to construct and consistently maintain a highly rated portfolio of hit music programming has great proprietary value. The Arbitron Ratings Company periodically estimates audience shares for radio stations within a given geographic market.[22] Advertising rates obviously rise as a station's Arbitron rating rises. Therefore, there is an opportunity cost to a radio station of playing one record rather than another, and this opportunity cost increases with the station's Arbitron rating. When a station with a high Arbitron rating plays a particular record, it transmits to other radio stations a market signal about the expected broadcast value of that record. In this way, the composition and turnover of the playlist of a highly rated radio station can be a leading indicator of eventual consumer demand for particular records.

Two factors particularly shape the economic organization of record promotion. One is the short product life cycle of the typical hit record and accompanying album. The magnitude of consumer demand for a specific record cannot be readily quantified when a radio station must make the timely decision of whether or not to add that record to its playlist; yet most records effectively stop selling within three months after release. Consequently, a primary objective of record company promotion efforts is to induce some minimum sufficient number of highly rated radio stations to add a record to their playlists so that the record is reported in the hit singles charts of weekly trade publications like *Billboard* and *Radio & Records*. Although *Billboard* ranks hit singles on the basis of both airplay and sales,[23] *Radio & Records* ranks them solely on the basis of airplay reports from approximately 250 CHR stations.[24] *Radio & Records* categorizes radio stations by relative market size and market share, labelling a station Parallel 1, Parallel 2, or Parallel 3.[25]

22. Arbitron Ratings Company, Description of Methodology vii (1986).

23. *E.g.*, Billboard, May 17, 1986, at 72.

24. *E.g.*, Radio & Records, May 29, 1987, at 78.

25. *See, e.g., id.* at 80. *See also* Rolling Stone, *supra* note 19, at 21, col. 4. Each of the roughly sixty Parallel 1 stations in the United States and Canada reaches one million or more listeners and is highly rated in its geographic market. *Radio & Records* weighs airplay on Parallel 1 station most heavily in compiling its chart. As a rule of thumb, for a record to rank in the Top 40 of *Radio & Records*, it must be on the playlists of about 140 to 150 radio stations. The record is then called a "Breaker." *See, e.g.*, Radio & Records, *supra* note 24, at 86. *See also* L.A. Times, Mar. 18, 1984, § V, at 8, col 2;

The second factor that shapes the economic organization of record promotion is the FCC's "rule of twelves," a regulation that prohibits a single entity from owning more than twelve AM radio stations, twelve FM radio stations, and twelve television stations.[26] Actually, until August 1984, an even more stringent "rule of sevens" prohibited a single entity from owning more than seven of each kind of station.[27] In either case, the regulation constrains the horizontal scale of a radio network, thereby preventing an individual firm from fully exploiting, through internal management control, economies of scale in assembling hit radio programming.

The short product life cycle of a hit record and the rule of twelves together imply that a team of record promoters must act with relative simultaneity to inform program directors at radio stations in geographically disperse markets that a particular artist has a new record well suited to those stations' respective audiences. For temporal and geographic efficiency, therefore, a promotional staff must be a team of a certain minimum scale. A record company that has relatively few releases, or releases arriving from temperamental recording artists on unpredictable schedules, frequently would have excess capacity if it were vertically integrated into record promotion to the extent necessary to accommodate peak loads. Not surprisingly, record companies subcontract part of the promotion function to independent contractors known as "independent promoters."

B. *Independent Promotion*

Although there were estimated to be 200 people in the independent promotion business throughout the United States in 1986 (including staff and independent subcontractors),[28] between "fewer than a dozen"[29] and thirty were said to dominate the field and operate in an informal cooperative known as "The

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Billboard, Mar 22, 1986, at 81. The terms "Parallels" and "Breakers" are registered trademarks of *Radio & Records*. *See* Radio & Records, *supra*, note 24, at 3.

26. 37 C F R. § 73.3555(d) (1985).

27 *In re* Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73 636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations, 100 F.C.C.2d 17 (1984). *See also* Fowler & Brenner, *A Marketplace Approach to Broadcast Regulation*, 60 Tex. L. Rev. 207, 245-47 (1982).

28. L.A. Times, *supra* note 10, at 12, col. 1; Wall St. J., Apr. 18, 1986, at 6, col. 1.

29. Wall St. J., *supra* note 28, at 6, col. 1.

Network."[30] This cadre became so known because its members reportedly were "often hired to work as a loosely knit association in promoting the same record nationwide,"[31] and had allocated among themselves access to playlists at forty-one important radio stations in two dozen American cities.[32] One reported member of The Network explained:

> Independent record promoters . . . are retained by [record] companies in order to secure playtime for the [record companies'] recordings on radio stations throughout the United States. Radio playtime is highly prized by the [record] companies because extended playtime serves to enhance a recording's public exposure and therefore its sales potential. In order to secure this important playtime for their client label companies, independent record promoters . . . provide radio stations with pertinent information and data related to the quality and nature of the recording, its likely demographic appeal, its advertising support, sales performance and, ultimately, the likelihood of its public acceptance as a "hit record."[33]

According to this description, the independent promoter appears to broker hit singles, disseminating information relevant to a radio station's decision whether or not to alter its current portfolio of records. His purpose is to persuade the programming director of a radio station that adding a particular record to the station's playlist (or playing a record already on the playlist more frequently and at peak hours) will, on the margin, increase the station's Arbitron market-share rating, thereby increasing demand for advertising on that station. If he is credible and accurate, the independent promoter makes the market for hit singles more efficient.

1. *Specific Human Capital and Exclusive Dealing*

Over time, independent promoters evidently developed specific human capital for dealing with radio stations—which, for lack of a more rigorous term, the popular press called "clout."[34] A preliminary investigation of independent promo-

30. Rolling Stone, *supra* note 19, at 21, col. 1; L.A. Times, *supra* note 25, at 1, col. 4; L.A. Times, Oct. 21, 1983, § I, at 1, col. 1.

31. L.A. Times, *supra* note 30, at 1, col. 1.

32. Wall St. J., *supra* note 28, at 6, col. 3.

33. Complaint in Isgro v. Recording Indus. Ass'n of Am. at 6-7, No. 86-2740 (C.D. Cal. filed Apr. 30, 1986).

34. *See, e.g.*, L.A. Times, *supra* note 30, at 1, col. 1. On a superficial level, "clout" merely describes an independent promoter's business success, but fails to convey any

tion conducted by the Senate Subcommittee on Oversight and Investigations in 1984 reported:

> These promoters bring some continuity and stability to a very transient industry. While radio station personnel often change employment throughout the United States, independents maintain their geographic locations and their acquaintanceships with the station personnel. It is also believed by some radio stations that independent record promoters who work a variety of record labels bring objectivity and experience to promotion of a record that a company promoter would not bring because of his vested interest in the company's product.[35]

If the Subcommittee's assessment was correct, an independent promoter's investment in such highly specific human capital would tend to develop under circumstances that would maximize the probability that he would in fact capture the income stream derivable from his investment.

Not surprisingly, a pattern of exclusive dealing appeared to emerge whereby individual independent promoters reportedly controlled access to individual radio stations. Based on interviews and documents obtained from three record companies, the *Wall Street Journal* reported in April 1986 that in thirty-three of forty-one instances "all three companies independently cited the same promoter as providing access to a particular station."[36] This congruence of choice among the three record companies suggests the existence of implied, if not explicit, exclusive dealing arrangements between radio stations and independent promoters. Despite this apparent industry pattern, however, there was no clear allocation of entire geographic radio markets among independent promoters. Indeed, geo-

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causal explanation for the origin, magnitude, and duration of his competitive advantage. The "clout" of independent promoters may have a deeper efficiency basis, however.

35. Memorandum on Improper or Illegal Activities in the Record Industry from the Subcommittee Staff to the Members of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce 3 (Sept. 14, 1984) [hereinafter 1984 Subcommittee Memorandum]. *See also* Billboard, Mar. 15, 1986, at 16.

36. Wall St. J., *supra* note 28, at 6, col. 3. "In seven instances, at least one of the companies indicated that it didn't know a promoter for a station. In just one case did the companies disagree about which promoter could provide access." *Id.* For example, one independent promoter reportedly was the unanimous choice for securing airplay at WCAU-FM in Philadelphia, KIIS-FM in Los Angeles, and KKBQ-FM in Houston; he also reportedly had strong access to stations in Dallas, New Orleans, and Norfolk, Virginia. *Id.*

graphic market allocation is unessential to any of several possible explanations for exclusive dealing in this context.

The question that the Subcommittee left unanswered and that the *Wall Street Journal* article raised is why the investment in such specific human capital did not occur within a single firm: Why could not the program director of a highly rated radio station, if efficiently compensated for his specific human capital and for the opportunity cost of his more general human capital, provide the same continuity and objectivity that the independent promoter supposedly provided? The answer must be that the radio station owner and program director fared better with independent promoters than without, a possibility that appears likely when one examines loopholes in the payola statute.

2. *The "Friendship Exception" to Payola*

In 1979, the FCC held in an administrative ruling that, with respect to gifts given to radio station personnel by record promoters, "social exchanges between friends are not 'payola'."[37] This ruling carved a gaping loophole in section 508 of the Communications Act. Suppose that an independent promoter gives gifts to "friends" who happen to be the owners or personnel of a radio station, but he does not ask for future airplay as the quid pro quo for his gifts today. The FCC's "friendship exception" appears to immunize such conduct from the payola statute. This immunity would explain why independent promoters were reported to have provided extravagant prizes to radio stations for giveaway contests,[38] and why one unidentified executive at an artist management company described the following hypothetical relationship between an independent promoter and a program director:

> Say a program director [PD] and an indie are good friends . . . . And the indie was also friends with the PD's wife. So for her birthday, the indie bought the wife a $5000 mink coat. It's a gift. Is that illegal?
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> . . . The indie takes the guy out to dinner . . . . They share some blow [cocaine] and maybe he lets him take the rest of the gram home. He lets him use his credit card. When the PD's vacation comes up, the indie has a condo in Miami he can stay in. Now does that mean that every record that the indie works gets played? No. They're friends. They really are

37. *In re* Applications of Kaye Smith Enter., 71 F.C.C.2d 1402, 1408 (1979).
38. Wall St. J., *supra* note 28, at 6, col. 1.

friends.[39]

Obviously, such gifts would benefit the program director, especially if he did not report them as taxable income and this in-kind income were unlikely to be detected by the Internal Revenue Service. Such gifts also would benefit the station owner by enabling him to pay his program director a lower salary than he would in the absence of the gifts.

One can view these gifts as a nonsalvageable investment to establish credibility—that is, a kind of earnest money or hostage held by the radio station owner or employee. The independent promoter can recoup this nonsalvageable investment only if his association with the particular radio station is long-lived and he continues to deliver airplay recommendations of high quality—that is, only if he does not act opportunistically vis-a-vis the radio station. Alternatively, one can view these gifts less charitably as the tacit advance payment for an unannounced airplay upon demand. Either way, the independent promoter would be willing to make an outlay of only one-*n*th as much if *n* independent promoters were currying favor with the same radio station. In such case, a record company seeking airplay at a particular station in a particular city could choose between several promoters, thus diluting the "clout" of any one independent promoter who had made a very substantial gift (such as an automobile), and possibly preventing him from recouping his "investment" quickly enough to allow him an attractive rate of return.

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39. Rolling Stone, *supra* note 19, at 22. *Cf.* Macaulay, *Non-Contractual Relations in Business A Preliminary Study*, 28 AM. SOC. REV. 55, 63 (1963) (discussing longstanding personal relationships and exchanges of gifts between salesmen and purchasing agents); Billboard, May 28, 1977, at 77, col. 2 (describing radio station manager's view that gifts from a friend of seventeen years who was a record producer was not payola because "[n]othing was asked in return").

Neil Young satirized independent promotion in *Payola Blues*, on EVERYBODY'S ROCKIN' (Geffen Records, GHS 4013, 1983):

> Well here's three thousand
> That ought to get it on.
> "Thanks a lot, man
> I love your new song."

Finding $3,000 to be insufficient, he ups the ante:

> How about this Mercedes Benz?
> That ought to get it on.
> "Well, thanks a lot, man
> I'll play it all day long."

