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Digital Media Association

Testimony of

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on

"Music Licensing under Title 17" – Part One

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Chairman Coble, Ranking Member Nadler, Vice-Chairman Marino and members of the Subcommittee thank you for inviting me to testify today. My name is Lee Knife and I currently serve as the Executive Director of the Digital Media Association - or "DiMA" for short.

DiMA is a nationally recognized trade association that represents many of the leading players in the digital music marketplace. You're probably familiar with many of our larger members which include companies like Amazon.com, Apple, Google/YouTube, Microsoft, and Rhapsody - but there are several additional companies we represent that play an equally important part in the development of the digital music ecosystem.

In little more than a decade's worth of time, the role our companies have grown to play within the music industry is simply amazing.

With respect to *consumers*, our ingenuity has provided fans of online music with access to new services and offerings that satisfy almost every conceivable price point - from online music download stores - to on-demand streaming - to ad-supported Internet radio and more recently, cloud-based offerings.

With respect to *copyright owners*, our efforts have meant the creation of new revenue streams that have handsomely rewarded content creators and their agents for their creative endeavors. SoundExchange, for example, recently reported a 312% increase in the total sum of royalties it paid to recording artists and labels in 2012 versus 2008. This is thanks to monies paid by services operating under the 114 compulsory license - many of which we represent.

With respect to songwriter incomes, ASCAP and BMI, the two largest PROs, recently reported record high revenues of $944 million each in 2013. Meanwhile, SESAC, the smallest of the three PROs, has witnessed its revenue grow from just $9 million in 1994 to $167 million in 2013.

All of these accomplishments, I'm pleased to report, have come as DiMA members increasingly have been able to successfully convert would-be "pirates" into regular users of legitimate, royalty-paying music services.

This task hasn't been easy; and the current music licensing regime we're asked to navigate makes it no less difficult. It's safe to say that if we were writing from a "blank slate" no one would have developed the current system we're asked to operate under today.

In the remaining minutes of my time, I plan to offer a few thoughts on what *essential elements* should be included in any future music licensing reform package - followed by a quick evaluation of why I think two recently introduced legislative proposals, in particular, constitute bad public policy.

A twenty-first century licensing regime that's properly suited to handle the needs of an innovative industry and a consumer base that's consistently demanding increased *legal* access to content "*when"* and "*where"* they want it has to include:

1) efficiency;
2) transparency;
3) safeguards that adequately protect licensees from anti-competitive behavior;
4) a "level playing field" among similarly-situated competitors; and
5) it should shield licensees from excessive legal risks when acting diligently and in good faith.

Greater efficiency has two immediately apparent benefits. For licensees, it guarantees new products and services can be brought to market sooner - which will help us in our fight against "online pirates". For creators, greater efficiency will mean less of the royalties we pay for the right to perform or distribute content will be used to cover administrative expenses. Last year alone, more than $200 million in royalties paid by music licensees was redirected just to cover PRO operating expenses. Greater efficiency means fewer middle-men and more money in the pockets of songwriters.

The importance of transparency is obvious. If service providers can't find the rightful owner of a copyright protected work they can't license it and pay for it - which means a creator misses out on a royalty and the general public is deprived of the benefit of enjoying his or her creativity. For creators, greater transparency provides full visibility into the total payments made by music services and the way those payments are administered by the agencies and affiliates which artists rely on to administer their rights. This, in turn, will allow those artists to make better informed decisions about which agents they choose to employ, to maximize the net payments they ultimately receive.

In the area of competition, the need to protect licensees from anti-competitive behavior may be greater now than in any time in history, due to the recent consolidation in the recording and music publishing industries. Some, particularly in the context of the licensing of musical works, have taken issue with this notion - and even asked that certain requirements imposed under the Department of Justice's consent decrees be modified. Before taking this considerable step, we would strongly urge policymakers to review the history of the ASCAP and BMI consent decrees - which is attached to this testimony – and also recent federal court cases which have made note of continuing anti-competitive behavior carried out by various parties acting on behalf of the music publishing industry.

Furthermore, on the subject of competition, a hallmark of a good competitive landscape requires a "level playing" field be established among similarly-situated competitors. For several years now, webcasters have had one simple request. Namely, that the same rate-setting standard - "801b" - that's currently used to determine performance royalties for cable and satellite radio be used to establish rates for Internet radio. Record labels have relied on the "801b" standard while licensing their musical works needs since the 70s; while cable and satellite radio providers have relied on it while licensing sound recordings since the 90s – all without any significant issues. It's time to update the section 114 compulsory license so that the rates for Internet radio are determined under the same "801b" rate-setting standard as well.

The last element, regarding the reduction of legal risks around certain licensing activities, has been commented on extensively. Suffice it to say, a twenty- first licensing regime has to avoid adherence to a series of outdated penalties intended only as a remedy to be applied to egregious violators, which are frightening and are sometimes employed as negotiating leverage, as they chill innovation on the part of licensees acting diligently and in good faith.

Considered collectively, the elements I outline above - along with the longer set of comments attached to today's remarks - provide a roadmap to a new system for music licensing that will benefit creators and artists by allowing distributors to cater to fans of online music.

Two recently introduced bills - H.R. 4079, the "Songwriter Equity Act" and H.R. 4772, the "RESPECT" Act - take us in the wrong direction by seeking to create additional anomalies within the music licensing framework which cater to the unique interests of only a limited group of stakeholders.

In closing, I would like to thank you again for inviting me to testify today and I look forward to answering any questions you may have.

Attachments:

1) Comments of the Digital Media Association in Response to the Copyright Office's Notice of Inquiry on "*Music Licensing*" (May 2013);
2) Einhorn, Michael A., "*Intellectual Property and Antitrust: Music Performing Rights in Broadcasting*". Columbia Journal for Law and the Arts, 2002.

Before the
UNITED STATES COPYRIGHT OFFICE
Washington, D.C.

In the Matter of: Music Licensing Study	Docket No. 2014-03

Comments of the Digital Media Association ("DiMA")

The Digital Media Association ("DiMA") respectfully submits the following comments in response to the above-referenced Notice of Inquiry (the "Notice of Inquiry"). DiMA commends the Copyright Office for initiating this inquiry, and appreciates the opportunity to participate.

DiMA is the leading national trade organization dedicated to representing the interests of licensed digital media services, including many of the leading players in the digital music marketplace today. DiMA's members include Amazon.com, Apple, Google/YouTube, Microsoft, Pandora, RealNetworks and Slacker, and a complete list of its membership may be found at http://www.digmedia.org/about-dima/members. Although DiMA is submitting a single response to the Notice of Inquiry, DiMA's members operate a broad array of different digital music service types and consumer offerings with different music licensing needs. However, as distributors of copyrighted sound recordings and musical works through legitimate music services, DiMA's members share many common interests, and are directly affected by existing methods of licensing music, as well as the mechanisms for obtaining music licenses that are shaped by U.S. copyright law. DiMA has been actively involved in many of the recent studies, analyses, public inquiries and roundtables conducted by the Copyright Office on various aspects of copyright law. Through the Copyright Office's efforts, we believe that Congress has already been provided with much important background on music licensing issues.

The interests of DiMA and its members are aligned with those of the rights owners in several significant respects. First, DiMA members share the belief that rights owners should be appropriately compensated for the use of copyrighted works. Second, DiMA members also share the belief that the long-term survival of the music business depends on the ability to develop profitable, sustainable digital music services that will delight consumers for generations to come. The legitimate music services represented by DiMA's members have collectively paid billions of dollars in royalties to content owners, recording artists and songwriters in a marketplace where the sale of physical products – long the content owners' primary source of revenue – has continued to decline year-over-year. In the face of this decline, digital music services, including many of the streaming services operated by DiMA's members, are generally viewed by the music business as its salvation.[1] Significantly, the delivery of engaging,

[1] IFPI Digital Music Report 2014, at 6 (2014), *available at* http://www.ifpi.org/downloads/Digital-Music-Report-2014.pdf.; *see also* Ben Sisario, *Spotify Hits 10 Million Subscribers, a Milestone*, N.Y. Times, May 21, 2014, *available at* http://www.nytimes.com/2014/05/22/business/media/spotify-hits-milestone-with-10-million-paid-subscribers.html?_r=1.

innovative music services by DiMA members is critical to the central public policy underlying our copyright system: affording the widest range of consumers access to the widest range of creative works.[2]

However, the complex process for music licensing in the digital landscape that exists today in the United States – the framework of which is based on U.S. copyright law – threatens to chill investment in legitimate music services, and the continued development and expansion of innovative services that are essential to the survival of the recorded music industry. Accordingly, we are pleased that the Copyright Office is continuing its examination of the effectiveness of existing methods of licensing music. We remain hopeful that, after evaluating the issues, Congress will consider ways to modernize U.S. copyright law in a manner that assures consumers continued access to a vibrant marketplace for music products and services in the digital era.

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[2] *See, e.g., Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932) ("The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors."); *Harper & Row v. Nation Enterprises*, 471 U.S. 539, 558 (1985) ("the immediate effect of our copyright law is to secure a fair return for an 'author's' creative labor. But the ultimate aim is, by this incentive, to stimulate the creation of useful works for the general public good." (quoting *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975))); *Feist Publ'ns v. Rural Tel. Serv. Co.*, 499 U.S. 340, 349-50 (1991) ("The primary objective of copyright is not to reward the labor of authors, but '[to] promote the Progress of Science and useful Arts.'").

EXECUTIVE SUMMARY

- Fragmentation of copyright rights and rights ownership. The mechanisms for obtaining music licenses in the United States are rooted in various distinct rights recognized under U.S. copyright law, where sound recordings, and the musical works embodied within them, are routinely owned by different copyright holders. In fact, the rights within the musical work rights bundle itself are routinely owned by more than one copyright holder. This fragmentation did not severely disrupt the historical business model for the sale of recorded music products because the distributors and retailers that sold and resold physical products (and promoted them) did not need to license any copyrights, and third parties (i.e., terrestrial radio broadcasters) licensed musical work public performance rights to promote the sale of these recorded music products through radio airplay.

- Shifting of licensing responsibility. In the digital environment, music services are functionally equivalent to the distributors and retailers that sold music under the historical business model, but licensing responsibility has shifted to them – a first in the history of the music industry.

- The impact of rights fragmentation and the shifting of licensing responsibility on digital music services. The above-referenced rights fragmentation and shifting of licensing responsibility to service providers under the current legal and regulatory framework established by U.S. copyright law has created formidable challenges for digital music services for various reasons unique to music licensing in the digital environment, including the following:

    - The need for licensing ubiquity, and the new legal uncertainties. As a result of the convergence of rights in the digital era, digital music services are subjected to legal uncertainties around the precise rights implicated for particular activities, overlapping claims for royalty payments, and significant potential legal exposure. Concurrently, as the music business has shifted from ownership models to access models, digital music services are confronted with the need to secure licenses from tens of thousands of rights holders, covering tens of millions of tracks, in order to offer consumers commercially viable services. Failing to secure the necessary licenses is not an option.

    - The unprecedented market power of rights owners, and the "tug-of-war" over royalties. Rights owners enjoy unprecedented market power, and because each negotiation and ratesetting proceeding occurs in parallel (at different times, in different places and before different ratesetting tribunals operating under different ratesetting standards), each rights owner seeks to increase its own royalty, generally without regard to the royalties that services have to pay the various other rights owners. As discussed further below, an example of this phenomenon was seen in recent proceedings involving musical composition public performance licensing for Internet radio services. Effectively, this dynamic has resulted in a ratcheting effect whereby digital music service providers have been thrust into the middle of a "tug-of-war" among rights owners over royalties. The net result of this "tug-of-war" is royalty rates that are (i) not presented to copyright users in a unified way such that digital music services can evaluate, forecast and understand their aggregate royalty expense for all of the copyright rights needed, and (ii) in the aggregate, are unjustifiably high and, ultimately, unsustainable.