Id

3. *Other Possible Efficiencies of Exclusive Dealing*

There are additional reasons why independent promoters and radio stations might want to organize their relationships through exclusive dealing arrangements. Although compensated by a record company, the independent promoter in practice may be less an agent of the record companies than an agent of the highly rated Parallel 1 radio station. For such a station, the supply of new records vastly exceeds airplay capacity; a CHR station may routinely receive fifty or more new singles each week,[40] but it has a much smaller number of playlist slots—perhaps three or four—to allocate each week to new releases. Selecting the best commercial prospects among those new releases entails an opportunity cost that increases with the audience size of the radio station. In practice, therefore, a radio station may choose to rely on the independent promoter exclusively to broker the station's finite airplay capacity.

The allocation of finite airplay capacity also can be viewed as the purchase of the raw inputs from which a radio station manufactures its final product—namely, a portfolio of records that, after repeated broadcast, are likely to be demanded by consumers, allowing advertisers on that station to achieve a high degree of market saturation. The composition and turnover of that portfolio are themselves a kind of proprietary information that competing radio stations can appropriate quickly and at trivial cost simply by listening to the first radio station's broadcasts.[41] The implicit *exclusive buying* arrangement between an independent promoter and an individual radio station in a geographic market may, therefore, have been adopted not to limit competition between rival radio stations in the "sale" of airplay to record companies, but rather to protect a highly rated radio station's property right in its superior portfolio of programming for a specific audience within its geographic mar-

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40. *See* L A. Times, May 4, 1980, Calendar Sec., at 4, col. 2 *See also* RECORDING INDUSTRY ASSOCIATION OF AMERICA, INC., INSIDE THE RECORDING INDUSTRY: A STATISTICAL OVERVIEW, UPDATE 1986, at 5 (1986).

41. A program director in charge of designing the playlists for nine radio stations observed:

> It would be easy for me to just sit back and wait for a song to hit the Top 15 before I jump on it. Then I could be sure of playing all of the hits. Of course, by that time the audience has already moved on to listen to whatever stations have been playing those records all along You have to keep on top.

L.A. Times, *supra* note 40, at 4, col. 1.

ket.[42] Such a station might have sought to preserve its competitive advantage by restricting the independent promoter's prerogative to make programming recommendations to other stations in the same geographic market. By so doing, the highly rated radio station could lengthen the lead time before which competing stations freely could exploit appropriable information—namely, the profit-maximizing composition of the broadcast playlist.[43]

Economies of scale also may explain the pattern of exclusive dealing between independent promoters and highly rated radio stations. The economic function of record promotion is to influence favorably the decisions of those possessing the managerial authority to dictate the composition of radio station playlists. A record promoter would prefer to deal with a large network of radio stations with identical programming objectives. At one extreme, it would be most efficient if the record promoter needed to persuade only a monopolist who dictated the playlists of all radio stations. At the other extreme, it would be least efficient if the record promoter individually had to persuade the program director at each of the thousands of AM and FM radio stations on the air in the United States.[44] The rule of twelves, of course, artificially limits the horizontal scale of a network of radio stations that can operate under the managerial discretion of a single entity to at most twenty-four radio stations, only twelve of which (until the advent of AM stereo) could broadcast in stereo. In the interest of portfolio diversification, however, the owner of a network of twelve FM radio stations probably would not operate all of those stations under the CHR format.[45] Consequently, a record promoter probably would not encounter even the transactional efficiency of dealing with one manager who controls the airplay decisions for twelve CHR stations broadcasting in FM stereo.

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42. *Cf.* Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982).

43. *Cf.* Sidak, *Debunking Predatory Innovation*, 83 COLUM. L. REV. 1121 (1983).

44. As of January 1, 1985, there were 4,754 AM and 4,888 FM radio stations on the air in the United States. BROADCASTING PUBLICATIONS, BROADCASTING CABLECASTING YEARBOOK H-55 (1986).

45. For example, in 1984 CBS operated five of its seven FM radio stations under the CHR format, one under the "Album Oriented Rock" format, and one under the "Solid Gold" (oldies) format. CBS, INC., 1984 ANNUAL REPORT 16 (1985). We set to one side the argument that portfolio diversification among types of radio formats is unnecessary because investors themselves can diversify their individual investment portfolios.

In this environment of risk diversification and FCC regulation, independent promoters may be able to achieve economies of scale in record promotion by constructing ad hoc radio networks among legally unrelated stations having identical formats.[46] The horizontal scale of these ad hoc networks could exceed the twelve-station maximum for FM stations under the rule of twelves, thereby enabling the network and its affiliated radio stations to achieve scale economies in record promotion and the selection of CHR programming. The independent promoters' exploitation of scale economies in programming could explain not only their ability to secure widespread Parallel 1 airplay for a record, but also their reported ability to suppress airplay of a particular record at such radio stations.

C. *RICO and the Growth of Independent Promotion*

During the mid-1970s, CBS reportedly spent less than $1,000 annually on independent promotion.[47] By 1980, CBS reportedly was spending between $4 million and $5 million,[48] and by 1983, between $8 million and $10 million.[49] This precipitous growth in expenditures for independent promotion at CBS and other record companies commonly has been attributed to three factors. First, the recession that struck the record industry in 1979 caused record companies to reduce drastically their in-house promotion staffs and hire independent contractors as needed,[50] thereby shifting a portion of the risk of demand fluctuations. Second, record company executives came to believe that the success of a record increasingly depended on

46. For a discussion of ad hoc networks and the economies of scale that may occur when one entity controls many stations, see *In re* Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C.2d 17, 44-46 (1984).

47. 1984 Subcommittee Memorandum, *supra* note 35, at 2-3. *See also* Billboard, *supra* note 35, at 16.

48. L.A. Times, Nov. 16, 1980, Calendar Sec., at 83, col. 2.

49. 1984 Subcommittee Memorandum, *supra* note 35, at 2-3.

50 Warner Communications, Inc , *supra* note 18, at 29; Wall St. J., Feb. 28, 1986, at 7, col. 2 Record industry sales grew significantly but unevenly from 1950 until the late 1970s. Kronemyer & Sidak, *supra* note 17, at 263. Between 1978 and 1985, the American record industry experienced declining and then relatively fixed demand. Expressed in constant 1984 dollars, the estimated value of retail sales peaked in 1978 at $6.2 billion and then collapsed to $4.0 billion by 1982—the lowest level since 1968. In 1984 and 1985, sales were relatively constant at about $4.4 billion (in 1984 dollars), which was only scarcely higher than real industry sales in 1972. *Id.*; Recording Industry Association of America, Inc., *supra* note 40, at 4.

radio airplay in small and medium sized markets.[51] Smaller record companies, however, generally could not afford to maintain a promotion network encompassing every city targeted for airplay.[52] Independent promoters, therefore, enabled smaller record companies to pool their requirements for local promotion and avoid vertically integrating into an activity that none of them could conduct independently at minimum efficient scale.

A third, less common explanation for the growing reliance on independent promoters was the popularity of "disco" music in the late 1970s. In its 1979 annual report, WCI blamed declining industry demand partly on a "disproportionate amount of [radio] air time . . . [being] devoted to disco music in relation to its record sales, leaving less time available to promote records with much broader sales potential."[53] This argument is tautological. It does not explain why radio stations would play records that consumers did not really demand—unless the demand for the free broadcast of music differs qualitatively from the demand for purchased prerecorded music, which seems, to say the least, counterintuitive.

The disco explanation also assumes an inelastic supply of airplay slots—or, more precisely, an inelastic supply of the number of gross impressions that radio stations can impart to listeners in a geographic market. Perhaps, in context, this assumption is plausible, because the number of radio stations (particularly FM stations, which can broadcast in stereo) in the United States is a proxy for the supply of airplay slots, and the FCC limits by licensure the supply of radio stations.[54] New FM capacity grew rapidly from 1970 to 1978, but grew only half as quickly from 1978 to 1985.[55] Beginning in 1981, however, there were more hours of music available per station because the FCC eliminated its requirement that a station reserve a certain percentage of its total broadcasting hours for news and

51. WARNER COMMUNICATIONS, INC., *supra* note 18, at 29. Whether this belief is correct is unclear.

52. Billboard, *supra* note 35, at 16.

53. WARNER COMMUNICATIONS, INC., *supra* note 18, at 29.

54. *See* Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1 (1959).

55. From 1970 to 1978, the number of FM radio stations on the air increased from 2476 to 3972, or at a compound annual growth rate of 6.1%. BROADCASTING PUBLICATIONS, *supra* note 44, at H-55. This growth in airplay capacity should have ensured that the market for on-the-air advertising of new prerecorded music was competitive. In contrast, between 1978 and 1985, only 916 new FM radio stations went on the air, causing total FM airplay capacity to reach 4,888 stations and the compound annual growth rate of new capacity to fall to 3.0%. *Id.*

current events.[56] Consequently, a radio station could either lengthen its playlist or play the same records on its playlist more times each day. Many radio stations chose the latter strategy.[57] But regardless of FCC public-service or licensure regulations, at all times the supply of CHR airplay slots must be highly elastic because new entry of capacity for airplay of hit records can consist merely of a licensed station changing its format to CHR. Although capacity constraints for CHR airplay may exist at a particular moment in time, the disco explanation cannot explain changes in CHR airplay capacity—and hence changes in the derived demand for independent promotion—between 1978 and 1986.

A fourth and largely ignored factor that surely contributed to heavier reliance on independent promotion was the enhanced risk in the late 1970s and early 1980s that a record company might incur treble damage liability under the Racketeer Influenced and Corrupt Organizations Act (RICO) for its in-house promotional activities.[58] By making payola a crime in 1960, Congress created an incentive for record companies to avoid vertical integration into promotional activities that are illegal or are merely susceptible to being mischaracterized as illegal. However, the penalty for distributing payola was relatively small, and the probability of detection and prosecution remote. Few criminal prosecutions for payola violations can be found,[59] and sections 317 and 508 of the Communications Act were held in 1975 not to imply a private right of action.[60] Thus, before RICO was passed, the incentive for record companies to avoid vertical integration into record promotion was not great.

RICO changed the magnitude of that incentive. The volume of RICO litigation grew precipitously in the late 1970s and

56. *See* Report and Order, Deregulation of Radio, 84 F.C.C.2d 968 (1981), *aff'd in part*, Office of Communication of United Church of Christ v. FCC, 707 F.2d 1413 (D.C Cir. 1983).

57. *See* Warner Communications, Inc., *supra* note 18, at 20.

58 18 U.S.C. §§ 1961-68 (1982). *See generally* Sedima, S.P.R.L. v. Imrex Co., 473 U.S 479 (1985).

59. *See, e g*, United States v. Vega, 447 F.2d 698 (2d Cir. 1971), *cert. denied*, 404 U.S. 1038 (1972); Daily Variety, Dec. 24, 1976, at 1, col. 5. *See also infra* note 93 and accompanying text. Although the FCC may investigate allegations of payola (in connection with a license renewal proceeding, for example), it is the Department of Justice that prosecutes alleged violations of section 508. *See, e.g., In re* KMAP, 63 F.C.C.2d 470, 479 (1977).

60. Guitar v. Westinghouse Elec Corp., 396 F. Supp. 1042, 1054-57 (S.D.N.Y 1975), *aff'd mem.*, 538 F.2d 309 (2d Cir 1976).

early 1980s.[61] This growth encouraged contracting-out of record promotion not only because it implicitly raised the size of the penalty for payola by threatening private treble damage suits under RICO, but also because it signaled an increased probability of such litigation. In other words, the expected loss from being implicated in payola expanded significantly. The deterrent effect of RICO—and, indirectly, the deterrent effect of the payola statute—probably increased significantly, just as the deterrent effect of antitrust enforcement increased measurably when private class action suits for treble damages became a credible threat under the antitrust laws.[62]

RICO probably also affected the structure of transactions between independent promoters and radio stations. Either mail fraud or wire fraud[63] can constitute the predicate act of "racketeering activity" necessary for establishing RICO liability. The growth of RICO liability, therefore, created a strong incentive for parties giving or receiving payola to conduct all necessary communications and transactions in person, which in turn probably made record promotion more labor-intensive and raised the minimum scale necessary for temporal and geographic efficiency. It also encouraged close personal relationships between the record promoter and radio station personnel—the nondelegable, highly specific human capital mentioned earlier—that would enable the parties to minimize the volume and specificity of potentially incriminating communication conducted by mail or wire.