    - Interdependence of interests. Because of the interdependence of interests among rights owners, creative talent and digital music services, the conduct of any one party in the music licensing marketplace can have adverse consequences for the others, and the public interest. There is no centralized body with general oversight to effectively balance these competing interests and minimize the collateral consequences that one "hold out" rights owner can have on all others parties in the ecosystem.

- The current music licensing mechanisms do not work well in the digital environment. The existing music licensing structures are not well-suited for the digital era, as they (i) lack necessary transparency, (ii) are not efficient, and (iii) do not provide a "level playing field" for competitors in terms of ratesetting standards, royalty rates or functionality rules because of platform distinctions or historical anomalies. Nor do these structures often provide a suitable counter-balance to the market power of rights owners.

- Six essential pillars for modernization of copyright laws for the digital environment. U.S. copyright law is in need of modernization for the digital environment, and, as noted above, a holistic view of the entire music licensing ecosystem should be taken. For modernization to be effective, the framework for the new digital era should be based on the following six essential pillars:

  - **Continued Government Oversight and Regulation of Music Licensing Activities:** A music licensing framework that appropriately counter-balances the unique market power and negotiating leverage of copyright owners, and takes digital music services out of the middle of the rights owner "tug-of-war" over royalty rates that has driven up royalty costs to levels that are unsustainable, would facilitate a healthy and sustainable digital music marketplace.

  - **Transparency and a centralized database:** The digital marketplace needs a publicly available, centralized database that contains information about rights ownership of musical works and sound recordings on a work-by-work level and on which digital music services can rely. For such a database to be truly effective, it needs to be accurate, comprehensive and reliable, as well as use standard industry identifiers such as International Standard Recording Code ("ISRC") and International Standard Musical Work Code ("ISWC") numbers that show the relationship between the musical works and sound recordings that embody them, and vice versa. However, as experience with the development of the Global Repertoire Database ("GRD") in Europe has shown, if left entirely to private industry without government oversight, these universal standards (and the centralized database itself) are unlikely to get implemented.

  - **Licensing Efficiencies and Reduced Transaction Costs:** The music licensing marketplace would benefit from a framework that promotes licensing efficiencies and reduced transaction costs for music licensing activities, implemented through vehicles such as compulsory blanket licenses and common agents.

  - **Clarification of Rights**: A music licensing framework where rights owners are not able to drive up royalty rates based on legal uncertainties arising out of the convergence of reproduction, distribution and public performance rights in the digital environment would foster growth and promote new entry into the digital music marketplace.

  - **Reduction of Legal Risks Around Licensing Activities:** Immunity from infringement liability (including statutory damages) for copyright users that have acted diligently and in good faith based on the information contained in the centralized database would reduce risk and encourage further innovation. Further, any entitlement to statutory damages in other contexts should be conditioned on the registration of accurate rights ownership information in the centralized database, utilizing universal standards.

- **"Level Playing Field":** A music licensing framework that creates a "level playing field" where one music service is not advantaged over another in terms of ratesetting standards, royalty rates or functionality rules because of platform distinctions or historical anomalies would increase competition on the merits, thereby incentivizing innovation.

I. INTRODUCTION AND OVERVIEW

1. The current legal and regulatory framework was designed for a historical business model (the sale of physical products) and is ill-suited for the digital environment.

A. Licensing responsibility under the historical business model.

As the Copyright Office has noted in the Background section for this Notice of Inquiry, many of the sound and enduring principles in U.S. copyright law are challenged when applied to the music business in the digital environment. The historical business model for recorded music products was relatively simple and straight-forward. Record companies sold physical products embodying sound recordings, musical works and other copyrighted materials (including artwork) to distributors and retailers, who in turn, resold those finished goods to consumers. Significantly, these distributors and retailers did not need to obtain copyright licenses from content owners in order to *resell the finished goods* because record companies delivered them with "all rights cleared."[3] Moreover, copyright law did not require retailers to seek licenses from content owners in order to engage in activities intended to *promote these sales,* such as in-store public performances of records.[4]

Under the pre-digital model, licensing activity for the promotion of physical product sales was generally the responsibility of parties other than the retailers – such as terrestrial radio broadcasters. These parties, not the retailers, licensed the necessary rights to promote the sale of records, such as by means of terrestrial FM and AM radio airplay. Moreover, the only rights broadcasters needed to secure were public performance rights in the underlying musical works, as Congress has long refrained from recognizing an exclusive right for the public performance of sound recordings by means of terrestrial radio airplay.

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[3] This included the right to reproduce and distribute the musical works embodied in the physical products. It is worth noting that the migration from selling physical products to permanent digital downloads has done little to change this basic construct, at least in the United States. Whether sold or resold on wholesale or agency models, record labels generally still bear responsibility for acquiring and administering mechanical licenses for the musical works embodied in the sound recordings, and paying the required mechanical royalties to musical work rights owners.

[4] Congress has long exempted retailers from the requirement to license musical work public performance rights for such promotional activities under Section 110(7). In the digital environment, there is no equivalent of Section 110(7). Accordingly, for the use of sound clips to promote the sale of permanent digital downloads within the digital download store environment, digital music services are responsible for acquiring and administering musical work public performance rights, and paying the required pubic performance royalties. Congress created the exemption for the promotion of physical sales in response to *Chappell & Co. v. Middletown Farmers Market & Auction Co.*, 334 F.2d 303 (3d Cir. 1964), a case brought under the 1909 Act, which "held that the public performance of phonorecords in an establishment selling such phonorecords to be an infringing public performance for profit, notwithstanding defendant's argument that it was merely engaged in advertising the phonorecords and not in a 'public performance for profit.'" Melville B. Nimmer & David Nimmer, 2 *Nimmer on Copyright* § 5.18[F] (2013) (internal citations omitted). In the Fairness In Music Licensing Act of 1998, Congress extended this exemption beyond "copies or phonorecords of the work" to include "the audiovisual or other devices utilized in such performance." Fairness In Music Licensing Act of 1998, Pub. L. No. 105-298, 112 Stat. 2827 (1998); *see* 17 U.S.C. § 110(7) (2012). Although the exemption set forth in Section 110(7) has not been extended to digital, and the Southern District of New York recently ruled that the public performance of sound clips in equivalent digital contexts does not constitute a fair use of the musical works, we believe that uses that do not substitute for sales, but instead, promote them, should be encouraged and not discouraged, regardless of whether they are digital or analog in nature. *See United States v. Am. Soc'y of Composers, Authors, and Publishers*, No. 41-cv-1395, 2009 WL 484449 (S.D.N.Y. Apr. 3, 2009).

B. **<u>The evolution of the music business from the historical physical business model to the digital environment</u>**.

Over the past ten to fifteen years, the music business has been transformed by the digital landscape. Consumers – who are intended to be the primary beneficiaries of our copyright system – have largely benefited from this transformation.[5] We have seen paradigm shifts in the following areas:

- The *way* that sound recordings and musical works are delivered to the consumer (as new digital product configurations and services replace traditional physical products);
- The *technology platforms* used to deliver sound recordings and musical works (as the Internet, mobile carrier networks, cable television networks, satellite television networks and satellite radio networks replace traditional brick-and-mortar retailers and terrestrial broadcasters);
- The *consumer electronics devices* used by consumers to enjoy sound recordings and musical works (as connected, highly portable devices such as smart phones, tablets and lightweight computers replace conventional CD players, turntables and cassette players);
- The *business models* used to create revenue-generating opportunities (as subscription, freemium, bundled and ad supported digital business models replace simple a la carte physical sales);
- Consumer expectations about *how* music can be consumed (as an array of product types, such as permanent downloads, limited downloads and streams – which often enable consumers to be in control of the media they consume by "personalizing" their experiences in a multifaceted, immersive way – replace traditional physical product types);
- Consumer expectations about *when* music can be consumed (as digital music services provide consumers with instant access to music without having to drive to brick-and-mortar stores or wait for mail order shipments to arrive);
- Consumer expectations about the *quantity of titles available* (as consumers migrate to access model services, legitimate digital music services must offer and make available a "critical mass" of licensed works to remain commercially viable, unlike the historical business model where it was acceptable for some titles to be out of stock); and
- A culture that expects licensed digital music services to provide ubiquitous access to all content at *low cost or no cost at all* (as free-to-the-user illegal alternatives are plentiful, unlike the marketplace for traditional physical products).

With respect to these paradigm shifts, DiMA's members have risen to the occasion and are responsible for much of the innovation and substantial financial investment that has transformed the music industry for the better (such as the development of the download, streaming, subscription, locker and other digital business models that represent the future of recorded music delivery). The digital music services offered by DiMA's members provide a variety of compelling, immersive consumer experiences that satisfy the needs of a highly segmented array of consumers.

C. **<u>Licensing responsibility has shifted in the digital environment</u>**.

In most industries, the manufacturers of products are responsible for sourcing the various components and rights necessary to deliver goods to their network of wholesalers and distributors, so they

[5] Mark Cooper, *Copyright Policy, Creativity And Innovation In The Digital Economy: Comments of the Consumer Federation of America*, (November 13, 2013), *available at* http://www.ntia.doc.gov/files/ntia/consumer_federation_of_america_comments.pdf.

may be resold to other businesses or directly to end user customers without the need to acquire additional components or rights. Under the historical business model, record companies performed the role of the manufacturer, and, as such, they delivered physical record products to their network of distributors and retailers with "all rights cleared." In the digital environment, these roles have been reversed, and digital music services (i.e., the retailers) must source many of the component parts of the product – individual copyright based rights – and bear all of the burdens and responsibilities for (i) acquiring and administering those rights and (ii) paying the required royalties out of their own share of the revenues generated.

These incremental responsibilities and burdens have vastly complicated the licensing landscape, and diminished the operating margins for digital music services that now perform these converged roles. For example, unlike the physical distributors of yesteryear, today's digital distributors must identify and locate licensors of rights associated with sound recordings, musical works and other copyrighted materials (such as artwork); negotiate and administer licenses; and navigate the complex web of rights ownership in the U.S. and global licensing paradigms.[6] Under the current licensing framework and industry structure, digital music service providers are forced to bear the entire burden of reconciling any conflicting demands from rights owners, who often assert overlapping royalty claims for the same uses of the same works.[7] This change represents a seismic shift in the distribution of recorded music product – and one with far-reaching repercussions, as detailed below.

2. The effects of the current legal and regulatory framework in the digital environment.

A. <u>The current legal and regulatory framework enhances the negotiating leverage of rights owners</u>.

The challenges faced by digital music services are formidable and fundamentally different from the challenges faced by retailers and distributors under the historical music business model. The shift in licensing responsibility from record companies to digital music services, compounded by the unique and byzantine nature of music licensing in the digital environment under the current legal and regulatory framework established by U.S. copyright law, has significantly *enhanced the negotiating leverage of right owners* (and diminished the leverage of licensees). This framework has proven detrimental to digital music service providers and actually has served to undermine the shared belief that rights owners should be appropriately compensated for the use of copyrighted works. The following attributes of today's music licensing model, as supported by the current legal and regulatory framework, are among the most problematic:

- <u>Fragmented rights ownership</u>. Based on anachronistic distinctions in U.S. copyright law, sound recording and musical work rights are markedly fragmented[8] and controlled by numerous rights owners. Adding further complication, rights within the musical work

[6] Although it is beyond the scope of this Notice of Inquiry, it is worth mentioning that many digital music service providers that operate legitimate music services in the U.S. also operate services in other countries. These services must navigate similarly complex copyright regimes on a country-by-country basis, adding further complexity to the burden of the digital music service providers.

[7] These overlapping claims stem from the convergence of various Section 106 rights in the digital era, which is discussed in more detail elsewhere in this response.

[8] Examples of this fragmentation include the separation of sound recording and musical work rights, the separate licensing structures for copyright rights within the musical work rights bundle, and the separate international licensing structures for musical work rights and certain sound recording rights.

rights bundle itself may be further fragmented across numerous rights owners.[9] Accordingly, in order to comply with their licensing responsibilities, digital music services must acquire, retain and administer licenses under copyright from a *multitude* of rights owners. The effects of this fragmentation on licensees in the music licensing marketplace are discussed in greater detail in our response to Question 4 below.[10]

- Access services, and the need for licensing ubiquity. While it might be possible to launch a digital music service with only the sound recordings owned and controlled by the three major labels and a few independent labels and aggregators, doing so would limit the service's commercial viability in light of consumer expectations that "everything" should be available. Moreover, few services can be commercially viable without musical work licenses from *all* music publishing rights owners, because musical work rights generally cut across the lines of sound recording copyright ownership (e.g., musical works in sound recordings owned or controlled by Warner Music Group are controlled by tens of thousands of music publishers and not exclusively by Warner/Chappell, its affiliated music publishing company). The need for licensing ubiquity requires services to secure licenses from tens of thousands of rights holders, covering tens of millions of tracks, in order to meet consumer expectations in the digital environment.

- New legal uncertainties arising out of rights convergence. Reproduction, distribution and public performance rights have converged in various ways, and the lines between them are often unclear. Accordingly, the multitude of rights owners with whom digital music services must secure licenses often assert overlapping claims for the same or analogous rights, which can increase a digital music service provider's overall royalty expense by requiring redundant payments for a single use of a copyrighted work (i.e., "double dipping" by rights owners). For example, the performance rights organizations (PROs) long asserted that digital downloads and ringtones implicated public performance rights in addition to "mechanical" reproduction rights; while this position was ultimately rejected by multiple legal decisions,[11] it cast a shadow of uncertainty for digital music services and led to the unnecessary payment of millions of dollars in duplicative royalties for many years. In addition, this convergence of rights increases transaction costs as digital music services must often clear, for example, both public performance and reproduction/distribution rights in a musical work for a use whose historical analog would have only required one or the other such clearance.

- Unprecedented market power of rights owners. After decades of industry consolidation, rights owners now have unprecedented market power (and significantly more market

[9] For example, the musical work "We Are Young" as recorded by the recording artist "fun." splits musical work copyright ownership among four different songwriters and seven different publishers. As a further example, the musical work "Get Lucky," as performed by Daft Punk, which won this year's GRAMMY Award for Best Pop Duo/Group, has four separate songwriters and four separate music publishers

[10] Fragmentation, in the context of musical works, also harms songwriters in that their intended royalty payments are often redirected to cover arguably duplicative administrative expenses. *See Reforming Section 115 of the Copyright Act for the Digital Age: Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the H. Comm. of the Judiciary*, at 110th Cong. 14 (2007) (statement of Marybeth Peters, Register of Copyrights) ("The system would also offer substantial advantages to rights holders. Under a blanket license system, there are economies of scale that reduce the administrative costs associated with the collection and distribution of the royalties.").

[11] *See, e.g., In re Cellco Partnership*, No. 09-cv-7074, 2009 WL 3294861 (S.D.N.Y. Oct. 14, 2009); *United States v. Am. Soc'y of Composers, Artists, and Performers*, 485 F. Supp. 2d 438 (S.D.N.Y. 2007).

power than any of the individual services that require particular licenses from all of them).[12]

- Lack of a "level playing field." The complex patchwork of *laws*,[13] *regulations*,[14] *private voluntary licensing arrangements*, *collective licensing arrangements*,[15] and *court rulings*[16] that comprise the current legal and regulatory framework for music licensing have created an unlevel playing field, that unfairly tilts competition, typically in favor of legacy technologies, at the expense of innovating technologies. For example, ratesetting standards, royalty rates and functionality rules provide an advantage to some service types over others. These issues are discussed in greater detail in our responses to Questions 8 and 9 and our consolidated response to Questions 12 and 13 below.

- Lack of transparency. The lack of a publicly available, centralized database for musical works and sound recordings makes it difficult, if not impossible, for digital music services to determine what rights they do and do not have at any given time.[17] This creates a host of problems and inefficiencies which are discussed in greater detail in our responses to Questions 1, 3, 5 and 22 below.

- Statutory damages. The current risk of statutory damages under U.S. copyright law enhances the leverage and bargaining power of rights owners, because the law imposes severe economic consequences for any mistakes on the part of licensees, however technical and regardless of "fault."[18] U.S. copyright law lacks a "safe harbor" from statutory damages that would shield copyright users from infringement liability if they have acted diligently and in good faith based on the best information available, which is often limited because of the lack of a centralized database, as noted above.

B. **The rights owner "tug-of-war" over royalty rates, and its effect on the aggregate royalty expense of digital music services**.

In the licensing marketplace, the fragmented rights ownership structure creates an environment in which each individual licensor negotiates for a greater share of services' revenue in separate, but parallel,

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[12] See e.g., Flavia T. Fortes, *Music Industry Consolidation: The Likely Anticompetitive Effects of the Universal / EMI Merger*, American Antitrust Institute 7 (Aug. 30, 2012), *available at* http://www.antitrustinstitute.org/sites/default/files/White%20paperEMI%20Universal.pdf. ("A hypothetical merged Universal/EMI would have had nearly 40% of the market in 2011, leaving only Sony with nearly 30% and Warner with less than 20% among rival 'majors.' This 4-3 reduction would take the market from 'moderately concentrated' to 'highly concentrated'…"); *see also* notes 36 and 37 *infra* and accompanying text.

[13] Such laws include the statutory licenses codified in Sections 112, 114 and 115 of the Copyright Act.

[14] Such regulations include the rates and terms for various statutory licenses codified in the CFR and the Federal Register.

[15] Such collective licensing arrangements include the collective licensing of musical work public performance rights under antitrust consent decrees.

[16] Such court rulings include interpretations of the laws codified in Sections 112, 114 and 115, the scope and meaning of the antitrust consent decrees, and the boundaries between rights under state laws and federal copyright

[17] It is worth noting that this information is rarely provided by rights owners to licensees in practice, even in direct deals where the information is readily available. Moreover, some of the private databases utilized by the rights owners themselves reflect conflicting ownership information. For example, the database used by a PRO may show that a musical work is owned or controlled by a music publisher, but that music publisher's own database may not include any reference to the musical work at all.

[18] *See* 17 U.S.C. § 504 (2012).

negotiations with digital music services. Understandably, each licensor focuses on its own individual self-interests – namely, how to maximize its own share of the total revenue pie. As a result of this fractured approach, these individual licensors generally have no interest in considering (i) the aggregate amount of royalties paid by distributors to all licensors, (ii) the value the service itself provides, such as the substantial investment, creativity and innovation, including patents and other intellectual property, that enhance the overall user experience, and, accordingly, the value of the music for the consumer,[19] and (iii) the costs of other inputs and participants in the value chain. Unlike the relative simplicity of the historical business model, distribution in the digital environment requires digital music services to share revenues with a wide array of other value chain participants, such as mobile network operators, Internet service providers and consumer electronics vendors, who bring much needed scale and relationships with consumers. Further, digital music service providers are often required to bear considerable infrastructure, technical and operational costs by utilizing third party vendors to provide necessary services and functions.

With all of these costs and expenses, the percentage of revenue that any digital music service can make available to all rights owners (and still turn a profit) is relatively fixed. However, when an individual rights owner successfully negotiates with a service for a greater share of the service's revenue, the resulting incremental royalty expense reduces the digital music service's share of revenues rather than reallocating a fixed pool of "wholesale costs" among the different rights owners. As a result, the digital music service provider frequently finds itself in the middle of a "tug-of-war" among the rights owners over royalties. The situation may be exacerbated in circumstances where individual rights owners enhance their negotiating leverage even further by withholding their licenses until other licensors have concluded their deals with the service.

Perhaps nowhere has this "tug-of-war" been more publicly recognized than in the recent ASCAP ratesetting proceeding involving Pandora Media. As noted by Judge Cote in a decision handed down in that proceeding in March 2014, the underlying premise for Sony/ATV's purported withdrawal of its catalog from the ASCAP repertory for certain digital uses was not that they felt the long-standing, well-established range of royalty rates for *musical work* public performance rights was unreasonable in *absolute terms*, but rather, when compared to the extraordinarily high royalty rates being paid by webcasters for *sound recording* rights under the Section 112 and 114 statutory licenses, they were not reasonable in *relative terms.*[20]

This all leads to upward pressure on royalty rates, which is entirely borne by the digital music services. Thus, much of the current debate over rates stems from disagreement among the labels, publishers and PROs about how to allocate the *content owners' fixed share of the pie*, rather than from a notion that service providers are not paying enough, in the aggregate, for content.[21] The net result of this "tug-of-war" over royalties among rights owners is aggregate royalty rates that are unjustifiable and, ultimately, unsustainable.

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[19] The value of the digital music services' contribution is discussed in greater detail in Section I.2.D below.

[20] *In re Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395, 2014 WL 1088101, at *25 (S.D.N.Y. Mar. 18, 2014) ("*Pandora II*") ("In his interview with Billboard.biz, reported on January 18, Bandier explained that the rates 'are quite reasonable. When you compare it to the rate record companies are getting, it was really miniscule.'").

[21] It is not novel for the content user to pay an all-in royalty for multiple rights in the copyright bundle. For example, music services pay a total fee for the combined right to the public performance of sound recordings under 17 U.S.C. § 114 and for any ephemeral reproductions that result from such a public performance under § 112(e). 37 C.F.R. § 380.3(c) (2013) ("The royalty payable under 17 U.S.C. 112(e) for the making of all Ephemeral Recordings used by the Licensee solely to facilitate transmissions for which it pays royalties shall be included within, and constitute 5% of, the total royalties payable under 17 U.S.C. 112(e) and 114.").

C. **Interdependence of interests**.

On a *macro level*, each of the stakeholders in the music licensing marketplace shares a common interest in, and would benefit from, a functional licensing structure that enables and facilitates long term, sustainable and profitable digital music businesses. On a *micro level*, however, the licensing structure that exists today enables each of the fragmented rights owners to "jockey for position" in the manner noted in Section I.2.B above, without regard for the *collective effect* that these individualized negotiations have on the potential profitability of digital music services (or the shared goal of building long-term, sustainable and profitable digital music businesses for the future).

Because of the symbiotic relationship between rights owners, creative talent and digital music services, the conduct of any one actor in its individualized negotiations can have unintended collateral consequences for the other unrelated parties. For example, a musical work that is held back from a digital music service over licensing issues would not only affect the publisher and the songwriter, but the record label and featured performer in the sound recording as well, and vice-versa. Because these individualized negotiations take place at different times, in different places, with different rights owners, and under different standards, the interdependence of interests often gets "lost in the shuffle." The "common good" – as well as the long term public interest in ensuring the continued existence of a vibrant music ecosystem where digital music services can operate long-term, sustainable businesses that can delight consumers for generations to come – would be served by copyright modernization and continued government oversight over certain key aspects of music licensing activity.

D. **In the rights owner "tug-of-war" over royalties, the value added by digital music service providers is often overlooked**.