D. *Incomplete Contract Specifications*

The threat of RICO liability created an incentive for record companies to retain independent contractors for record promotion in order to insulate themselves from imputed criminal liability or complicity.[64] It also affected the terms of that contractual relationship. During the mid-1980s, a record company would retain independent promoters under contracts with incomplete and unspecified terms that reflected the record company's need to minimize its knowledge of the promoter's

61. ABA SECTION OF CORPORATION, BANKING AND BUSINESS LAW, REPORT OF THE AD HOC CIVIL RICO TASK FORCE 55 (1985).

62. *See* Block, Nold & Sidak, *The Deterrent Effect of Antitrust Enforcement*, 89 J. POL. ECON. 429 (1981).

63. 18 U.S.C. §§ 1341, 1343 (1982).

64. *See generally* Robinson, *Imputed Criminal Liability*, 93 YALE L.J. 609 (1984).

activities. This incompleteness surely reduced the transactional efficiency of the usual bilateral contractual arrangement.

It is highly unlikely that a record company expected that its purchase of independent promotion services came with any guarantee that the independent promoter would secure airplay. Any understanding, express or implied, that such a representation was being made could subsequently implicate the record company and its executives in a violation of the payola statute. Under the federal statute governing criminal complicity, a record company can be punished as a principal to payola if it "aids, abets, counsels, commands, induces or procures" the act of payola or "willfully causes" the act to be done by another, such as an independent promoter.[65] A record company, therefore, would refrain from commanding an independent promoter to contract with a radio station to secure airplay for a record without sponsorship identification. The record company also might avoid inquiring whether the independent promoter uses payola in conducting his business, and particularly whether he intends to use payola to promote the record for which the record company has retained him. For example, when asked how independent promoters could promise to secure airplay, one record company president responded: "You tell me; all I know is how much it costs."[66] If the record company failed to steer this course of precautionary ignorance and the independent promoter in fact dispensed payola, the record company might be deemed to have willfully caused the independent promoter to have committed an act of payola. In that case, the record company could be punished as if its own employee had committed the act of payola.

Some record companies even documented their precautionary ignorance by executing with independent promoters a highly specific no-payola warranty that belied the otherwise vague contractual relationship that one would expect a record company to enter into with an independent promoter. For example, Polygram asserted in a court document that a particular independent promoter

> entered into retainer agreements with . . . Polygram to provide services, on a non-exclusive basis, as [an] independent promoter[] of phonograph records. The terms and condi-

65. *See* 18 U.S.C. § 2 (1982)
66. L.A. Times, Oct. 21, 1983, *supra* note 30, at 20, col. 3.

> tions of the retainer agreement entered into by [the independent promoter] include, among other things, a warranty and representation that [the independent promoter has] read sections 317 and 508 of the Federal Communications Act of 1934, as amended, and the rules and regulations promulgated thereunder, and that none of [the independent promoter's] activities under the retainer agreements would be in violation thereof.[67]

In addition, Polygram required the independent promoter to warrant that he would comply with standards of conduct established by the Record Industry Association of America (RIAA), which prohibited engaging in payola, kickbacks, distribution of illegal drugs, or "attempting to influence in any illegal or unethical manner trade media chart ratings or reviews."[68] Furthermore, Polygram required the independent promoter to sign a standard no-payola affidavit stating that he had read sections 317 and 508 of the Communications Act, would not violate them, and understood the criminal sanctions for violating those statutes.[69] Finally, Polygram asserted that the independent promoter "further warranted and represented that there was no action, proceeding or investigation pending against [him] which would prevent, interfere with or hinder [his] performance under the retainer agreement."[70]

These formalities between Polygram and its independent promoters reduced two legal risks associated with record promotion. First, they reduced the likelihood that Polygram could be found guilty of complicity in a criminal violation of the payola statute that might be committed by an independent promoter. Second, these formalities reduced the risk that, in a civil case alleging some form of tort injury, Polygram could be found liable for the negligent hiring of an independent contractor whose actions caused injury to a third party.

It is far from clear that, by securing such representations from independent promoters, Polygram (and probably other record companies) tacitly encouraged independent promoters to violate the law. Presumably, independent promoters had a comparative advantage in conforming their professional activi-

67. Answer of Defendant Polygram Records at 6, Isgro v. Recording Indus. Ass'n of Am., No 86-2740 (C D. Cal filed June 30, 1986) [hereinafter Polygram Answer].

68. *Id* at 6-7.

69. *Id.* at 7 Radio stations require similar affidavits from employees. *See, e.g., In re* KMAP, 72 F.C.C.2d 241, 251 (1979).

70. Polygram Answer, *supra* note 67, at 7.

ties to the vagaries of the payola statutes (such as the "friendship exception") and, in exchange for a risk premium, were willing to bear the risk of inadvertently violating those statutes from time to time. At the same time, however, there is no reason to believe that independent promoters are not profit maximizers who seek to avoid unnecessary risk. The sentences and fines for violating the payola statute (and other criminal laws) are expected costs that any independent promoter would want to minimize. It is likely that much of the behavior suggested by the popular press to constitute illegal payola was in fact no more than the skillful exploitation of loopholes in sections 317 and 508 of the Communications Act and their accompanying regulations.

The incompleteness of the contractual relationship between the record company and the independent promoter appears also to have influenced the duration of their contract. Despite the likelihood of recurrent engagements of the same independent promoter on the same terms, record companies decided to forgo the transactional efficiency of long-term contracts. *Billboard* reported in March 1986 that independent promoters were hired on a project-by-project basis and that there was "no known contractual relationship between a label and an independent for promotion,"[71] by which *Billboard* evidently meant there was no known long-term contract that explicitly articulated the obligations of both parties and was capable of being enforced by a court. This situation suggests that, in the absence of an explicit government-enforceable contract between the record company and the independent promoter, the record companies relied on "self-enforcing" contracts in which the performance of the independent promoter was ensured not by the record company's threat of litigation, but by its threat of withdrawing repeat business.[72]

E. *Compensation for Contractual Performance*

In light of the record companies' inability to demand a guarantee of receiving actual airplay, it is not surprising that by in-

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71. Billboard, *supra* note 35, at 16.

72. The theory of self-enforcing contracts is explained in Klein & Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 615-16 (1981). *See also* Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521 (1981); Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AMER. ECON. REV. PAPERS & PROC. 356, 358 (1980); Macaulay, *supra* note 39.

dustry custom the independent promoter was paid a retainer plus a fee based on reported airplay. The standard fee for securing reported airplay depended on the relative audience size of the radio station, denoted by *Radio & Record*'s Parallel system. In 1984, the standard fees paid to an independent promoter were $2,000 to $2,500 for securing reported airplay on a Parallel 1 station, $750 for a Parallel 2 station, and $500 for a Parallel 3 station.[73] By 1986, the standard fee for a Parallel 1 station reportedly had risen to $5,000.[74] In addition to paying such fees on a per-reporting-station basis, the record companies paid bonuses called "spiffs:"

> With all the major labels employing the same independents, "spiffing the action" can help to get the promoter's priority, the reasoning goes. If the going rate is $2000, a double "spiff" would be $4000. If another company counters with $4000, the "spiff" could jump to $5000.
>
> "That goes on all the time," said *Radio & Records* [publisher Robert Wilson] . . . . "I've heard they (the independents) are getting $10,000 for certain key (radio station) call letters."[75]

Given the limited capacity for FM airplay in the short run, and the vast number of new pop singles released each week, the demand for airplay—and hence the derived demand for independent promoters' services—probably often exceeded supply. Thus, although standard fees were recognized for securing reported airplay at stations having the same Parallel rating, it seems likely that "spiffing the action" was actually the prevailing pricing practice, which would comport with one independent promoter's claim that there was "intense price competition between the [record] labels in securing the services of independent promoters . . . ."[76]

The escalation in the size of standard fees for independent promotion and the prevalence of the practice of "spiffing the action" suggest that independent promoters were raising price as a form of opportunistic holdup. By 1984, the chairman of Geffen Records, estimated that it would cost about $80,000 to

73. L.A. Times, *supra* note 25, at 8, col. 2.
74. Rolling Stone, *supra* note 19, at 22, col. 1.
75. L.A. Times, *supra* note 25, at 8, col 2.
76. Plaintiffs' Memorandum of Points and Authorities in Opposition to Motions to Dismiss the Complaint Pursuant to Federal Rules of Civil Procedure 11 and 12(b)(6) at 8, Isgro v Recording Indus. Ass'n of Am., No. 86-2740 (C.D. Cal. filed Aug. 11, 1986) [hereinafter Plaintiffs' Opposition Motion].

"break" a record into the Top 40.[77] Merely "breaking" a single into the Top 40, however, does not guarantee that the record will be popular enough to stimulate sales, in profitable quantities, of the album containing the single. Additional promotional expenditures probably would be necessary to achieve a high chart position. The total independent promotion expense for a Top 20 single in early 1986 was reportedly between $150,000 and $250,000.[78]

F. *"Paper Adds"*

A paper add is a report to a trade publication by a radio station that a particular song has been added to the station's playlist when in fact it has not.[79] To the extent that a record company's interest in hiring an independent promoter is to get a song actually played on the radio, the paper add is either a deception of the record company by the independent promoter, or a failure by the independent promoter to perform satisfactorily under the necessarily vague specifications of his contract. Of course, if a paper add at a Parallel 1 radio station fools enough lesser rated CHR stations, then the record may get airplay after all. However, the folklore of the record industry has it that the commercial worth of a record is intrinsically "in the grooves." Supposedly, a paper add lacks this intrinsic worth, causing listeners to reject the record, and the record to descend the hit singles chart more rapidly than would a legitimate hit.

Despite the dissimilarity between the "new payola" scandal of 1986 and prior payola episodes, the paper add problem was analogous to a situation that Professor Coase discovered to have existed in the early 1900s, when a music publisher would pay a singer to include the publisher's songs in his performance.[80] If the singer failed to perform the songs as promised, the publisher would threaten litigation, presumably for breach of contract. Paper adds, however, are more difficult to monitor and remedy than were breaches of contractual performance

77. L.A. Times, *supra* note 25, at 8, col. 3.

78. Wall St. J., *supra* note 28, at 6, col. 1.

79. *Id.* at 6, col. 4; L.A. Times, *supra* note 25, at 1, col. 6; Wall St. J., Feb. 16, 1984, at 37, col. 3. *Radio & Records*, for example, generally does not deem a record to be an "add" unless the reporting station plays it at least four times daily. L.A. Times, *supra* note 25, at 8, col. 4.

80. Coase, *supra* note 1, at 273.

under the common song-plugging agreement between music publisher and vaudeville singer. Even if a record company could monitor an independent promoter to detect instances when he performed unsatisfactorily, the payola prohibition effectively would deny the record company any recourse through litigation.

There are, however, two other possible explanations for paper adds and the suppression of airplay by independent promoters that do not rely on the opportunistic-behavior arguments developed thus far. The first is predation by a dominant record company. Record Company *A* may have hired independent promoters already representing Record Company *B* to suppress or merely seek published (as opposed to actual) airplay of one of *B*'s records.[81] However, press reports of the "new payola" contain no such suggestion. Further, like any predatory strategy, predation through the suppression of a competitor's airplay would require market power by the predator in order to have a chance at successfully monopolizing the market.

A second alternative explanation for paper adds relates to the protection of intellectual property by a highly rated radio station. Such a station might publish an intentionally inaccurate playlist simply to confound rival stations in the same geographic market seeking to erode the first station's market share by imitating its playlist. Unfortunately, this method of protecting rights in intellectual property imposes external costs on record companies and on radio stations in other geographic markets that rely on published playlists.