While DiMA's members recognize the value of music as one of the critical inputs for their innovative services, content owners have tended to ignore, or undervalue, the massive investment by digital music service providers for many of the other critical inputs that allow services to delight consumers. In fact, the innovative services that are the result of the substantial investments made by DiMA members fulfill the primary goal of the Copyright Act: consumer access to creative works. The transformation of the music business to the digital environment could not have occurred without the substantial investment, creativity and innovation of legitimate digital music providers in developing and deploying these services, but the value added is often overlooked in ratesetting proceedings under statutory licenses and in individual negotiations with rights owners. This significant inequity was pointed out by Judge Cote in an ASCAP ratesetting decision handed down in March 2014:

> A rights holder is, of course, entitled to a fee that reflects the fair value of its contribution to a commercial enterprise. It is not entitled, however, to an increased fee simply because an enterprise has found success through its adoption of an innovative business model, its investment in technology, or its creative use of other resources. It appears that Sony, UMPG, and ASCAP (largely because of the pressure exerted on ASCAP by Sony and UMPG) have targeted Pandora at least in part because its commercial success has made it an appealing target. Pandora has shown that its considerable success in bringing radio to the internet is attributable not just to the music it plays (which is available as well to all of its competitors), but also to its creation of the [Music Genome Project] and its considerable investment in the development and maintenance of that innovation. These investments by Pandora, which make it less dependent on the purchase of any individual work of music than at least

some of its competitors, do not entitle ASCAP to any increase in the rate it charges for the public performance of music.[22]

3. The need for continued regulatory oversight in the area of music licensing.

A. The purpose of U.S. copyright law, and the required balancing of interests.

The fundamental purpose of U.S. copyright law is to serve the public interest by striking the optimal balance between (i) encouraging the creativity of authors by granting exclusive property rights in works of authorship, and (ii) fostering an efficient and competitive marketplace that ensures access to those works of authorship.[23] Because the public interest is at the core of copyright protection, the rights of authors are limited in various ways (as opposed to being absolute). These limitations – which range from the finite duration of copyright protection (as specified by the Constitution) to the myriad exceptions, exclusions and limitations established under U.S. copyright laws and the corresponding federal regulations, as well as the court rulings that have interpreted those laws and regulations – serve as a critical counter-balance to the market power of rights owners in the music licensing marketplace.

B. Congress and the Department of Justice have long recognized that a music licensing marketplace cannot properly function without regulatory oversight.

Both Congress and the Department of Justice have long recognized that the marketplace for copyrights creates ample opportunities for rights owners to frustrate, rather than enhance, an efficient competitive environment for the licensing of copyrighted works. These opportunities stem from the market power of rights owners, and the lack of available substitutes for the copyright rights needed. As a result, for over a century, the various rights conferred by U.S. copyright law have been subject to a regime of regulatory oversight that supplements, and operates in parallel with, the general principles of antitrust laws that apply to every industry. Each of these mechanisms and procedures was enacted to counter-balance the unique market power of copyright owners, and to ensure that copyright users can bring innovative technologies, products and services to consumers at fair prices, without being held up by the status of rate negotiations and/or ratesetting proceedings.

(a) The compulsory "mechanical" licenses for the reproduction and distribution of musical works embodied in phonorecords.

Since 1909, Congress has implemented a system that has allowed record labels to obtain compulsory "mechanical" licenses for the reproduction and distribution of musical works embodied in phonorecords, in order to ensure that there was a vibrant marketplace for the sale of recorded music.[24] As noted above, under the historical business model, retailers were also exempt from the need to secure musical work public performance licenses under Section 110(7) in furtherance of the same goal. As a

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[22] *Pandora II*, 2014 WL 1088101, at *46.

[23] *See* Nimmer, *supra* note 4, § 1.03[A] ("[T]he authorization to grant to individual authors the limited monopoly of copyright is predicated upon the dual premises that the public benefits from the creative activities of authors, and that the copyright monopoly is a necessary condition to the full realization of such creative activities." (internal footnote omitted)).

[24] *See* Nimmer, *supra* note 4, § 8.04[A] (2013) ("The Congress that enacted the 1909 Act was concerned with the possible emergence of 'a great music monopoly'. To forestall this threat, Section 1(e) of the 1909 Act enacted a compulsory license provision.").

result of this combination of regulations, retailers and record companies were free to sell recorded music without being encumbered (or potentially held back) by music licensing issues.[25]

(b) The public interest in "radio" in all of its forms, and the Section 112 and 114 statutory licenses.

In 1995 (and as further amended in 1998), Congress granted a compulsory license for the performance of sound recordings by means of non-exempt digital audio transmissions under Section 114 (and a corresponding compulsory license for the making of ephemeral recordings used to facilitate non-exempt digital audio transmissions under Section 112).[26] These compulsory licenses are particularly significant because they represent Congressional recognition that without them, market failures would have deprived the public of the benefits of new digital music services, including Internet radio services, satellite radio services, and radio services delivered through cable television and satellite television systems.[27]

(c) Exceptions and exclusions under U.S. copyright law.

In addition to the compulsory licenses noted above, Congress has also counter-balanced the unique market power of musical work and sound recording copyright owners through a long history of exceptions and exemptions to the exclusive rights otherwise conferred by Section 106.[28]

C. Antitrust considerations.

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[25] Since 1909, Congress has established various other statutory licenses to counter-balance the unique market power of copyright owners, including the following: compulsory license for secondary transmissions by cable systems (§ 111(d)); compulsory license for public performance of musical works in jukeboxes (§ 116); compulsory license for the public performance of musical works and display of pictorial, graphic and sculptural works by public broadcasting entities (§ 118); compulsory license for secondary transmissions by satellite carriers (§ 119); compulsory license for the reproduction and distribution of musical works in digital phonorecords (§ 115); compulsory license for the performance of sound recordings by means of non-exempt digital audio transmissions (§ 114); compulsory license for the making of ephemeral recordings used to facilitate non-exempt digital audio transmissions (§ 112); and sui generis right for the importation and distribution of digital audio recording devices (§ 1004).

[26] Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (codified at 17 U.S.C. §§ 112, 114); Digital Millenium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified in relevant part at 117 U.S.C. §§ 112, 114).

[27] S. Comm. on the Judiciary, Digital Performance Right in Sound Recordings Act of 1995, S. Rep. No. 128, 104th Cong., 1st Sess. 25 (1995), reprinted in 1995 U.S.C.C.A.N. 356 ("The Committee is aware of concerns that the copyright owners of sound recordings might become 'gatekeepers' and limit opportunities for public performances of the musical works embodied in the sound recordings.").

[28] Examples of these exceptions and exemptions include the following: exemptions from the reproduction right for ephemeral recordings (§ 112(a)), computer programs (§ 117(a)(1)) and computer maintenance (§ 117(c)); an exemption from the distribution right under the first sale doctrine (§ 109(a)); exemptions from both the reproduction and distribution rights for libraries and archives (§ 108) and for public broadcasting of sound recordings as part of educational programs (§ 114(b)); an exemption from both the reproduction and adaptation rights for computer program archives (§ 117(a)(2)); and exemptions for public performances for classrooms (§ 110(1)), instructional broadcasting (§§ 110(2), 111(a)(2)), religious services (§ 110(3)), fraternal organizations (§ 110(10)), non-profit performances (§ 110(4)), vending establishments (§ 110(7)), transmissions to handicapped persons (§ 110 (8)), secondary transmissions in hotels (the *Jewell-LaSalle* exemption) ((§ 111(a)(1)); display transmissions of television and radio in small commercial establishments (the *Aiken* exemption) (§ 110(5)), non-profit secondary transmitters (§ 111(a)(5)), nonsubscription broadcast transmissions (§ 114(d)(1)(A)), and retransmission of an exempt nonsubscription broadcast transmission (§ 114(d)(1)(B)).

Antitrust laws provide another critical counter-balance to the market power of rights owners in the music licensing marketplace. The exclusive rights conferred by copyright law are often in tension with both the public interest and the interests of intellectual property rights users. In the early part of the twentieth century, the prevailing antitrust view held that the inherent monopoly rights conferred by the granting of exclusive rights under our intellectual property laws were *incompatible* with the fundamental purpose of our antitrust laws (which were designed to protect against the abuses of monopoly power).[29] The more modern view, as recently set forth by the U.S. Department of Justice and the Federal Trade Commission, is that our intellectual property laws (including copyright) and antitrust laws share the same fundamental goals (i.e., enhancing consumer welfare and promoting innovation), and "work in tandem to bring new and better technologies, products, and services to consumers *at lower prices*."[30]

Under the modern view, the purpose of our antitrust laws as they relate to intellectual property rights is to "ensure that new proprietary technologies, products and services are bought, sold, traded and licensed in a *competitive environment*."[31] However, even under the modern view, it is well recognized that a competitive environment with robust competition in the marketplace cannot exist in markets where intellectual property rights are held by rights owners with significant *market power*, and there are no *good substitutes* reasonably available to the users of those intellectual property rights in the marketplace.

(a) The ASCAP and BMI antitrust consent decrees.

The unique market power of rights owners in the context of licensing musical work public performance rights under the American Society of Composers, Authors and Publishers ("ASCAP") and Broadcast Music, Inc. ("BMI") collective licensing regimes has long been counter-balanced by the antitrust consent decrees that the Department of Justice has put in place to govern the conduct of ASCAP (since March 1941) and BMI (since January 1941).[32] The processes and protections assured by these consent decrees serve several important roles that are critical to an efficient, properly functioning marketplace for these rights, and are discussed in greater detail in our responses to Questions 5, 6 and 7 below.

(b) The looming specter of publisher withdrawals from ASCAP and BMI.

In 2011 and 2012, various music publishers attempted to withdraw their catalogs from the ASCAP and BMI repertory for certain digital uses.[33] In two separate legal decisions handed down in 2013 by the federal courts with jurisdiction over ASCAP and BMI ratesetting proceedings, these courts

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[29] U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* 1 (2007).
[30] *Id.* (emphasis added).
[31] *Id.* (emphasis added).
[32] *See* Christopher Harrison, *You Gotta Fight for the Right to Publicly Perform*, 21 Texas Entm't and Sports L.J. 5 (2012).
[33] In May 2011, EMI Music Publishing purported to withdraw its catalogs from ASCAP's repertory for certain digital uses, effective as of January 1, 2012. Several other music publishers, including Warner/Chappell, Universal Music Publishing Group and BMG, followed with similar "partial" withdrawals. *See In re Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395, 2013 WL 5211927, at *3 (S.D.N.Y. Sept. 17, 2013) ("*Pandora I*"). In September 2012, EMI Music Publishing and Sony/ATV Music Publishing purported to withdraw their catalogs from BMI's repertory for certain digital uses, effective as of January 1, 2013. Several other publishers – BMG Rights Management, Kobalt Music Group, Universal Music Publishing Group, Wixen Music Publishing and George Johnson Music – followed with similar withdrawals, effective as of January 1, 2014. *See Broadcast Music, Inc. v. Pandora Media, Inc.*, Nos. 13-cv-4037, 64-cv-3787, 2013 WL 6697788 (S.D.N.Y. Dec. 19, 2013) ("*Pandora III*").

ruled that partial withdrawals are not permitted under the antitrust consent decrees.[34] However, both of these decisions left open the possibility that music publishers could withdraw their respective catalogs from ASCAP's or BMI's repertory for *all purposes.* It is rumored that the music publishers and the PROs are seeking modifications to the consent decrees to allow for partial withdrawals, which would give them the ability to withdraw their musical catalogs from the ASCAP and BMI repertories for only certain limited digital uses. As noted in these decisions and publicly reported articles,[35] the publishers attempted to withdraw certain digital rights for one simple reason – to further enhance their individual negotiating leverage to extract higher royalties (and other terms) from digital music services that have no reasonable substitutes for the rights they need (musical work public performance rights). The possibility of future withdrawals (in full or, if the consent decrees were to be modified, in part) threatens to undermine the key processes and protections assured by the antitrust consent decrees. The potential effects of such withdrawals are discussed in greater detail in our response to Question 5 below.

D. **The unprecedented market power of rights owners**.

It bears repeating that the market power of musical work and sound recording rights owners is greater now than any other time in our history. A little over fifteen years ago, there were six major record labels. Today, with the recent acquisition by Universal Music Group (the largest of the major record labels) of EMI (the smallest), there remain only three. On the musical work side, a little over fifteen years ago, there were six major music publishers. Today, with the recent acquisition of EMI Publishing (the largest of the major music publishers) by Sony/ATV, there remain only three. The increased concentration of market power of the major labels and the major publishers *greatly enhances* the leverage of right owners (and further diminishes the leverage of digital music services) when negotiating licenses for sound recordings and musical works.

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[34] In a legal decision that was handed down by the federal court with jurisdiction over ASCAP ratesetting proceedings in September 2013, Judge Cote ruled that under the antitrust consent decree that governs ASCAP's conduct, if a music publisher has made its catalog available for licensing by ASCAP to the public *in any respect* (*i.e.*, partially or fully), that catalog is therefore a part of ASCAP's "repertory" for *all* purposes (thereby rendering the purported partial withdrawals for certain digital uses *ineffective* for any purpose, with the result that the publishers involved remained *"all-in"* as a result of any purported partial withdrawal of rights). *Pandora I* , 2013 WL 5211927, at *6-*8. In a separate legal decision that was handed down by the federal court with jurisdiction over BMI ratesetting proceedings in December 2013, Judge Stanton similarly ruled that that under the antitrust consent decree that governs BMI's conduct, publishers cannot effectuate withdrawals for some uses (such as certain digital uses) without withdrawing their catalogs for all uses, and therefore, a purported partial withdrawal of a publisher's catalog from BMI's repertory for certain digital uses is effectively a withdrawal of that catalog from BMI's repertory for all purposes (thereby rendering the purported partial withdrawals for certain digital uses an *effective withdrawal for all purposes and service types*, including broadcast radio stations, television networks, bars and restaurants, with the result that the publishers involved remained "all-out" as a result of any purported partial withdrawal of rights). *Pandora III*, 2013 WL 6697788, at *4

[35] *Pandora II*, 2014 WL 1088101, at *14, *35 ("[The publishers] believed that because the two PROs were required under their consent decrees to issue a license to any music user who requested one, they could not adequately leverage their market power to negotiate a significantly higher rate for a license to publically perform a composition."); Bill Donahue, *Judge In ASCAP-Pandora Royalty Row Spells Out Rate Ruling*, Law 360, Mar. 19, 2014, *available at* http://www.law360.com/articles/519905/judge-in-ascap-pandora-royalty-row-spells-out-rate-ruling; Ed Christman, *Why Publishers Lost Big Against Pandora*, Billboard, Mar. 20, 2014, *available at* http://www.billboard.com/biz/articles/news/publishing/5944618/why-publishers-lost-big-against-pandora-analysis ("Both of those rates [negotiated by Sony and Universal directly with Pandora after the publishers' attempted partial withdrawals from ASCAP] are substantially higher than the 1.85% royalty rate that ASCAP was being paid by Pandora and neither qualify as market rates according to the Judge, because negotiating circumstances compelled Pandora to accept such rates.").

E. The relationship between market power and music licensing issues.

The relationship between market power and negotiating leverage is well known to the rights owners themselves. For example, in its opposition to the merger of Universal Music Group and EMI, Warner Music Group submitted testimony to the United States Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights illustrating how a major label with market power can use its leverage in negotiations with digital distributors to extract economic concessions and other favorable contract terms.[36] Warner's testimony went on to explain how a combined Universal Music Group/EMI would have such unprecedented market power that it would "be able to exercise its blocking position to coerce exclusionary deals and extract higher royalties, advances and other favorable terms by virtue of its market power alone."[37]

Further, in their capacity as the *licensees* of musical work rights (for the records they create, manufacture and distribute under the historical business model), the major labels have supported the existence of the compulsory license for the reproduction and distribution of musical works on a continuous basis since 1909, and have participated in each proceeding to adjust royalty rates and terms under Section 115 ever since, including the industry-wide settlements in 2008 and 2012, respectively.[38]

4. Copyright modernization is needed to ensure a legal and regulatory framework that will work in the digital environment.

A. Copyright modernization should take a holistic, rather than a "piecemeal" approach in the area of music licensing.

As the Register of Copyrights has previously noted, Congress generally moves slowly in the copyright space for a variety of reasons, including the complexity of the subject matter, the intensity of interested parties on particular issues, general public indifference on copyright matters, and finite time

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[36] *The Universal Music Group/EMI Merger and the Future of Online Music: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary*, 112th Cong. (2012) (statement of Edgar Bronfman, Jr., Director, Warner Music Group), *available at* http://www.judiciary.senate.gov/imo/media/doc/12-6-21BronfmanTestimony.pdf.

[37] *Id.*

[38] *See, e.g., Adjustment or Determination of Compulsory License Rates for Making and Distributing Phonorecords,* Docket No. 2011-3 CRB Phonorecords II (Feb. 1. 2011) (RIAA Petition to Participate), *available at* http://www.loc.gov/crb/proceedings/2011-3/ (stating that "RIAA participated in all previous proceedings to adjust royalty rates under Section 115 [and] has a significant interest in the royalty rates and terms that are the subject of this proceeding"); *Discussion Draft of the Section 115 Reform Act (SIRA) of 2006: Hearing Before the Subcomm. on Courts, the Internet and Intellectual Property of the H. Comm. on the Judiciary*, 109th Cong., 2d Sess. (2006) (statement of Cary H. Sherman, President, Recording Industry Association of America, Inc.) (arguing that proposed expansions of the 115 compulsory mechanical license to new forms of digital delivery were not broad enough, and advocating further expansion by "extend[ing] the blanket license to ALL products and services covered by the mechanical compulsory license…" (emphasis in original)); *Comm. on the Judiciary*, *Copyright Law Revision,* H.R. Rep. No. 83, at 66 (1st Sess. 1967) ("[T]he record producers argued vigorously that the compulsory license system must be retained. They asserted that the record industry is a half-billion-dollar business of great economic importance in the United States and throughout the world; records today are the principal means of disseminating music, and this creates special problems, since performers need unhampered access to musical material on nondiscriminatory terms. Historically, the record producers pointed out, there were no recording rights before 1909 and the 1909 statute adopted the compulsory license as a deliberate anti-monopoly condition on the grant of these rights. They argue that the result has been an outpouring of recorded music, with the public being given lower prices, improved quality, and a greater choice.").

given other domestic and international priorities.[39] Consequently, the current legal and regulatory framework for music licensing developed in a piecemeal manner, and is the product of accommodating the needs, goals and desires of special interest groups who "jockey for position" in their lobbying efforts to effectuate specific and narrow changes at any given time based on historical legal distinctions and rights recognized under U.S. copyright law.

However, the various issues and problems with the current music licensing framework have created a "perfect storm" that has led to systemic failure in the music licensing marketplace. The only way to fix this broken system and to address these issues, problems and inefficiencies is to view the music marketplace in a holistic way. Such a holistic approach should cut across the lines of traditionally recognized rights under U.S. copyright laws, and across the interests of particular groups that developed licensing practices in the pre-digital era.

Further, any solution must take into account the public interest in creating a licensing environment that allows digital music service providers to operate long-term, sustainable businesses that can delight consumers for generations to come. We could not agree more with the sentiments of the Register of Copyrights who, quoting former Register of Copyrights Thorvald Solberg, stated that "there comes a time when 'the subject matter ought to be dealt with as a whole, and not by further merely partial or temporizing amendments.'"[40]

B. The "Six Pillars" of U.S. copyright law modernization for the digital environment.

As the Copyright Office considers making its recommendations to Congress regarding potential areas for the modernization of U.S. copyright law, DiMA urges the Copyright Office to take a holistic view of the entire music licensing ecosystem, and provide a framework for the new digital era that is based on the six essential pillars discussed more fully in the Executive Summary section above:

- *Continued Government Oversight and Regulation of Music Licensing Activities*
- *Transparency and a Centralized Database*
- *Licensing Efficiencies and Reduced Transaction Costs*
- *Clarification of Rights*
- *Reduction of Legal Risks Around Licensing Activities*
- *"Level Playing Field"*

[39] Maria A. Pallante, *The Next Great Copyright Act*, 36(3) Colum. J.L. & Arts 315, 319 (2013).
[40] *Id.* (quoting Thorvald Solberg, *Copyright Law Reform*, 35 Yale L.J. 48, 62 (1926)).

II. RESPONSES TO THE SPECIFIC QUESTIONS POSED BY THIS NOTICE OF INQUIRY

MUSICAL WORKS

1. Please assess the current need for and effectiveness of the Section 115 statutory license for the reproduction and distribution of musical works.

A. <u>The Section 115 statutory license for the reproduction and distribution of musical works is vital</u>.

First, the Section 115 statutory license provides an *essential counter-balance to the unique market power of copyright rights owners*. It does this by providing a mechanism for immediate license coverage, thereby negating the rights owner's prerogative to withhold the grant of a license. Importantly, this immediate license coverage is not dependent on the status of rate negotiations and/or ratesetting proceedings. Without the ability to obtain this immediate obligatory coverage, some of the innovative digital music services in the marketplace today may not have been able to attain a significant enough number of musical work licenses to be considered attractive by consumers, while others would have been unable to launch at all, and thus would have been kept out of the marketplace entirely.

Second, the Section 115 statutory license provides a *useful benchmark for direct deals*. The royalty rates established by Section 115 ratesetting proceedings are often used as benchmarks for direct licenses of musical work rights, especially in cases where particular consumer offerings do not squarely fit into one of the statutory license categories available under Section 115 or its rate structure.

Third, the Section 115 statutory license provides a *framework for negotiating statutory rates by industry consensus*. By providing antitrust immunity for collective licensing discussions to settle ratesetting proceedings under Section 115, this essential framework enables stakeholders to negotiate rates and terms for a variety of digital music service types, consumer offerings and business models. This process was used successfully in 2008 and 2012, when rates and terms for a wide variety of physical and digital product types were negotiated by the relevant stakeholders, and implemented into the Code of Federal Regulations.[41]

Fourth, the Section 115 statutory license provides *necessary procedures for self-auditing and certification*. The self-auditing requirements provide rights owners with appropriate financial assurances regarding accountings.[42] At the same time, these requirements provide digital music services with appropriate protections against the possibility of direct audits by potentially tens of thousands of individual rights owners, which would be virtually impossible to administer and settle, and would significantly interfere with the day-to-day operations of digital music services.