Paper adds may create substantial social as well as private costs. Unless rationally expected with relative accuracy, the paper adds harm the record company that paid to secure actual airplay, because they cause the record company to fabricate, and record distributors to order, more copies of an album than consumer demand warrants. At the same time, paper adds harm other record companies and radio stations because the intentionally incorrect market information they represent distorts the true ordinal ranking of hit singles and makes pub-

81. The musical *Dream Girls* contains such a suggestion with respect to soul music in the 1960s and 1970s. *See* L.A. Times, *supra* note 25, at 1, col. 2. *Cf.* Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209 (1986); Salop & Scheffman, *Raising Rivals' Costs*, 73 AMER. ECON. REV. PAPERS & PROC. 267 (1983).

lished hits charts less reliable. Although this disinformation may produce some social benefit by protecting the intellectual property of a highly rated radio station in the manner described above, it also reduces the information efficiency of the hit singles market.[82] Finally, if paper adds are a predatory tactic used by one record company against another, they impose the same resource costs identified above, yet without the kind of offsetting windfall to consumers created by an attempt at predatory pricing.[83]

G. *Summary and Implications*

Radio airplay provides advertising for records. FCC regulations, however, limit the ability of record companies to procure available advertising capacity efficiently. The rule of twelves prevents a record company from owning a network of CHR stations of sufficient scale to achieve simultaneous national broadcast exposure of new records, and the payola statutes and the sponsorship identification rules make it illegal to write enforceable contracts for the purchase of unannounced airplay.

The expected penalty cost of violating the payola prohibition probably increased significantly between the late 1970s and 1986 because of the enhanced threat of private RICO litigation. To avoid this expected penalty cost, and probably also to avoid the cost of excess capacity for in-house promotional personnel during a period of declining industry demand, the record companies contracted-out promotional activities to independent promoters. The illegality of payola, however, effectively prevented the record company from fully specifying and monitoring the independent promoter's performance. Knowing this, independent promoters could act opportunistically by raising prices and by shirking duties under their intentionally vague agreements with record companies.

Notwithstanding their ability to act opportunistically, independent promoters appeared to be capable of enhancing the

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82. This reduction in information efficiency is comparable to the "fraud on the market" theory recognized under federal securities law as reducing the information efficiency of the capital markets *See* Note, *The Fraud-on-the-Market Theory*, 95 HARV. L. REV. 1143 (1982). This variety of harm would explain why, in 1985, *Radio & Records* reprimanded, and subsequently dropped from its pool of reporting stations, about twenty stations that repeatedly reported paper adds Rolling Stone, *supra* note 19, at 22, col. 1.

83. *Cf.* Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 269 (1981).

informational efficiency of the market for hit singles. Developing specific human capital for dealing with radio stations, they appeared to create implicit exclusive dealing arrangements with particular highly rated radio stations. At the same time, however, it appears that independent promoters had, and exercised, the power to reduce market efficiency by disseminating false information regarding the amount of airplay actually given to particular records.

II. The "New Payola" Scandal of 1986

The opportunistic behavior that characterized the "new payola" cannot be found in the inquiries into payola during the 1970s. Indeed, those earlier payola incidents suggest that, as recently as the 1970s, independent promoters played no notable role in the allocation of radio airplay. In contrast, the events leading to the "new payola" scandal indicate that, by 1980, the record companies faced a continuing problem of opportunistic behavior that lasted until major legal conflicts and government investigations ensued in 1986.

A. *Payola in the 1970s*

In March 1972, syndicated columnist Jack Anderson reported that he and his associates had "uncovered evidence of a new payola scandal."[84] Record companies, he alleged, furnished radio station personnel with cash or cash equivalents, along with free records that could then be sold to retailers (and possibly even returned by each retailer to the record company for full credit against the applicable wholesale price).[85] The RIAA's president reacted diplomatically: "Reported instances of payola do not in my judgment reflect the true broad profile of the recording industry . . . . But there are undoubtedly some single 'bad apples' among us . . . ."[86] No industry-sponsored or

84. Anderson, *New Disk Jockey Payola Uncovered*, Washington Post, Mar. 31, 1972, at D15, col. 5.

85. In much the same way, MCA was alleged in 1986 to have engaged in or been victimized in two separate incidents by suspicious transactions involving "cut-out" records. Cut-outs are surplus records no longer considered saleable by a record company and therefore sold in bulk at substantial discounts. L.A. Times, Mar. 3, 1986, § IV, at 1, col. 2; Wall St. J., Mar. 31, 1986, at 15, col. 6; L.A. Times, Mar. 31, 1986, § IV, at 1, col. 5. *See also* L.A. Times, Nov. 20, 1986, § IV, at 2, col. 3; Billboard, Nov. 29, 1986, at 74.

86. Recording Industry Association of America, Inc., Press Release (Mar. 31, 1972) (quoting RIAA president Stanley M. Gortikov).

federal investigation resulted from Mr. Anderson's article.

Events with broader repercussions unfolded in May 1973, when a federal grand jury in Newark, while investigating drug charges against a mob figure, uncovered a connection to the director of artist relations at Columbia Records (now the CBS Records Group). Allegations of deficient internal controls, conflicts of interest, involvement with organized crime and narcotics, and payola quickly followed. Columbia's president ultimately was fired, although he was not implicated in the charges.[87]

By late June 1973, the focus of the Newark grand jury expanded to include other record companies, radio stations, and industry practices.[88] The RIAA's president issued a statement on July 1, 1973 acknowledging the possibility that some of the reported practices might be taking place and urging record companies to establish monitoring systems to guard against such practices. In turn, Senator James L. Buckley of New York called for an investigation into the by-then widely reported drug and payola charges of the FCC, Internal Revenue Service, and other government agencies.[89] On July 3, 1973, he wrote to the presidents of the RIAA and the major record companies, inquiring into the extent of drug use by prominent recording artists. On August 1, 1973, the Senate Subcommittee on Patents, Trademarks and Copyrights, chaired by Senator John L. McClellan of Arkansas, announced that it too would investigate alleged corruption in the music business.[90]

The RIAA promised full cooperation with Senator Buckley's and Senator McClellan's inquiries. Later, the RIAA announced a "comprehensive action program designed 'to help insure that business practices within the industry are based on sound legal and moral principles.' "[91] In particular, the program promulgated standards of conduct, calling for any record company

87. Wall St. J., June 19, 1973, at 46, col. 1; N.Y. Times, June 20, 1973, at 27, col. 1.

88. N.Y. Times, June 22, 1973, at 1, col. 1; L.A. Herald-Examiner, July 8, 1973, at 1; N.Y. Times, July 19, 1973, at 22, col. 4 (eight additional stations subpoenaed), Billboard, July 21, 1973, at 1; L.A. Times, July 22, 1973, Calendar Sec., at 1, col. 1. *Cf* Rolling Stone, Aug. 2, 1973, at 6.

89. N.Y. Times, July 11, 1973, at 48, col. 1.

90. N.Y. Post, July 11, 1973, at 9; N.Y. Times, July 14, 1973, at 55, col. 4; N.Y. Post, July 18, 1973, at 2; Rolling Stone, Aug. 2, 1973, at 12.

91. Recording Industry Association of America, Inc., Press Release (July 23, 1973); Billboard, Sept. 15, 1973, at 10.

employee who maintains contact with radio stations to sign a "no-payola" affidavit of the sort described in Part I.

Ultimately, twenty-one persons were named in indictments from the Newark grand jury. In June 1975, seven indictments were handed down by grand juries in four cities, naming nineteen persons (including the presidents of three record companies) and six corporations.[92] At least three subsequent payola indictments publicly reported in December 1976 actually resulted from the Newark grand jury investigation.[93] Thereafter, and possibly in receipt of the Newark grand jury's conclusions, the FCC announced that it would hold additional hearings into payola.[94] Its focus was not so much the classic pay-for-play payola as the conflicts of interest experienced by radio station personnel involved in related business ventures, such as record production and concert promotion.[95] Following extensive public hearings in Washington, D.C. in early 1977, the FCC inquiry was converted into a non-public proceeding[96] and subsequently transferred to Los Angeles, where it faded from view.[97]

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92. Wall St. J., June 25, 1975, at 2, col. 2.

93. In one incident, the program director of a New York radio station was indicted and subsequently convicted of perjury for falsely denying to the Newark grand jury that he had received payola. Variety, Dec. 15, 1976, at 61; Variety, Dec. 22, 1976, at 85 In another incident, three former officers of Avco Records pleaded guilty to conspiring to pay payola Daily Variety, Dec. 24, 1976, at 1. In a third incident, the general manager of a Union, New Jersey radio station was indicted for tax evasion based upon his failure to report payola income. Daily Variety, Dec. 22, 1976, at 85.

94. *In re* Inquiry into Alleged Violations of Sections 317 and 508 of the Communications Act of 1934, As Amended, and the Rules Thereunder, 62 F.C.C.2d 111 (1976); Billboard, Jan. 8, 1977, at 1.

95. Billboard, May 28, 1977, at 6. *See also* Billboard, Mar. 12, 1977, at 4; Billboard, June 4, 1977, at 4.

96. *In re* Inquiry Into Alleged Violations of Sections 317 and 508 of the Communications Act of 1934, As Amended, and the Rules Thereunder, 65 F.C.C.2d 90 (1977). The FCC said that "the proceeding was closed in large part to facilitate the gathering of evidence from members of the music and entertainment industry reluctant to testify publicly about improper or illegal behavior." *In re* Booth Am. Co., 76 F.C.C.2d 434, 441 (1980).

97. Billboard, July 23, 1977, at 3. Federal investigations of the record industry shifted to alleged price fixing, for which a grand jury was convened in Los Angeles in November 1976. Variety, Feb. 2, 1977, at 1, col. 5; N.Y. Times, Feb. 13, 1977, at 19, col. 1; L.A. Times, Mar. 7, 1981, § I, at 19, col. 1. In April 1979, the head of the Los Angeles office of the Antitrust Division of the Justice Department recommended the indictment of several record companies. *Id.* Although no indictments resulted, the major record companies subsequently paid $26.2 million to settle price-fixing claims brought by private plaintiffs. *See* United Nat'l Records v. MCA, 1985-2 Trade Cas. (CCH) ¶ 66,846 (E D. Ill. 1985).

B. *Independent Promotion in the Early 1980s*

The "new payola" scandal of 1986 did not resemble the payola scandals of the 1970s. By 1980, record companies used independent promoters extensively for record promotion. In November 1980, WCI terminated its relationships with independent promoters[98] because, in the words of the chief executive of WCI's Elektra/Asylum label, the costs had become "unbearable," having increased during "the last several years . . . four and five times what they once were," thus representing for some record companies "the difference between a profit and a loss."[99] Even before WCI severed its ties with independent promoters, the other major record companies reportedly had considered terminating their independent promoters,[100] but apparently faced a prisoners' dilemma. One record company executive said that the record companies previously had not dropped their independent promoters "because each company wanted the next company to do it first" and that the "lead had to be taken by the Warner Communications labels or CBS."[101] Even when WCI did terminate its independent promoters, no other record company openly followed WCI's "lead;" instead, WCI's competitors reportedly increased their independent promotion expenditures to gain greater shares of airplay.[102]

Under an implicit self-enforcing contract, the termination of repeat business (rather than litigation) is the method of punishing opportunistic behavior. However, like the unsuccessful efforts of music publishers to ban payola in 1916 and 1917,[103] WCI's November 1980 termination of independent promoters lasted only briefly. By 1981, WCI reportedly had resumed us-

98. Billboard, Nov 8, 1980, at 1; L.A. Times, *supra* note 48, at 82, col. 3.

99. L.A. Times, *supra* note 48, at 82. The total cost of successfully promoting one hit single reportedly had risen to $150,000. *Id.* One record executive said that the high cost of independent promotion had driven the break-even output level for a pop release to more than 250,000 units, so that "we're losing money even on hit records." *Id.* By dropping independent promoters, WCI was expected to save between $3 million and $6 million annually. Billboard, *supra* note 98, at 1.

100. Billboard, *supra* note 98, at 49. One record company president said that independent promotion was "an expensive part of promotion and it's gotten out of hand in the last four months." Billboard, Nov. 15, 1980, at 3 (quoting RSO Records president Al Coury).

101. Billboard, *supra* note 98, at 49.

102. *See* L.A. Times, *supra* note 30, at 21, col. 3. CBS reportedly considered such action and subsequently may have discontinued or curtailed use of independent promoters. Billboard, *supra* note 98, at 1.

103. Coase, *supra* note 1, at 272-79.

ing independent promoters,[104] suggesting either that WCI successfully persuaded independent promoters to improve the quality of their performance or, more likely, that WCI had an inadequate remedy under its seemingly self-enforcing contracts because independent promoters enjoyed some degree of market power by which they could harm record companies that chose to terminate repeat business. It seems, therefore, that if the high price of independent promotion contained an implicit premium to independent promoters not to engage in opportunistic behavior, WCI's inability to do without the service signaled that the premium was too low.[105]

Record executives perceived that independent promoters had the ability to exclude records from receiving radio airplay at major CHR stations. Some record executives speculated that WCI's decline in profitability in 1982 reflected its supposed inability to gain radio exposure for its releases because of retaliation by independent promoters for WCI's termination of business relationships with those promoters in November 1980.[106] Despite the perception that independent promoters were engaging in extortion, WCI's unsuccessful attempt in 1980 to end its use of independent promoters evidently did not prompt any government inquiry. In 1983, however, then-Representative Albert Gore, Jr. did call for an investigation into payola.[107] No hearings were ever held, however, because potential witnesses refused to testify. Some witnesses, Senator

104. L.A. Times, *supra* note 25, at 8, col. 1.

105. As Professors Klein and Leffler have shown with respect to opportunistic behavior generally, the magnitude of the price premium that constitutes "protection money" is the discounted value of the expected gain from opportunistic hold-up. It is the product of (1) the extent of contractual incompleteness (that is, the probability of hold-up) and (2) the amount of specific and nonsalvageable capital in which the victimized party has invested (that is, the gain derivable from the hold-up). Klein & Leffler, *supra* note 72, at 624; Klein, *supra* note 72, at 358. However, in the absence of any obvious specific investments by the record company in independent promoters, the ability of independent promoters to raise prices is evidence not of opportunistic hold-up so much as market power, resulting from economies of scale or (as we tended to dismiss earlier, *see supra* text following note 36) collusion.

106. Several years later, the publisher of *Radio & Records* was quoted as saying: "When CBS and Warner quit using independents, there is no doubt that the 'indies' tried very hard to keep their records off the air." L.A. Times, *supra* note 25, at 8, col. 2. The publisher said that significant Parallel 1 stations were "holding . back" CBS and Warner records and likened the payment of independent promotion fees to "protection money." *Id* at 8, col. 1. Consequently, record company executives have often cited the episode to support their belief that "failure to pay the most influential promoters on a fairly regular basis can lead to a record's being in effect blacklisted from the airwaves." *Id.*

107. United Press Int'l Release, *supra* note 10.

Gore subsequently said in 1986, refused to testify because of the fear of physical retaliation, and others refused because of a "conspiracy of silence" in the record industry.[108]

C. *The Senate's Preliminary Investigation of 1984*

The *Los Angeles Times* was instrumental in publicizing the phenomenon of paper adds and the escalating cost of independent promotion. On October 21, 1983, the *Times* stated in a front-page story that The Network was responsible "for promoting nearly every single that the [record] companies believe has a shot at success," including records by popular acts such as Michael Jackson and The Police.[109] According to the *Times*, the record companies in 1983 feared that independent promoters would suppress airplay if they did not buy independent promotion services.[110] The program director at a major Top 40 radio station said that "pretty regularly" a particular independent promoter "would tell my boss, 'Don't go on this record because the record label has not been willing to pay for having that one promoted.' "[111] Of course, the independent promoter could have been conveying valuable information to the program director: The record company may have been unwilling to allocate independent promotion funds for a particular record because it believed that the record lacked commercial potential. In this respect, a record company's decision to employ independent promotion on a record might have served as a credible commitment—a market signal of the degree to which the record company itself believed that it was supplying radio stations with a record that consumers actually would demand.[112]

The *Los Angeles Times* followed its October 21 article with a November 1, 1983 editorial calling for a government investigation to determine whether independent promoters were using

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108. L.A. Times, *supra* note 10, at 12, col. 6.

109. L.A. Times, *supra* note 30, at 1, col 1

110. The president of one record company reportedly said:

> These are very powerful guys, and dangerous in terms of the effect they can have on your company. I wouldn't go so far as to say that they can keep your records off the radio, it's just that the records don't seem to get on if you don't hire them.

Id. at 20, col. 2.

111. *Id.*

112. *See* Klein & Leffler, *supra* note 72, at 633-34.

payola to secure airplay.[113] On March 18, 1984, the *Times* published another exposé on independent promotion,[114] this time focusing on the attempt of Geffen Records (a WCI affiliate) to secure airplay for the single *I Am Love* by Jennifer Holliday.[115] The *Times* also uncovered evidence that some stations may have reported the song as a paper add. In particular, the *Times* said that Geffen Records had hired a prominent Los Angeles independent promoter to attempt to have *I Am Love* added to the playlist of KIQQ, a highly rated CHR station in Los Angeles; that *Radio & Records* reported that KIQQ had added the song to its playlist; and that Geffen Records consequently paid the independent promoter a standard fee of $2,500. The *Times* maintained, however, that KIQQ never actually played the song, a fact which the *Times* claimed to verify in a subsequent interview with KIQQ's program director.[116]

In response to these *Los Angeles Times* stories, the Subcommittee on Oversight and Investigation of the House Committee on Energy and Commerce conducted a three-month preliminary investigation of independent promotion in 1984. The Subcommittee concluded on September 14, 1984 that, although paper adds made the broadcast industry "susceptible to improper relationships between promoters and radio stations,"[117] a full Senate investigation was unwarranted:

> The Subcommittee staff determined that because of the enormous sums of money involved and the manner in which record promotion and the charting of records operate, there are ample opportunities and incentives for improper or illegal activities. However, while the staff found this industry susceptible to such improper activities, the staff uncovered no credible evidence of specific incidents of improper or illegal activity. As a consequence, the staff recommends that the Subcommittee not undertake a full investigation at this time.[118]

Specifically, the Subcommittee found that it would not violate the payola statute to compensate an independent promoter "if

113. L.A. Times, Nov. 1, 1983, § II, at 6, col. 1.

114. L.A. Times, *supra* note 25, at 1, col. 1.

115. On FEEL MY SOUL (Geffen Records, 4014-2, 1983).

116. L.A. Times, *supra* note 25, at 8, col. 1. KIQQ, however, disputed the allegation that it had intentionally misreported airplay of *I Am Love* to *Radio & Records* so as to generate a paper add. *Id.*

117. 1984 Subcommittee Memorandum, *supra* note 35, at 3.

118. *Id.* at 2.

he could encourage a radio station employee to report that a particular record was being played whether or not that record was in fact broadcast on the station."[119] In other words, the Subcommittee confirmed the legal conclusion that independent promoters no doubt already understood and acted upon—namely, that paper adds cannot constitute unlawful payola because section 508 prohibits only the undisclosed acceptance of valuable consideration for the actual *broadcast* of programming material. The mere *reporting of airplay* by a station in exchange for valuable consideration does not necessarily imply the existence of an agreement to sell undisclosed airplay.

Notwithstanding the Subcommittee's opinion that paper adds cannot constitute payola, lawyers for the National Association of Broadcasters in June 1985 warned members: "While 'paper adds' don't appear to break any specific FCC rule . . . the misreporting of such information by phone may violate the Federal Wire Fraud statute," invite "civil suits for fraud," and "be considered by the FCC as bearing on the licensees' character qualifications."[120] A likely plaintiff in such a civil suit would be a disgruntled record company that had retained an independent promoter who had secured a paper add.[121]

In January 1986, a startup company called Broadcast Recognition Systems tested a radio monitoring system capable of, among other things, evaluating the frequency of paper adds. The company entered digital patterns of hundreds of pop songs into a computer and, with the cooperation of MCA Records, continuously compared those patterns, on a twenty-four-hour basis for twelve weeks in early 1986, to the live broadcasts of the five most highly rated rock or Top 40 radio

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119. *Id.* The Subcommittee also concluded that no violation of the payola statute could arise from the common practice of compensating an independent promoter "if he obtained a copy of a station's play list in advance of its publication, thereby claiming to the record company that he secured the company's position on the play list." *Id.* It is difficult to imagine what purpose this practice would serve other than to confound the record company's attempts to monitor an independent promoter's contractual performance

120 Billboard, Apr. 19, 1986, at 91. *See also* Billboard, *supra* note 35, at 106. These warnings followed renewed press reports that record companies were distributing payola through independent promoters. N.Y Times, Mar 6, 1985, at A14, col. 3.

121 If one accepts the predation explanation for paper adds, the plaintiff could be a record company claiming antitrust or business tort injury caused by a conspiracy between a rival record company, an independent promoter, and a radio station. Alternatively, if one accepts the intellectual property explanation for paper adds, the plausible plaintiff would be a lesser rated radio station alleging that it had detrimentally relied on fraudulently inaccurate published playlists.

stations in Los Angeles. The results confirmed that the published playlists of these radio stations contained errors of substantial magnitude and raised the possibility that a new technology would reduce the cost of monitoring the contractual performance of independent promoters.[122]

D. *The Record Industry's Aborted Investigation of 1985-86*

Even before Broadcast Recognition's results were available, MCA, along with Motown and Arista (an RCA/Ariola affiliate), had urged the RIAA to investigate independent promoters.[123] The *Wall Street Journal* reported that, in a letter dated July 15, 1985, Motown's president wrote to the president of the RIAA: "We should be meeting about the high cost of trying to get our records played on radio, which, to a great extent, has nothing to do with the record's quality but rather with who pays the most."[124] By 1984, the industry reportedly was spending between $40 and $60 million on independent promotion,[125] and, by 1985, between $60 and $100 million.[126]

On October 1, 1985, the RIAA's board of directors resolved to spend up to $100,000 for a private investigation "to determine whether or not the conduct of Independent Promotion involves or results in criminal violations or other violations of federal regulations or law."[127] An RIAA memorandum concluded that independent promoters would most likely have violated payola, mail fraud, wire fraud, and RICO statutes under federal law, and fraud, extortion, and blackmail statutes under state law.[128] The memorandum stated that the investigation's purpose was "to determine whether or not there is a need for

122. For example, one station ranked Falco's *Rock Me Amadeus* No. 1 when the song was actually No. 23 on the basis of airplay. Another station ranked Prince and the Revolution's *Kiss*, on PARADE (Paisley Park/Warner Bros. Records, 25395, 1986), No. 20 when the song was actually No. 1 on the basis of airplay. Wall St. J., May 2, 1986, at 28, col. 3; Radio & Records, May 23, 1986, at 37; Billboard, May 17, 1986, at 10; H B. Oppenheimer & Associates, Inc., Preliminary Draft of MCS Presentation to Record Companies (Apr. 25, 1986)

123 Wall St. J., *supra* note 28, at 6, col. 1.

124. *Id.* at 6, col. 4.

125. 1984 Subcommittee Memorandum, *supra* note 35, at 2.

126. N.Y. Times, Feb. 28, 1986, at D3, col. 1; Daily Variety, Mar. 3, 1986; Wall St. J., Mar. 6, 1986, at 35, col. 1.

127. J. Schoenfeld, Memorandum on Investigative Project Regarding Independent Promotion to RIAA Legal Committee 1 (Nov. 4, 1985), *reprinted in* Plaintiffs' Opposition Motion, *supra* note 76, at Ex. E. The board's vote was reportedly 23-3. Wall St. J., *supra* note 28, at 6, col. 1.

128. J. Schoenfeld, *supra* note 127, at 1.

civil litigation or the filing of complaints with appropriate Government agencies."[129] Despite the seemingly narrow mandate of the October 1 resolution, the RIAA memorandum envisioned that an RIAA attorney would meet with "company counsel and key company executives or promotional personnel" at the various record companies "to obtain all information about the normal practices of independent promoters."[130] CBS reportedly opposed the generality of this proposed investigation, both because its own internal investigation had failed to uncover improprieties committed by independent promoters and because CBS believed that an investigation jointly undertaken by competing record companies through its trade association might invite an antitrust suit by an independent promoter alleging a group boycott.[131] CBS finally agreed in mid-October 1985 to support an RIAA investigation that would examine not the overall business practices of independent promoters but rather the narrower question of whether they had committed violations of law.[132]

Quite apart from fearing litigation, and in light of the unsuccessful efforts of WCI (and possibly CBS) to drop independent promoters in 1980, CBS and the other record companies probably were skeptical that even an overt collective reprisal against independent promoters could be sustained. The record companies again confronted a prisoners' dilemma: A boycott of independent promoters would benefit a record company that secretly continued to pay for airplay, while it would harm any

129. *Id.* at 2. In great likelihood, if the RIAA were to turn over evidence of wrongdoing to prosecutors in the hope of instigating a government investigation and prosecution of independent promoters, it and its members would be protected from antitrust liability by the *Noerr-Pennington* doctrine. United Mine Workers v. Pennington, 381 U.S. 657 (1965); Eastern R.R. President's Conf. v. Noerr Motor Freight, 365 U.S. 127 (1961). Generally speaking, this doctrine immunizes from antitrust liability good faith efforts, even if conducted cooperatively between horizontal competitors, to influence governmental bodies to act in a manner that may impose a competitive disadvantage on another firm or set of firms. At least one appellate court has extended the immunity to investigations to uncover criminal wrongdoing by another firm that has harmed the investigating firm. Forro Precision v. International Bus. Machs. Corp., 673 F.2d 1045, 1060-61 (9th Cir. 1982), *cert. denied*, 471 U.S. 1130 (1985).