Finally, the Section 115 statutory license provides *necessary procedures for notice and cure based on inaccurate accountings*. The Section 115 statutory license provides rights owners with appropriate opportunities to question accountings and provides digital music services with appropriate

[41] *See* Adjustment of Determination of Compulsory License Rates for Mechanical and Digital Phonorecords, 78 Fed. Reg. 67938 (Nov. 13, 2013) (final rule) (codified at 37 C.F.R. § 385) ("setting the rates and terms for the section 115 statutory license for the use of musical works in physical phonorecord deliveries, permanent digital downloads, ringtones, interactive streaming, limited downloads, limited offerings, mixed service bundles, music bundles, paid locker services, and purchased content locker services"); Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4510 (Jan. 26, 2009) (final rule) (codified at 37 C.F.R. § 385) (same).
[42] *See* 17 U.S.C. § 115(c)(5) (2012).

opportunities to rectify, clarify and/or address the concerns of rights owners without jeopardizing license coverage. This mechanism for assuring *continuous license coverage* during periods of discussion (or dispute) provides another counter-balance to the unique market power of copyright owners that is as essential as the *initial* immediate license coverage provided by the Section 115 statutory license upon service of an NOI.

B. **<u>A number of significant problems with the Section 115 statutory licensing process limit the effectiveness of the Section 115 statutory license</u>**.

Although the continued existence of the Section 115 statutory license for the reproduction and distribution of musical works *is vital*, there are a number of *significant problems* with the licensing *process* that currently *limit its effectiveness*:

- <u>Song-by-song licensing is inefficient and expensive</u>. The current process of song-by-song licensing has not worked well under the historical business model for a variety of reasons,[43] and is particularly ill-suited for the digital environment. While the Section 115 statutory license provides an important tool for securing licensing ubiquity, the process of securing that ubiquity is highly inefficient and costly because millions of works must be licensed individually from the tens of thousands of different rights owners who own and control the required rights. Moreover, to the extent that a service chooses to file statutory license notices with the Copyright Office for the many musical works for which the relevant rights owners cannot be identified, the costs can be overwhelming given the volume of works at issue.[44]

- <u>The licensing process under Section 115 lacks necessary transparency</u>. The lack of a publicly available, centralized database for musical works limits the effectiveness of the licensing process in several significant respects:

    - First, it requires each of the dozens of digital music services to dedicate separate internal systems and personnel to developing rights owner information on a song-by-song basis, or to engage third-party service providers such as The Harry Fox Agency ("HFA") or Music Reports, Inc. to do so on its behalf. In either case, the undertaking is incredibly costly, and because the same information is developed by multiple parties (including the record labels) in parallel, there is much duplication of effort.

    - Second, in cases where statutory licenses under Section 115 are supplemented with direct licenses with music publishers, it is difficult to determine what is (and is not) covered by any given direct license, since this information is seldom provided by the music publishers to their own licensees. Accordingly, it is almost impossible to ascribe an

[43] For example, Section 115 requires services to clear the underlying publishing rights for newly released sound recordings before distributing them, but such a task is nearly impossible in many cases, where there are co-writers of a musical work and those co-writers do not determine their individual relative percentages of ownership (if any) until *after* the phonorecords which embody them are commercially released. This is a challenge that the major labels themselves have faced under Section 115 when securing mechanical licenses for physical products under the historical business model.

[44] The filing fee for "[r]ecordation of a notice of intention to make and distribute phonorecords" under 17 U.S.C. § 115 is $75 for the first title and $20 for each additional title for each group of ten titles. Circular SL 4L, *Copyright Office Licensing Division Service Fees*, *available at* http://www.copyright.gov/fls/sl04l.pdf (last visited May 14, 2014). Thus, the Copyright Office filing fee amounts to $255 for every ten musical works with unknown authors. For example, ten thousand (10,000) unknown authors would cost a service more than two-hundred fifty thousand dollars ($250,000) in filing fees alone to protect the service from potential statutory damages for infringement of the reproduction and distribution rights in musical works whose authors are nowhere to be found.

appropriate value to a direct license agreement, and to determine which musical works must be separately licensed through statutory licenses under the licensing process in Section 115.

- Third, despite the best intentions of a digital music service provider to identify accurately every musical work rights owner for every musical work, there are inevitably musical works whose owner(s) cannot be identified at all, or that are misidentified as a result of inaccurate information contained in the incomplete privately available databases relied upon today by digital music services.

- Fourth, the statutory licenses under Section 115 are only available if the copyright owner has already made or authorized a recording of the composition that has been distributed to the public in the U.S.[45] It is quite challenging to ascertain whether this first use has, in fact, occurred, as most of the privately available databases relied upon by digital music services (including the musical work information independently developed by the record labels themselves) lack this critical information. This problem is especially acute in circumstances where co-writers of musical works disagree about the relative percentages of their individual contributions to the work as a whole, and do not resolve these intra-songwriter and intra-publisher disputes over "splits" until long after the initial commercial release.

The risk of any resulting "rights gaps" exposes digital music service providers to the possibility of statutory damages, even in instances where the digital music service provider has acted diligently and in good faith based on the best information available to them, with limited (if any) control over how to mitigate this legal risk. This significantly limits the effectiveness of the licensing process, and exposes digital music services to levels of risk that are not equitable under the circumstances.

- <u>The risk of statutory damages for "timing" issues inherent in the Section 115 licensing process</u>. Given the difficulties noted above in determining whether a first use has occurred, the specter of statutory damages for failing to timely send NOIs under the Section 115 licensing process exposes digital music service providers to levels of risk that are not equitable under the circumstances.

- <u>The lack of financial certainty caused by "timing" issues inherent in the Section 115 licensing process</u>. For digital music services that rely on licenses under Section 115 as well as separate licenses for the public performance of musical works, it is often impossible to determine the appropriate deduction for musical work public performance royalties at the time that accountings under the Section 115 licenses are due. This is because the calculation of "mechanical" royalty rates under Section 115 requires that public performance royalties be deducted; and public performance rates are often not determined – whether by "interim agreement," "final agreement" or ratesetting proceeding – until long after the close of the month during which Section 115 royalties are due. As a result, digital music service providers must often make assumptions about how much to accrue, and then hold the accrued amounts for substantial periods of time (which is not beneficial for music publishers or songwriters who desire to get paid more quickly). Further, once the actual rates become known, digital music services must recalculate their royalties, restate their earnings for prior periods (which investors do not like), and send restated Section 115 royalty statements (which is costly and administratively burdensome).

[45] 17 U.S.C. § 115(a)(1). Section 115(b)(1) provides in relevant part as follows: "Any person who wishes to obtain a compulsory license under this section shall, before or within thirty days after making, and before distributing any phonorecords of the work, serve notice of intention to do so on the copyright owner."

- Monthly accountings. In direct license agreements for rights otherwise covered by the Section 115 statutory licenses, it is customary for digital music services to pay rights owners on a *quarterly basis*. Similarly, in recording agreements with recording artists it is customary for record labels to pay mechanical royalties to artists who are also songwriters on a quarterly basis, even in circumstances where the record royalties payable for the uses and exploitations of the sound recordings that embody these musical works are paid on a less frequent basis.[46] However, royalties under the Section 115 statutory licenses are required on a *monthly basis*. Because of the vast number of rights owners and musical works licensed under the Section 115 statutory licenses, each set of accountings requires administrative resources and out-of-pocket costs. The more frequently accountings are required, the less efficient and more burdensome it is for the digital music services that pay these royalties.

- "Hard-coded minima." The royalty rate structures for some (but not all) rate categories under the Section 115 statutory licenses set minima that reflect reproduction and distribution rights only,[47] rather than an "all-in" minimum that also includes the cost of royalties for public performance rights.[48] If musical work public performance rights are not available at "reasonable rates" through the processes and protections under the ASCAP and BMI antitrust consent decrees for any reason,[49] the "hard-coded minima" in Section 115 could cause the "all-in" rates to be exceeded, which was never intended by the stakeholders that negotiated the voluntary settlement of the rates and terms under the Section 115 statutory licenses in 2008 and 2012. Such a phenomenon would undermine the Section 115 ratesetting process as a whole.

2. Please assess the effectiveness of the royalty ratesetting process and standards under Section 115.

A. The royalty ratesetting process under Section 115 has generally been effective.

As noted in our response to Question 1, the royalty ratesetting process under Section 115 provides an essential *framework* for negotiating statutory rates by industry consensus, which is only possible because of the antitrust immunity for collective licensing discussions to settle rate setting proceedings under Section 115. Through this framework, stakeholders are able to negotiate rates and terms for a variety of digital music service types, consumer offerings and business models and bring them to market for the benefit of consumers.

B. The royalty ratesetting process under Section 115 could be made more effective.

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[46] *See, e.g.,* Matthew Bender, 8-159 Entertainment Industry Contracts FORM 159-1 (Exclusive Recording Artist Agreement [Long Form] with Commentary), at ¶¶ 8.01, 11.01(d) (2014).

[47] The royalty minima for the following rate categories covers the reproduction and distribution rights only, and do not cover public performance rights: "standalone non-portable subscription—streaming only," "standalone non-portable subscription—mixed," "standalone portable subscription service," and "bundled subscription services." *See* 37 C.F.R. § 385.13 (2013).

[48] The royalty minima for the following rate categories are truly "all-in," meaning that the PRO fees for the public performance rights are included in (and can be deducted from) the minimum amount owed for the mechanical rights: "free nonsubscription/ad-supported services," "mixed service bundle," "music bundle," "limited offering," "paid locker service," and "purchased content locker service." *See* 37 C.F.R. §§ 385.13, 385.23.

[49] For example, in the event that music publishers withdraw entirely from ASCAP and BMI, or, alternatively, just for certain digital uses in the event that the antitrust consent decrees were to be modified by the Department of Justice to allow for partial withdrawals.

Although the royalty ratesetting process under Section 115 has generally been effective, the fast-moving digital landscape sometimes outpaces the five year cycle for ratesetting proceedings under Section 115. The royalty ratesetting process under Section 115 would be *more effective* if it provided a mechanism for *interim ratesetting proceedings* on an as-needed basis for *new* service types, consumer offerings and business models that develop in between the regular ratesetting proceedings. As the music business continues its evolution from the historical business model to the digital environment, it is essential that digital music services meet consumer expectations, and a process under Section 115 that recognizes the pace of change could be incredibly valuable.

C. **The royalty ratesetting standards under Section 115 have generally been effective**.

Since 1976, royalty ratesetting proceedings under Section 115 have been governed by the standard set forth in Section 801(b),[50] which provides in relevant part as follows:

> (1) To make determinations and adjustments of reasonable terms and rates of royalty payments as provided in sections 112(e), 114, 115, 116, 118, 119, and 1004. The rates applicable under sections 114(f)(1)(B), 115, and 116 shall be calculated to achieve the following objectives:
>
> (A) To maximize the availability of creative works to the public.
>
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
>
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
>
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[51]

The Section 801(b) standard for ratesetting proceedings under Section 115 was adopted as part of the copyright revisions implemented in 1976.[52] As previously noted, in their capacity as the *licensees* of musical work rights under the historical business model, the record labels have long argued that this standard correctly balances the relevant factors required to yield a fair and equitable royalty for the exercise of musical work reproduction and distribution rights under the Section 115 statutory licenses. The Section 801(b) standard has been time-tested to provide fair rates (i.e., "reasonable fees") that have been accepted for more than half a century in many different contexts, including ratesetting proceedings under Sections 114(f)(1)(B), 115, and 116.

3. **Would the music marketplace benefit if the Section 115 license were updated to permit licensing of musical works on a blanket basis by one or more collective licensing entities,**

[50] *See* H.R. Rep. No. 94-1476, at 111 (1976) ("This [Section 115] rate will be subject to review by the [CRT], as provided in section 801, in 1980 and at 10-year intervals thereafter.").
[51] 17 U.S.C. § 801(b) (2012).
[52] *See* H.R. Rep. No. 94-1476, at 173-74.

rather than on a song-by-song basis? If so, what would be the key elements of any such system?