130. J. Schoenfeld, *supra* note 127, at 2.

131. Wall St. J., *supra* note 28, at 6, col 1. CBS probably feared the similarities between the RIAA's proposed actions and those held to violate the antitrust laws in Fashion Originators' Guild of Am. v. FTC, 312 U.S. 457 (1941). In that case, a group of competitors organized a boycott of retailers who, through opportunistic behavior that was prohibitively costly for the defendants to monitor, facilitated the recurring misappropriation of the defendants' intellectual property.

132. Wall St. J., *supra* note 28, at 6, col. 1.

record company foolish enough to continue its boycott. Professor Coase showed that this kind of prisoners' dilemma rapidly thwarted the boycott of payola in 1916 and 1917 by music publishers.[133] Not surprisingly, the RIAA dropped its investigation on January 23, 1986, when two independent record companies (Chrysalis and A&M) and the most chronically unprofitable of the major record companies (Polygram) refused to participate.[134]

Some journalists insinuate that commercial bribery motivated the reluctance of record executives to endorse the RIAA's proposed investigation of independent promoters. The *Los Angeles Times* reported that the 1986 New York grand jury investigating the record industry was "looking into suspected 'kickbacks' from promoters to record executives,"[135] which *Rolling Stone* reported were rumored to equal ten to twenty-five percent of expenditures for independent promotion.[136] Although prior allegations of malfeasance by senior management in the entertainment industry lend some plausibility to this possibility,[137] neither the *Times* nor *Rolling Stone* ever substantiated their kickback theory regarding the RIAA's proposed investigation.

E. *The 1986 Suspension of Independent Promoters*

On February 24, 1986 the *NBC Nightly News* (which, like RCA Records, was at that time owned by RCA Corp.) reported from New York, in a story entitled "The New Payola," that "the FBI and police as far away as Los Angeles" were investigating "corrupt practices in the rock music business, and what appears to be re-emergence of payola at rock music radio stations."[138] NBC identified only two independent promoters and described them as "two of the most powerful and feared men in the rock

133. Coase, *supra* note 1, at 272-79.

134 Wall St. J., *supra* note 28, at 6, col. 1.

135 L A. Times, *supra* note 10, at 12, col. 2. *See also* N.Y. Times, Mar. 6, 1985, at 14, col. 3

136. Rolling Stone, *supra* note 19, at 21.

137 *See* D. McCLINTICK, INDECENT EXPOSURE (1982).

138. *NBC Nightly News* Transcript, Feb. 24, 1986, at Revised 11, *reprinted in* Affidavit of Ira S. Sacks in Support of Motion to Dismiss, Ex. E, Isgro v. Recording Indus. Ass'n of Am., No. 86-2740 (C.D. Cal. filed Aug. 11, 1986) [hereinafter *NBC Nightly News* Transcript]. *Billboard* earlier had reported in its gossip column "Inside Track" that a major television news network would soon broadcast an investigative report on the record industry. Billboard, Feb. 15, 1986, at 78.

music business."[139] The report alleged that many independent promoters had connections with organized crime, that the two independent promoters specifically identified had met in New York in January 1986 with leaders of the Mafia,[140] and that independent promoters had produced "a climate of fear in the rock music business."[141]

On February 27, a federal grand jury in New York subpoenaed the RIAA to produce all documents and materials regarding "an investigation into the role of independent promoters in the record industry and/or into related topics."[142] That same day, Capitol and MCA suspended use of independent promoters.[143] Capitol's chief executive said that his decision was prompted by the *NBC Nightly News* report, and that although Capitol had "no evidence to support the NBC allegations," it would conduct an internal investigation "to reassure ourselves that our company does not contribute unwittingly to any problem that might exist."[144] Capitol immediately instructed its law firm to review the company's "long-standing anti-payola program."[145]

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139. *NBC Nightly News* Transcript, *supra* note 138, at Revised 11.

140. *Id.*

141. *Id.* at Revised 13. On March 14, 1986, the attorney for one of the two independent promoters identified in the *NBC Nightly News* report demanded a correction and retraction from NBC, which NBC apparently refused to give. Letter from Steven J Cannata to NBC Nightly News 14 (Mar. 14, 1986), *reprinted in* MCA Records, Inc.'s Notice of Motion and Motion to Dismiss Pursuant to Rules 11 and 12(b)(6) of the Federal Rules of Civil Procedure, Ex. B, Isgro v. Recording Indus. Ass'n. of Am., No. 86-2740 (C.D. Cal. filed Aug. 11, 1986).

Only two persons interviewed by NBC actually appeared on camera—a Miami disc jockey who said that he had turned away offers of cash and cocaine from independent promoters, and a former disc jockey who claimed to have been threatened and blackballed when he started a record promotion business and stated publicly that he would not use payola. Billboard, Mar. 8, 1986, at 91. *Cf.* Variety, July 24, 1985, at 125, col. 5 (discussing no-payola record promotion firm).

142. Grand Jury Subpoena Duces Tecum to Recording Industry Association of America (filed Feb. 27, 1986 S.D.N.Y.), *reprinted in* Affidavit of Ira S. Sacks in Support of Motion to Dismiss, Ex 5, Isgro v. Recording Indus. Ass'n of Am., No. 86-2740 (C.D Cal. filed Aug. 11, 1986) [hereinafter RIAA Subpoena]. *See also* Daily Variety, Mar. 3, 1986 at 1.

143. N Y. Times, *supra* note 126, at D3, col. 1; Daily Variety, Feb. 28, 1986, at 1, col. 3.

144. N.Y. Times, *supra* note 126, at D3, col. 1-2.

145. Billboard, Mar. 8, 1986, at 1. That same evening, the disc jockey who appeared on the *NBC Nightly News* three days earlier, *see supra* note 141, reportedly was beaten by four armed men as he left radio station WINZ in Miami, although he apparently never filed a police report and refused to comment on the incident to FBI agents who questioned him afterwards. *See* Billboard, *supra* note 35, at 3; Rolling Stone, Apr. 24, 1986, at 22; Newsweek, Mar. 17, 1986, at 26.

By March 5, each of the remaining major and independent record companies had announced plans to reduce its use of independent promoters.[146] By March 6, the *Los Angeles Times* reported that record company executives already were speculating "which company—eager for an edge on the competition—will be the first to re-enter the controversial world of independent promotion."[147] One record executive called it "naive" not to expect record companies to resume independent promotion by June 1986.[148] This resumption, he said, would test whether "the labels can now cooperate in ways that they haven't been willing to do in the past" in order to "create a new system which doesn't cost a fortune and which will have . . . accountability that we haven't seen up until now."[149] During the final week of March, a federal grand jury in New York subpoenaed CBS, MCA, and Capitol to produce all documents regarding their use of independent promoters since January 1978.[150] On April 2, 1986, Senator Gore announced that the Senate Subcommittee on Investigations would investigate record promotion practices,[151] adding that "the record companies are the ones . . . most anxious about stamping this out."[152]

F. *The Aftermath of the 1986 Suspension*

Within a month of the suspension of independent promoters, the price of independent promotion reportedly fell by as much as fifty percent for AOR radio stations.[153] Demand for independent promotion shifted partly to the recording artists themselves and to music publishers, who previously benefited from the record companies' promotion expenditures.[154] Record companies appeared to increase expenditures for radio contests and giveaways[155] and substituted more in-house promotion personnel for independent promoters, in some cases

146 Daily Variety, *supra* note 142, at 1, col. 2; Daily Variety, Mar. 4, 1986, at 1; Wall St. J., *supra* note 126, at 35, col. 1.

147 L.A. Times, Mar. 6, 1986, § VI, at 1, col. 6.

148 *Id*

149. *Id.* at 12, col. 2.

150. Wall St. J., Apr. 1, 1986, at 3, col. 4; L.A. Times, *supra* note 10, at 1, col. 2.

151. Billboard, *supra* note 10, at 1; L.A. Times, *supra* note 10, at 1, col. 2.

152. Billboard, *supra* note 10, at 1.

153. Billboard, Apr. 5, 1986, at 77; Billboard, May 24, 1986, at 1.

154. Billboard, *supra* note 35, at 3.

155. Billboard, June 28, 1986, at 1.

hiring former independent promoters.[156] Some independent promoters changed the names of their businesses, calling themselves "marketing consulting firms."[157] *Billboard* reported, though not with statistical rigor, that radio stations had become more averse to adding records by new artists and that new records were taking longer to gain airplay at enough stations to "debut" on and ascend the national hits chart.[158] Meanwhile, Broadcast Recognition Systems claimed that substantial errors continued to appear in the published playlists of radio stations.[159]

On April 30, 1986, one of the two independent promoters identified by the *NBC Nightly News* filed an antitrust suit, claiming injury of $25 million, against the RIAA and all the major and independent record companies (or their affiliated labels) except CBS.[160] The independent promoter excluded CBS because he said there was not "any evidence of conspiracy or collusion with CBS at this time."[161] As an affirmative defense, Polygram asserted that the independent promoter had breached his retainer agreement by violating his no-payola representations and warranties.[162] Polygram also asserted that it was justified in terminating the independent promoter simply because of his implication in alleged violations of the payola and RICO statutes.[163] Although the "new payola" scandal did not prompt the FCC to launch any investigation of its own,[164] it did prompt three more grand juries in August 1986 to commence investigations into the record industry.[165]

By early 1987, the "new payola" scandal had faded, Senator

156. Billboard, *supra* note 153, at 3; Daily Variety, June 30, 1986, at 1, col. 4; Billboard, July 12, 1986, at 1.

157. Rolling Stone, *supra* note 19, at 21.

158. Billboard, *supra* note 35, at 106; Billboard, Apr. 26, 1986, at 1, col. 1.

159. Billboard, May 17, 1986, at 10.

160. Complaint in Isgro v. Recording Indus. Ass'n of Am., *supra* note 33. Motions to dismiss the plaintiff's lawsuit were denied in August and October 1986. Daily Variety, Aug. 12, 1986; Daily Variety, Oct. 17, 1986, at 31, col. 1. Another independent promoter filed a virtually identical complaint in September 1986. Complaint in BAMA, Inc. v. Recording Indus. Ass'n of Am., No. 86-6214 (C.D. Cal. filed Sept. 23, 1986) *See* Billboard, Oct. 11, 1986, at 94, col. 1.

161. Daily Variety, Apr. 30, 1986, at 16; Billboard, May 17, 1986, at 83, col. 1.

162. Polygram Answer, *supra* note 67, at 7-8.

163. *Id* at 6.

164. Daily Variety, May 12, 1986, at 1.

165. Daily Variety, Aug. 27, 1986, at 1. In September 1986, the Newark grand jury issued a 117-count indictment against twenty-one individuals that included charges of loan sharking and extortion, but not payola. Wall St. J., Sept. 24, 1986, at 18, col. 1; Daily Variety, Sept. 24, 1986, at 1, col. 5.

Gore's investigation reportedly having uncovered no evidence of wrongdoing.[166] After the November 1986 election, Senator Gore left the Permanent Subcommittee on Investigations to chair a different committee, leaving the Senate's investigation without any official head.[167] In April 1987, a spokesman for the Senator said that the investigation was "way on the back burner."[168] And, in May 1987, Capitol Records reportedly settled, on undisclosed terms, the first of two antitrust suits filed by independent promoters.[169]

G. *Summary*

It is curious that the RIAA's proposed investigation evidently did not consider the possibility that independent promoters might have violated sections 1 and 2 of the Sherman Act,[170] because horizontal price fixing or market allocation would be consistent with the high cost of independent promotion. This conspicuous omission suggests that the record companies were less concerned about the possibility of horizontal collusion among independent promoters than the possibility of opportunistic behavior resulting from the costliness of specifying and monitoring contractual performance for record promotion.

The "new payola" scandal of 1986 probably also resulted from different economic concerns than those that motivated prior payola scandals. The 1986 scandal reveals that an elaborate industry structure arose between 1978 and the early 1980s to shield the record companies from the risk of criminal or civil liability associated with the prohibition against using payola to procure airplay. Although this industry structure successfully shifted legal risk onto independent contractors, it introduced a new cost for record companies in the form of opportunistic behavior. The hallmark of this opportunistic behavior was the paper add—the intentional misreporting of radio airplay.

Opportunistic behavior is unstable over the long run. Predictably, the record companies tried several times during the 1980s to discontinue use of independent promoters. Finally, in 1986 the record companies either succeeded in instigating a

166 Rolling Stone, Mar. 26, 1987, at 30, col. 1.

167. Billboard, Feb. 14, 1987, at 3, col. 4.

168. L.A. Times, Apr. 24, 1987, § VI, at 2, col. 2.

169. L.A. Times, May 6, 1987, § IV, at 2, col. 6. Capitol was the only defendant reported to have reached a settlement with the independent promoter. *Id.*

170. 15 U.S.C. §§ 1, 2 (1982).

federal grand jury investigation of independent promotion or were fortunate enough to have such an investigation provide them the justification for simultaneously terminating their independent promoters for CHR radio stations. However, even terminating this inefficient form of independent contracting entailed transactions costs in the form of an antitrust suit against all the record companies except CBS.

III. Vertical Integration as a Counterstrategy

Why did the record companies not simply vertically integrate into radio broadcasting during the 1980s in order to obviate independent promotion? Given that the value of a record master is highly dependent on the accompanying allocation of radio airplay and that the costs of contract specification and monitoring are high, one would expect that a single firm would own both assets.[171] In other words, vertical integration would be a counterstrategy for opportunistic behavior. A record company that did vertically integrate into radio broadcasting would insulate from the payola statutes its allocation of captive airplay capacity at its affiliated radio stations. For example, if MCA acquired a highly rated CHR station, it could require the station to play every new MCA release. Elevating form over substance, section 317 of the Communications Act would permit an allocation of radio airplay achieved through complete vertical integration by merger while condemning the identical allocation if achieved (probably with a far smaller capital requirement) through partial vertical integration by contract. Of course, even after its acquisition by MCA, the radio station would still play the most popular songs by recording artists signed to other labels, because the merged firm would seek to maximize the combined profits from selling MCA's prerecorded music and the radio station's advertising time.

RCA Corp. and CBS did own radio stations, of course. As of 1986, RCA owned three AM and five FM stations, most broadcasting the "Adult Contemporary" format.[172] Evidently, however, only CBS expanded the scale of its radio network during 1978-86; it owned six AM and seven FM stations until July 1985, when, less than one year after the FCC relaxed the rule

171. Klein, Crawford, & Alchian, *supra* note 16, at 300.
172. Wall St. J., Oct. 16, 1986, at 14, col. 3.

of sevens to the rule of twelves, it acquired five more stations, for a total of seven AM and eleven FM stations.[173] There appears to be, therefore, only one instance suggesting that the FCC's rule limiting the horizontal scale of a radio network prevented efficient vertical integration by record companies. It is equally puzzling that Capitol, MCA, Polygram, and WCI did not respond to the opportunism of independent promoters by acquiring—or by merging or contracting with, or by being acquired by—the largest allowable network of CHR radio stations.

One possible answer to this puzzle is that successful CHR radio stations did not want to merge with record companies. If independent promoters had in fact allocated entire geographic markets and were brokering all CHR airplay within a given city, they would have effectively cartelized the market for payola. The result would be equivalent to a monopolist brokering the commercial advertising time for all CHR radio stations within a given city. It would also comport with the observed ability of independent promoters to raise prices and to suppress airplay of records for which independent promotion had not been purchased. If such horizontal coordination of radio markets were indeed occurring, CHR radio stations clearly would decline to merge with record companies, for such stations by so doing would sacrifice their share of whatever monopoly rents were derivable from the coordinated brokering of CHR airplay for hit records.[174]

This cartelization scenario, however, is not supported by the factual descriptions of independent promotion or by the appar-

173. CBS, INC., *supra* note 45, at 6, 16; CBS, INC., 1985 ANNUAL REPORT 12-13 (1986).

174. Thus, a portion of the record companies' expenditures on independent promotion should have been capitalized into the value of CHR radio stations—if not explicitly, then at least implicitly in the form of lower salaries for program directors and disc jockies, which would comport with the usual rapport reported to exist between key radio stations and independent promoters. The possibility that independent promoters were functioning as a joint-sales agency for cartelizing what was otherwise a competitive payola market suggests a further (although not necessarily persuasive) connection between FCC licensure and the escalating price of independent promotion. As mentioned in Part I, after 1978 the growth of new FM radio stations on the air slowed, *see supra* note 55 and accompanying text, and radio formats generally were viewed as becoming more homogeneous and risk averse. These factors may have reduced the competitive threat from supply substitutability of new airplay capacity in the early 1980s below the likely level in 1978, thereby increasing the likelihood that independent promoters successfully could cartelize access to radio playlists. *See generally* Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV 937 (1981).

ent failure of the RIAA to consider the possibility of violations of the Sherman Act in its proposed investigation of independent promoters. Furthermore, this possible explanation grossly understates the elasticity of supply for CHR airplay: For vertical integration into broadcasting to be an effective counterstrategy to independent promotion, a record company would not need to acquire a station that already was highly successful in the CHR format; rather, the record company merely could acquire a relatively unsuccessful radio station having an entirely different format, such as "Easy Listening" or "Country & Western," and change the station's format to CHR.[175]

The more likely answer to this vertical integration puzzle may be that, although FCC regulations discouraged record companies from vertically integrating into radio broadcasting, they did not prevent record companies and other firms from developing new products and services that sought to simulate in an unregulated context the gains in transactional efficiency that otherwise would be attainable from vertical integration into radio broadcasting. It is likely that simulating vertical integration in this manner cost a record company far less than acquiring a network of radio stations. Two successful companies—MTV and Westwood One—epitomize this possible explanation.

A. *MTV and the Advent of the Music Video*

On August 1, 1981, WCI vertically integrated into an entirely new broadcast medium for mass public exposure of pop music—Music Television, better known as MTV.[176] MTV quickly developed a reputation for stimulating demand for "new wave" artists, who were distinctive visually but whose music defied the homogeneous programming of CHR radio stations.[177] In 1982, WCI declared: "MTV's role as an alternative source for musical programming is additionally significant in the face of radio

175. For example, KROQ-FM in Pasadena, California was a relatively unsuccessful station that, under new ownership, was converted to a "new wave" format. The station briefly achieved the highest Arbitron rating in Los Angeles in the early 1980s and subsequently was resold in 1986 for approximately $45 million. Hollywood Rep., Apr. 22, 1986, at 6, col. 1.

176. *See generally* MTV NETWORKS INC., PROSPECTUS FOR 5,125,000 SHARES OF COMMON STOCK (Aug. 10, 1984; supplemented Aug. 21, 1984). MTV actually was a joint venture between WCI and American Express. *But see infra* note 187.

177. L.A. Times, July 27, 1986, Calendar Sec., at 64, col. 1; CBS, INC., 1982 ANNUAL REPORT 24 (1983).

playlists and formats that have become increasingly narrow in the past several years."[178] This perception persisted among record company executives throughout the mid-1980s.[179]

At first, music videos were a bargain compared to independent promotion. In 1981, the average four-minute video cost about $15,000 to produce,[180] and the record company commonly paid the entire cost of production. By 1986, however, as the medium matured and artistic expectations grew, typical production costs had risen to between $50,000 and $80,000 per video.[181] Accordingly, the record companies shifted the responsibility for video financing partly to the recording artist, treating the cost of a video as fifty-percent recoupable against album revenues for most artists.[182] In addition to this redistribution of costs, CBS announced in April 1986 that it would finance fewer videos.[183]

The commercial benefits of the music video also began to be questioned. First, MTV's ratings slipped in 1986, prompting speculation that music videos might be a passing fad.[184] Second, record executives began believing that videos actually hurt sales of some recording artists, especially older and hard-rock artists. Despite WCI's ebullient claim in 1984 that "MTV exposure has . . . substantially increased the life span of a hit record, resulting in additional sales volume for popular titles,"[185] WCI evidently questioned MTV's benefit to established artists so much by early 1986 that its own hard-rock band Van Halen—which had sold over 16 million records domesti-

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178. WARNER COMMUNICATIONS, INC., 1982 ANNUAL REPORT 20 (1983).

179. MCA Records president Irving Azoff said in 1986 that, in light of "a stiffening of opportunity to develop new artists" through CHR radio exposure, "MTV seems to be the only broadcast format broadening its guidelines with a commitment toward artist development." Billboard, *supra* note 25, at 81. Similarly, Arista Records president Clive Davis stated: "It took MTV to program new and different sounds, and it then forced the hand of the establishment-oriented [radio] stations to get with it " Billboard, *supra* note 160, at 3.

180. FORTUNE, Sept. 17, 1984, at 167-68.

181. Gertz & Culpepper, *Music Video: Realities of the Business*, in 1986 ENTERTAINMENT, PUBLISHING AND ARTS HANDBOOK 283, 291. The video for Madonna's single *Like a Virgin*, on LIKE A VIRGIN (Sire/Warner Bros. Records, 25157-1, 1984), for example, reportedly cost $150,000. FORTUNE, *supra* note 180, at 170. In 1984, an estimated 2000 videos were made, at an approximate cost of $100 million. *Id.* at 167.

182. Gertz & Culpepper, *supra* note 181, at 296-97. In other words, the record company could recoup half of the cost of the video (in addition to the other recoupable costs, such as the artist's advance) before it was required to commence paying the artist earned album royalties.

183. Billboard, *supra* note 120, at 1, col. 3.

184. Wall St. J., Aug. 7, 1986, at 8, col. 1; L.A. Times, *supra* note 177, at 64, col. 1.

185. WARNER COMMUNICATIONS, INC., 1984 ANNUAL REPORT 14 (1985).

cally since 1978[186]—released their new album without a video.[187]

B. *Westwood One and Syndicated CHR Radio Programming*

The syndicated CHR radio programming of Westwood One is another example of a new product that simulated some of the efficiency gains in record promotion that would flow from vertical integration by a record company into radio broadcasting. Westwood One produces programming consisting of live concerts, music and interview shows, national music countdowns, and short features. Into this programming Westwood One inserts advertisements from large national accounts such as Coca-Cola and Anheuser-Busch and leaves slots for participating radio stations to insert local advertising. This programming is then distributed free of charge to radio stations.[188] Westwood One, therefore, offers a large corporate advertiser economies of scale in disseminating, on a local basis throughout the country, a bundle of radio advertising targeted for consumers in specific demographic groups. It also offers a radio station free, high-quality programming with which to increase its listening audience and its local advertising revenue.

Apart from generating these efficiencies for traditional advertisers, Westwood One's programming offers record companies a partial substitute for airplay access at CHR radio stations. For programming purposes, Westwood One functions as a national radio network consisting of several thousand stations. The broadcast of a one-hour Westwood One concert program thus imparts many gross impressions compared even to the normal airplay rotation of a record at a number of highly rated CHR stations in metropolitan markets. Accordingly, the

186. Recording Industry Association of America, Inc., 1984 Supplement: Gold, Platinum, and Multi-Platinum Albums 21 (1985).

187. Billboard, Apr 26, 1986, at 1, col. 3. The Van Halen album, 5150 (Warner Bros. Records, 25394-1, 1986) quickly became *Billboard*'s No. 1 selling album in the United States. However, Van Halen subsequently released videos for *5150* and its accompanying concert tour. Shortly after the release of *5150*, the CBS rock band Journey, which had sold over 13 million records domestically since the 1970s, Recording Industry Association of America, Inc , *supra* note 186, at 17-18, announced that they too would release their new album, RAISED ON RADIO (CBS Records, OC-39936, 1986), without a video, stating that a video would have only a limited lifespan and would not increase record sales. Billboard, Apr. 26, 1986, at 1. By the time of Van Halen's release of *5150*, WCI already had sold its stake in MTV to Viacom International, Inc. *See* Wall St. J., Aug. 27, 1985, at 4, col. 2.