A. <u>The music marketplace would benefit if the Section 115 license were updated to permit licensing of musical works on a blanket basis by one or more collective licensing entities, rather than on a song-by-song basis</u>.

As previously noted in our response to Question 1, the current process for acquiring licenses under Section 115 on a song-by-song basis has many significant drawbacks including inefficiencies, expenses, lack of transparency, inequitable exposure to legal risk, lack of financial certainty and the possibility that all-in rates may not, in fact, be all inclusive. As discussed more fully in the next section, the music marketplace would greatly benefit from blanket licenses under Section 115.

B. <u>The Section 115 statutory license could be made more effective</u>.

The effectiveness of the Section 115 statutory license would be *significantly enhanced* by implementing a licensing regime that incorporated the following *key elements*:[53]

- <u>Blanket licenses</u>. For the reasons noted elsewhere, the music marketplace would benefit greatly from replacing the current process of licensing music on a song-by-song basis with a blanket license system (without the ability of rights owners to "opt-out"). Under this system, one license application would be served under a collective administration mechanism covering all musical works. For such a system to be effective, copyright users must nonetheless continue to have (i) payment options designed to ensure that they only pay for the rights they need (and the actual level of use and consumption), as per the current framework of Section 115, (ii) the ability to enter into direct licenses with rights owners in addition to (or in lieu of) these blanket licenses, and (iii) the ability to appropriately offset amounts paid under direct licenses from the minima prescribed by the blanket licenses.[54]

- <u>Transparency and a centralized database</u>. The problems and issues noted in Section II.1.B, above, could be greatly mitigated by the recommended centralized database of musical works and sound recordings.

- <u>Collective administration</u>. A mechanism should be established that enables the collective administration of musical work rights, in a manner similar (but not necessary identical) to the mechanism proposed in the context of the Section 115 Reform Act of 2006 ("SIRA").[55] Collective administration of musical work copyrights has worked in the context of public

[53] Several of these key elements were incorporated in the proposed Section 115 Reform Act of 2006 ("SIRA"), which was fully negotiated by interested stakeholders in 2006 but failed to be enacted into the copyright law for unrelated reasons.

[54] At a minimum, if song-by-song licensing is still required, there should be a system that facilitates an automated, electronic process for serving NOIs (in lieu of the current requirement under the implementing regulations that these NOIs be served in paper formats, which is inefficient, costly and more difficult to track and administer). *See* 37 C.F.R. § 201.18 (2013). Alternatively, if a SIRA-like structure for blanket licenses and collective administration is not implemented, there should be a safe harbor that shields copyright users from infringement liability if they have acted diligently and in good faith based on the information contained in the centralized database, to avoid inequitable outcomes.

[55] For clarity, we are not suggesting an implementation of SIRA exactly as was proposed in 2006. However, we believe that there are many elements and components from SIRA that would serve the music licensing marketplace well today.

performance rights in musical works (ASCAP, BMI and SESAC), and reproduction/public performance rights in sound recordings (SoundExchange, Inc.), but no similar mechanism exists for reproduction and distribution rights for Section 115 licenses. Difficult logistical issues – particularly the many reporting, payment and other operational issues – should be left to implementing regulations, and not addressed in Section 115 directly. However, it is critical that any collective administration mechanism be in addition to, and not in lieu of, the recommended centralized database for musical works, as digital music services should, at all times, retain the right to pay the required royalties directly to the applicable rights owners instead of through one or more common agents.

- Legal certainty. The copyright laws should be clarified to provide that the blanket license covers all intermediate copies (e.g., server, cache and buffer copies) necessary to facilitate the digital delivery of music, and intermediate copies for non-interactive streaming should be royalty free, or exempt (to avoid "double dipping" by rights owners based on claims arising out of overlapping copyright rights).

4. For uses under the Section 115 statutory license that also require a public performance license, could the licensing process be facilitated by enabling the licensing of performance rights along with reproduction and distribution rights in a unified manner? How might such a unified process be effectuated?

A. For uses under the Section 115 statutory license that also require a public performance license, the licensing process would be facilitated by enabling the licensing of performance rights along with reproduction and distribution rights in a unified manner.

As previously noted, the fragmentation of rights ownership and the convergence of rights increase the number of transactions that must be undertaken for the license of musical works, and each additional transaction diminishes licensing efficiencies, and increases transaction costs for both licensors and licensees.

B. How a unified process for the licensing of performance rights along with reproduction and distribution rights might be effectuated.

A process for licensing performance rights along with reproduction and distribution rights in a unified manner could be effectuated by a system that incorporated the following key elements:

- Collective administration. A mechanism should be put in place that enables the collective administration of an "all-in," combined mechanical and performance royalty. The rights owners would be responsible for allocating the aggregate "all-in" royalty among themselves (i.e., between the "mechanical" and public performance interests) based on factors that they deem to be reasonable and appropriate under the circumstances. By allowing the rights owners to make this allocation as between themselves, the digital music service providers would be taken out of the rights owner "tug-of-war" over royalty payments.

- Process for determining reasonable rates. In an ideal world, services that require a combination of musical work public performance rights, as well as reproduction and distribution rights under Section 115, would be able to acquire such rights from a single licensing source under a single statutory license and pay a single royalty to a common agent, similar to the way that SoundExchange administers the Section 112 (reproduction) and 114 (public performance) statutory licenses. However, DiMA recognizes that such a structure would require a fundamental alteration of the existing framework for musical work licensing. To the extent that the existing framework is retained, the collective licensing agent(s) DiMA is proposing for the collection of royalties under Section 115 would be authorized to collect the "all-in" royalty payable under Section 115, and then apportion an appropriate percentage of that royalty to the PROs, thereby removing the digital music service providers from the middle of the rights owner "tug-of-war" over publishing royalty payments.[56] Digital music services that require only public performance licenses would continue to operate under the current licensing framework that governs the PROs.

- No ability to opt-out. As a further counter-balance to the already significant market power of rights owners, to ensure the essential protections of the ASCAP and BMI antitrust consent decrees it is essential that rights owners not have the ability to "opt-out" of this licensing process.

- Transparency and a centralized database. For the reasons noted elsewhere, the licensing process would be greatly facilitated by the recommended centralized database for musical works, including information about the sound recordings in which such musical works are embodied.

C. A unified licensing process for licensing otherwise fragmented rights is not new.

The use of a collective administration mechanism to manage rights that are fragmented across different rights owners under U.S. copyright laws is not new, and has already been in place for some time with respect to the collection and administration of royalties under the Section 112 and 114 statutory licenses for sound recordings. In this context, SoundExchange, Inc. ("SoundExchange"), as the collective administration mechanism for statutory royalties under the Section 112 and 114 statutory licenses, collects a single "all-in" royalty that covers both the Section 112 and Section 114 rights. The recipients of these royalties, which include the sound recording rights owners, featured recording artists, and the relevant talent unions, determined among themselves the value of the Section 112 reproduction rights relative to the value of the Section 114 public performance rights, and the digital music services that pay these royalties were not placed in the middle of this determination.

5. Please assess the effectiveness of the current process for licensing the public performances of musical works.

A. The current process for licensing the public performances of musical works has generally been effective.

As previously noted, the blanket licenses (among other forms of licenses) offered by ASCAP, BMI and SESAC provide a framework that promotes licensing efficiencies and reduced transaction costs for both licensors and licensees alike. With regard to songwriters in particular, the process offers greater transparency in the context of performance royalty payments, as the general custom and practice in the music publishing industry is that songwriters, even if subject to arrangements with music publishers for the administration of musical work copyrights and related royalties, receive the "songwriter's share" of public performance royalties directly from ASCAP, BMI and SESAC, respectively.

The processes and protections assured by these consent decrees serve several important roles that are critical to an efficient, properly functioning marketplace for these rights:

[56] Difficult issues regarding how the licensing process would work under this structure need to be worked out, and should probably be addressed through the implementing regulations under Section 115.

- Immediate, blanket licensing. The process allows for immediate license coverage of a vast body of musical works on a "blanket" basis upon the service of a consent decree license request (and is not dependent on the status of rate negotiations and/or ratesetting proceedings). This is an essential counter-balance to the unique market power of rights owners, as it negates the prerogative of a rights owner of an exclusive right from withholding the license and enables digital music services to bring new offerings to market quickly and efficiently for the benefit of consumers.

- Non-discrimination on royalty rates. The "rate parity" concept in each of the antitrust consent decrees requires each of ASCAP and BMI to license all similarly-situated services on comparable terms. This provides another essential counter-balance to the unique market power of rights owners, and ensures that the rates set under the antitrust consent decrees are fair on a relative basis compared to comparable service types, which is essential to the "level playing field" required for services to compete with one another fairly in the marketplace.

- Reasonable rates. As a further counter-balance to the unique market power of rights owners, the process provides a mechanism that allows copyright users to resort to the federal courts with jurisdiction over ASCAP and BMI ratesetting proceedings to set "reasonable fees." This ensures that rights owners cannot use their combined market power to extract unreasonable royalty rates. The interpretation and implementation of the ratesetting standard in ASCAP and BMI ratesetting proceedings have generally been effective because the federal courts appropriately take into account several important factors when attempting to determine appropriate benchmark rates in the music licensing marketplace, such as whether the parties have equal access to information and whether both parties are compelled to act.[57] These critical factors, by contrast, are not recognized under the "willing buyer, willing seller" standard used in some ratesetting proceedings under the Section 112 and 114 statutory licenses. As discussed at greater length in our response to Question 8 below, this difference in interpretation and implementation yields vastly different economic results for copyright users.

B. Withdrawals of musical works from the repertories of ASCAP and BMI threaten to undermine the effectiveness of the current process for licensing the public performances of musical works.

As noted in Section I.3.C., recent decisions by the federal courts in rate setting proceedings under the ASCAP and BMI consent decrees have clarified that as a matter of antitrust law, music publishers cannot withdraw their musical catalogs from the ASCAP and BMI repertory for only certain limited digital uses. However, both of these decisions left open the possibility that music publishers could withdraw their respective catalogs from ASCAP's or BMI's repertory for *all purposes*. Alternatively, it is

[57] These critical factors were noted by Judge Cote in an ASCAP ratesetting decision handed down in March 2014, which cited a textbook definition of "fair market value": "A widely used description of fair market value is the cash equivalent value at which a willing and unrelated buyer would agree to buy and a willing and unrelated seller would agree to sell . . . *when neither party is compelled to act, and when both parties have reasonable knowledge of the relevant available information*. . . . Neither party being compelled to act suggests a time-frame context – that is, the time frame for the parties to identify and negotiate with each other is such that, whatever it happens to be, it does not affect the price at which a transaction would take place. . . . The definition also indicates the importance of the availability of information – that is, the value is based on an information set that is assumed to contain all relevant and available information." *Pandora II*, 2014 WL 1088101, at *32 (emphasis added) (quoting Robert W. Holthausen & Mark E. Zmijewski, *Corporate Valuation* 4–5 (2014)).

rumored that the music publishers and the PROs are seeking modifications to the consent decrees to allow for partial withdrawals, which would give them the ability to withdraw their musical catalogs from the ASCAP and BMI repertories for only certain limited digital uses. If either complete or partial withdrawals were to occur, the processes and protections assured by the antitrust consent decrees – in particular, the assurance of "reasonable fees" for copyright users – would be undermined.[58] In this event, if digital music services and music publishers are unable to agree on licensing terms, certain musical works would not be available, and the commercial viability of the services that require these licenses would be threatened, as consumer expectations of licensing ubiquity could not be achieved. As previously noted, the music publishers sought to withdraw their catalogs for one simple reason – to further enhance their individual negotiating leverage to extract higher royalties (and other terms) from digital music services.