188. WESTWOOD ONE, INC., PROSPECTUS FOR 1,000,000 SHARES OF COMMON STOCK (July 31, 1985). *See also* Rolling Stone, Sept. 25, 1986, at 32.

recording artist and his record company have an incentive to demand only nominal compensation from Westwood One in consideration for the broadcast rights to the artist's performance. Because the record company holds the exclusive right to exploit sound recordings of the artist made during the term of his artist-royalty contract, this is a substantial benefit to Westwood One.

When Westwood One in turn conveys to a local radio station the right to broadcast that performance free of any royalty, the record company in effect gives to that station whatever revenues are derivable in that geographic market from the broadcast of that artist's performance. These revenues must exceed the expected advertising revenue that the local radio station would make on the margin from simply airing another hour of its playlist—otherwise, the station would forgo the opportunity to broadcast the Westwood One program. In economic result, this transaction is as if the record company paid each radio station in the Westwood One network to play records by the featured recording artist. In legal result, it is completely permissible under the payola statute.[189]

IV. Deregulating Payola

Those who would stamp out the "new payola" neglect to ask why payola exists in the first place. Needless to say, they do not consider that deregulating payola might enhance consumer welfare. There is, in short, a failure to recognize that a market exists for hit singles, and that payola renders that market more efficient in its evaluation and dissemination of information that is valuable to both record companies and radio stations. Indeed, the "new payola" episode arguably occurred because Congress and the FCC have prevented an efficient market from developing. If record companies and radio stations were free to specify and monitor contracts for airplay, the market for hit singles would shed its corrupt image and a more efficient market for radio airplay would emerge. Rather than exacerbating the regulatory constraints that produced the "new payola," Con-

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189. In 1985, Westwood One acquired the Mutual Broadcasting System. Westwood One, Inc., 1985 Annual Report 2 (1986). In a move reflecting further vertical integration, Westwood One in 1986 agreed to acquire the company that publishes *Radio & Records*. L.A. Times, Dec. 5, 1986, sec. 4, at 2, col. 1.

gress and the FCC should deregulate the market for the on-the-air advertising of pop music.

A. *Proposal 1: A Weekly Clearinghouse of Record Sales Data*

One way to deregulate payola and remove its corrupt elements is to establish a clearinghouse for information regarding the demand for hit singles. Currently, trade publications such as *Billboard* publish a weekly chart consisting of an ordinal ranking of the 200 best selling albums. The usefulness of this information is limited in two serious respects. First, it does not convey the empirical magnitudes by which albums are ranked. Obviously, aggregate sales of records are cyclical throughout the year. The No. 1 album on March 1 might in fact experience fewer unit sales than the No. 5 album on December 20. In addition, there is no reason to assume linearity in the ordinal ranking of albums or singles, whether they are ranked on the basis of airplay or gross unit sales. Thus a jump from No. 10 to No. 5 is surely more significant in terms of unit sales or gross impressions than a jump from No. 60 to No. 50.[190]

The second problem with the present ordinal ranking of best selling albums is that it is a lagging indicator of the demand for a particular hit single. Therefore, it has limited usefulness for radio stations' portfolio decisions. Most albums do not begin to sell in substantial quantities until radio stations already have played a single from the album often enough to impart some threshold number of gross impressions on listeners. Consequently, the compilation of album charts usually occurs too late to aid a radio station deciding whether or not to add a record to its playlist.

As an alternative to the ordinally ranked hits charts, the record companies could agree to make available each week unit sales and returns figures by release. These figures could be provided to an on-line computer service available to the industry or in the current industry press. By mutual agreement between the record companies, these data could be audited independently and periodically to verify that each provider of information was in fact disclosing the most reliable and accu-

190. The Broadcast Recognition prototype tested at MCA in early 1986 confirmed the existence of nonlinearity of gross impressions in the actual playlists of CHR radio stations in Los Angeles. H.B. Oppenheimer & Associates, Inc., *supra* note 122, at 4.

rate information available.[191] Already these data are disclosed to the RIAA, albeit in discrete form, for the purpose of designating a record as "gold," "platinum," or "multi-platinum" for sales exceeding 500,000 units, one million units, and two million units, respectively. A more continuous measure of a record's sales would enable a radio station to make its portfolio decisions on the basis of contemporaneous information that correlates with actual aggregate demand for the record. Publishing actual sales and returns data would have the incidental benefit of making the labor market for recording artists far more efficient by accurately revealing the true revenue potential (and product life cycle) of each reported artist.

The full value of this disclosure system would not manifest itself immediately. Radio station programming decisions—as well as record company decisions regarding the size of artist royalty advances and of initial production runs for a particular album release—depend on expectations of future sales. Therefore, in the near term (of, say, one year) the principle value of a contemporary sales disclosure system would be to assemble a data base from which the expected sales of albums released in future periods could be reliably estimated.

Contemporaneous publication of sales data is common elsewhere in the entertainment industry and, because of the short product life cycle and degree of product differentiation, should not raise antitrust concerns about the exchange of output data among horizontal competitors. Each week, *Daily Variety* publishes the cumulative gross box office receipts of newly released movies, down to the last dollar. Like a new record album, a motion picture has a limited product life cycle for theatrical exhibition. The publication of box office receipts conveys a quantifiable market signal to theater operators of the demand for a specific release and, implicitly, the demand for the particular movie stars or director or producer featured in the motion picture. The contracting patterns in the movie and record industries are not so significantly different that record compa-

191. In a speech to the National Association of Recording Merchandisers (NARM) in February 1987, Elliot Goldman, RCA/Ariola's chief executive officer, attributed the "independent promotion fiasco" in part to "a sales reporting system that is based more on its vulnerability to manipulation than its accuracy of reporting." Hollywood Rep., Feb. 17, 1987, at 1, col. 3. He proposed that NARM, the RIAA, the National Association of Broadcasters, and the trade press "establish accurate and verifiable reporting systems to a central and non-corruptible source." *Id. See also* Goldman, *Controlling Your Own Destiny*, Billboard, July 12, 1986, at 9 (guest editorial).

nies—or, more importantly, consumers—would be damaged by disclosing this otherwise proprietary information.

B. *Proposal 2: A Free Market for Airplay, Coupled With Periodic Disclosure of Payments to Radio Stations*

Another way to improve the efficiency of the hit singles market is to allow unrestricted payments from a record company to a radio station in exchange for the contractually enforceable promise to deliver a specified amount of airplay. The pay-for-play market soon would adopt a standard contract for radio airplay, denominated by number of gross impressions and monitored at relatively low cost by a system like the Broadcast Recognition prototype successfully tested at MCA in early 1986.[192]

The ability of record companies freely to contract for radio airplay would be accompanied by the present disclosure requirement of section 317. However, rather than being required to disclose sponsorship at the time of broadcast, a radio station should be required to disclose sponsorship on a weekly basis to the major trade publications. Such weekly disclosures would specify by record and sponsor the amount of consideration received and the amount of airplay purchased for that consideration. Such disclosure could be integrated easily into the process by which the trade press already compiles the weekly hits charts every Tuesday night. The marginal cost of reporting this additional information, therefore, would be small.

The legislative authorization for such a disclosure procedure already exists. Section 317(d) of the Communications Act authorizes the FCC to waive the requirement that a radio station announce that it has received pay for play "in any case or class of cases with respect to which it determines that the public interest, convenience or necessity does not require the broadcasting of such announcement."[193] Quite clearly, if Congress authorized the FCC to waive the requirement for disclosure entirely in certain cases, it also authorized the FCC to mandate disclosure by some less intrusive (and, needless to say, more efficient) alternative than by the on-the-air announcement at the time a record is broadcast. Thus, pursuant to the rulemak-

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192. *See supra* note 122 and accompanying text.
193. 47 U.S.C. § 317(d) (1982).

ing authority under section 317(e) of the Communications Act,[194] the FCC could prescribe by modification of its existing sponsorship identification rules[195] that any licensed radio station publish, on a weekly basis in at least one nationally circulated trade publication, the information described above. In addition, the FCC could require each licensed radio station to file with the Commission quarterly and annual summaries of such data, which would be available for public inspection. The reporting of paper adds specifically would be prohibited. Failure to comply with these disclosure requirements would subject a radio station to possible nonrenewal of its license and to private civil suits alleging "fraud on the market" for hit record broadcasting.

In the short run, the record companies almost certainly would oppose the required disclosure of pay-for-play transactions outlined above. Shortly after the suspension of independent promoters, *Radio & Records* published a front-page editorial advocating that radio stations "sell the record companies air time for product play."[196] The editorial did not advocate the repeal of payola statutes. Rather it proposed that radio stations sell record companies blocks of commercial time long enough to play an entire single. The editorial emphasized that the proposal would ensure that "the money crosses the till in sight of all the players!"[197] In response, one record company president said that the proposal was "outrageous and ridiculous," that the record companies would "never go for it in a million years," and that he could not "imagine radio wanting to give up their power to select what records to play."[198]

Radio stations, of course, would not be relinquishing their prerogative to select records for their playlists. A radio station that accepts payola has an incentive not to broadcast a record if doing so will cause a larger marginal loss in advertising revenue than the station receives in marginal payola revenue. The same would be true of fully disclosed pay-for-play transactions. Except to the extent that paper adds would be eliminated, the disclosure of pay-for-play transactions would not change the allocation of scarce airplay. It would, however, substantially re-

194. *Id.* at § 317(e).
195. 47 C.F.R § 73.1212 (1985).
196. Radio & Records, Mar. 7, 1986, at 1.
197. *Id.*
198. L.A. Times, Mar. 16, 1986, Calendar Sec., at 78, col. 4.

duce the transactions costs of operating an organized exchange for radio airplay.

C. *Proposal 3: Rescission of the Rule of Twelves*

A third way to enhance the efficiency of the market for hit singles is for the FCC to rescind the rule of twelves. Radio networks of greater horizontal scale would emerge. They would offer record companies transactional efficiency in the securing of CHR airplay in multiple markets. Specifying and monitoring the contractual performance of such a firm could be substantially easier than for an equally large network of independent promoters.

The rule of twelves is an artificial restriction on efficient market structure. Its purpose is to preserve competition in the marketplace for ideas by promoting local programming and editorial diversity. It is far from clear, however, that the rule has preserved diversity in the repetitive programming of CHR radio stations. More fundamentally, the rule's premise is flawed. With over 9000 radio stations presently on the air in the United States, it is untenable that the FCC should set the maximum permissible horizontal scale of a broadcast network at twelve FM stations. Antitrust principles governing horizontal mergers can deal with mergers of radio stations quite adequately, even though competition in the marketplace for ideas is a special policy concern.[199]

V. Conclusion

Record companies produce far more new records than can be accommodated by the finite airplay capacity of the repetitive "Contemporary Hit Radio" playlists common to hundreds of American radio stations. Consequently, as Professor Ronald Coase showed in 1979, payola serves as a price system for efficiently allocating scarce advertising capacity for new pop records. Even if it must function underground, the market for hit records summarizes through this price system vast quantities of information about demand and supply.

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199. *In re* Amendment of Section 73.3555 of the Commission's Rules Relating to Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C.2d 17, 38-46 (1984).

The "new payola" scandal of 1986 demonstrates how the payola prohibition, in conjunction with FCC regulation of the market structure for radio broadcasting, can diminish the efficiency of that price system. The present regulatory regime has encouraged independent record promoters to act opportunistically vis-a-vis record companies in the allocation of airplay. Furthermore, these regulations and criminal statutes have encouraged the dissemination of false airplay information that actually reduces the informational efficiency of the market for hit singles—a result as counterproductive in principle as if the Securities and Exchange Commission were to promulgate a regulation that encouraged corporations intentionally to misstate their financial results.

After some time, there is no evidence that outlawing payola is necessary to ensure that new records receive airplay on the basis of aesthetic merit. The "new payola" scandal illustrates why Congress and the FCC should decriminalize and deregulate the advertising of pop music, allowing the market to function without exorbinant transactions costs and the specter of corruption.