In fact, such withdrawals would be contrary to the very policies that underlie the statutory licenses under Sections 112, 114 and 115, which were designed to ensure that services subject to such licenses could efficiently attain licensing ubiquity, and lawfully operate without having to negotiate individually with tens of thousands of rights holders. When these statutory licenses were created, it was not contemplated that musical works might be removed from the digital licensing purview of ASCAP and BMI. In fact, such withdrawals would open up a "back door" for musical work rights owners to undermine the objectives of the Section 112, 114 and 115 statutory licenses, and the public interest in ensuring that "radio" in all of its forms would not be kept out of the marketplace entirely because of music licensing issues, as noted Section I.3.B(b) above.

Finally, because of the interdependence of interests among sound recording and musical work rights owners, the result of a decision made by any one rights owner *not* to grant a requested license to a digital music service has *collateral consequences* for the other rights owners that have made a decision to *grant* a requested license. Empowering a "hold out" to effectively make a decision (with economic consequences) for other third parties, such as other record labels, music publishers, songwriters, featured recording artists, non-featured recording artists and non-featured vocal performers, turns the principal of recognizing exclusive rights under copyright on its head, and should be avoided.

C. **The current process for licensing the public performances of musical works could be made more effective**.

The effectiveness of the current process for licensing the public performances of musical works would be *significantly enhanced* by implementing a licensing regime that incorporated the following key elements:

- Transparency and a centralized database. The problems and issues noted in Section II.1.B, above, could be greatly mitigated by the recommended centralized database of musical works and sound recordings.[59] As Judge Cote determined in an ASCAP ratesetting decision handed down in March 2014, the music publishers acted in concert with ASCAP to modify ASCAP's internal rule set (known as the ASCAP Compendium) to allow music publishers to withdraw their catalogs from ASCAP's repertory for certain digital uses, for the sole and limited purpose of "closing the

[58] Partial withdrawals would also undermine the principle of platform parity in the consent decrees, which holds that similarly situated services must be treated the same by ASCAP and BMI. *See Am. Soc'y of Composers, Authors, and Publishers v. MobiTV, Inc.*, 681 F.3d 76 (2d. Cir. 2012) ("*MobiTV*"); *Pandora III*, 2013 WL 6697788, at *5 ("BMI cannot combine with [the publishers] by holding in its repertory compositions that come with an invitation to a boycott attached.").

[59] *See Meredith Corp. v. SESAC LLC*, No. 09-cv-9177, 2014 WL 812795 (S.D.N.Y. Mar. 3, 2014) ("*Meredith Corp.*"); *Radio Music License Committee, Inc. v. SESAC Inc*., No. 12-cv-5807 (E.D. Pa. Dec. 20, 2013) ("*RMLC*").

gap between the composition rates and the sound recording rates" through direct licenses outside the framework and protections of the ASCAP antitrust consent decree, which they believed "stood in the way."[60] Judge Cote also found that the lack of transparency regarding rights ownership was used as negotiating leverage, because the withholding of a list of the works in question, which was "readily at hand," denied Pandora the ability to (i) remove the ASCAP repertory controlled by those music publishers from the service if the parties could not reach agreement on economic terms, (ii) apportion any payments between the catalogs of two different music publishers, and (iii) evaluate whether a substantial advance payment paid by Pandora was likely to be recouped.[61] As a result, without this critical information, a digital music service provider is unable to assess its potential legal exposure for the use of unlicensed works (and mitigate any potential exposure by refraining from using those musical works, or taking them down, as the case may be), and determine the value of the blanket licenses and direct licenses offered by rights owners for the public performance of musical works.

- Immunity from statutory damages. To avoid inequitable outcomes, there should be a "safe harbor" that shields copyright users from infringement liability if they have acted diligently and in good faith based on the information contained in the recommended centralized database. Further, any entitlement to statutory damages in other contexts should be conditioned on the registration of accurate rights ownership information in the centralized database, utilizing universal standards.

- No ability to opt out. For the public policy reasons noted above, as a further counter-balance to the already significant market power of rights owners, it is essential that music publishers not have the ability to opt out of the blanket licenses.[62]

6. Please assess the effectiveness of the royalty ratesetting process and standards applicable under the consent decrees governing ASCAP and BMI, as well as the impact, if any, of 17 U.S.C. § 114(i), which provides that "[l]icense fees payable for the public performance of sound recordings under Section 106(6) shall not be taken into account in any administrative, judicial, or other governmental proceeding to set or adjust the royalties payable to copyright owners of musical works for the public performance of their works."

A. The royalty ratesetting process and standards applicable under the consent decrees governing ASCAP and BMI have generally been effective.

[60] *Pandora II*, 2014 WL 1088101, at *13-*14.
[61] *Id.* At *24 ("Sony understood that it would lose an advantage in its negotiations with Pandora if it provided the list of works and deliberately chose not to do so.").
[62] By opting out, the ability of a rights owner to extract an unreasonable royalty from a digital music service is greatly enhanced, as Judges Cote and Stanton recognized in the recent ASCAP and BMI rate setting proceedings with Pandora Media. These unreasonable royalty rates, in turn, would then be bootstrapped by rights owners as the new market rate to be used in future ratesetting proceedings. As such, very few music publishers (and perhaps as few as one) could effectively control the overall market rate for musical works, and the resulting bootstrapped rate would then have collateral consequences for other publishers and the performing rights organizations, to the detriment of all similarly-situated digital music services and, ultimately, the consumers of digital music services. Further, opt outs create other unintended consequences, such as the possibility that unreasonable rates extracted for the public performance of musical works would cause the all-in rates in 37 C.F.R. § 385 "Subpart B" – which were intended to be inclusive of the aggregate royalties paid for both musical work public performance rights, as well as reproduction and distribution rights – to be exceeded, which was never intended by the stakeholders that negotiated the industry-wide settlements for rates and terms under the Section 115 statutory licenses in 2008 and 2012, respectively.

As noted in our response to Question 5, the royalty ratesetting *processes* under the ASCAP and BMI consent decrees are critical to an efficient, properly functioning marketplace for the public performance of musical works. In addition to the reasons noted above, the oversight of the federal courts to set "reasonable fees" in ratesetting proceedings has been essential. The proceedings are in front of seasoned, tenured, federal judges who are regularly assigned these cases and are able to apply the terms of the consent decrees in a consistent manner. The trials are thorough and the resulting decisions tend to be thoughtful and well-reasoned. Furthermore, the proceedings themselves are conducted utilizing the Federal Rules of Civil Procedure and the Federal Rules of Evidence, which enable litigants to fairly and predictably obtain discovery, present evidence and rely on precedents.

The royalty ratesetting *standards* under the ASCAP and BMI consent decrees similarly provide an essential counter-balance to the unique market power of rights owners, and are equally critical. Under the consent decrees, the federal courts are required to set "reasonable fees" in ratesetting proceedings.[63] In practice, this ratesetting standard has been time-tested in numerous rate setting proceedings for more than half a century to determine rates that have been entirely consistent with this standard, and has consistently established royalty rates that appropriately approximate the "fair market value" of particular licenses in different contexts.[64]

For the reasons already noted in the context of Question 5 and elsewhere in this Notice of Inquiry response, full (or even partial) withdrawals of musical works from the repertories of ASCAP and BMI threaten to undermine the effectiveness of the current royalty ratesetting process and standards applicable under the consent decrees.

B. <u>The impact of 17 U.S.C. § 114(i)</u>.

With respect to the impact, if any, of 17 U.S.C. § 114(i), on the effectiveness of the royalty ratesetting process and standards applicable under the ASCAP and BMI consent decrees, it is worth mentioning that this provision is a good example of the type of legislation that results when special interest groups "jockey for position" in their lobbying efforts to seek specific and narrow changes to U.S. copyright law. The result is piecemeal modifications that benefit only those special interest groups, at the expense of other stakeholders and the public interest.

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[63] *See United States v. Am. Soc'y of Composers, Authors & Publishers*, No. 41-cv-1395, 2001 WL 1589999, at *6-7 (S.D.N.Y. June 11, 2001) ("ASCAP Consent Decree") ("[T]he burden of proof shall be on ASCAP to establish the reasonableness of the fee it seeks … Should ASCAP not establish that the fee it requested is reasonable, then the Court shall determine a reasonable fee based upon all the evidence."); *United States v. Broadcast Music, Inc.*, No. 64-cv-3787, 1994 WL 901652, at *1 (S.D.N.Y. Nov. 18, 1994) ("BMI Consent Decree") ("If the parties are unable to agree upon a reasonable fee within sixty (60) days from the date when [BMI] advises the [service] of the fee which it deems reasonable, the [service] may forthwith apply to [the Southern District of New York] for the determination of a reasonable fee … If the parties are unable to agree upon a reasonable fee within ninety (90) days from the date when [BMI] advises the [service] of the fee which it deems reasonable and no such filing by applicant for the determination of a reasonable fee for the license requested is pending, then [BMI] may forthwith apply to [the Southern District of New York] for the determination of a reasonable fee.").

[64] *MobiTV*, 681 F.3d at 82 ("When setting an appropriate rate, the District Court must attempt to approximate the "fair market value" of a license—what a license applicant would pay in an arm's length transaction. … In so doing, the rate-setting court must take into account the fact that ASCAP, as a monopolist, exercises market-distorting power in negotiations for the use of its music.") (citing *United States v. BMI (Application of Music Choice)*, 316 F.3d 189, 194 (2d Cir. 2003)); *Pandora II*, 2014 WL 1088101, at *31 (noting that Section IX of the ASCAP Consent Decree "requires the rate court to set a 'reasonable' fee for a requested license, but that [the] term is not defined in [the ASCAP Consent Decree]" and citing *MobiTV* as "[g]overning precedent" dictating that courts must approximate the fair market value in determining such a "reasonable fee").

This provision was implemented into U.S. copyright law in 1995 based on lobbying efforts by the music publishers and the PROs,[65] who were concerned that the rate for musical work public performance rights might be *reduced* if the rates for the newly created sound recording public performance rights were taken into account in musical work public performance ratesetting proceedings.[66] Remarkably, with the benefit of hindsight, the music publishers and performing rights organizations have now observed that the royalties established by the Copyright Royalty Board for the statutory licenses under Sections 112 and 114 are in certain cases incredibly high (and, as noted below, so high in some cases that they are unsustainable). Not surprisingly, music publishers are now seeking to use those rates as relevant benchmarks to *increase* the rates for musical work public performance rights. *In theory*, taking a holistic view of the total royalty expense that a digital music service provider should pay would be a positive development for the licensee, because the pool of revenue that any digital music service can make available to all rights owners as "fair compensation" (and still turn a profit) is fixed. However, the repeal of Section 114(i) would only further enhance the ability of musical work rights owners to exploit the fractured nature of rights ownership to their own advantage. Under this construct (i.e., using the sound recording public performance royalty rates as a *benchmark* for musical work public performance royalty rates), the royalty rate for musical work public performance rights would be *increased* without regard to the overall, aggregate royalty expense of the digital music service provider, since the federal courts that oversee PRO ratesetting proceedings do not have the jurisdiction to commensurately *reduce* the royalty payable for the corresponding sound recording rights.

Accordingly, *in practice*, the repeal of Section 114(i) would not result in a holistic determination of the total royalty expense that a digital music service provider should pay. Instead, it is, in a sense, a microcosm of how the current legal framework based on piecemeal changes to U.S. copyright law can serve as a vehicle for one group to take advantage of the fragmented nature of rights ownership to promote its own interests at the expense of the interests of others and, more importantly, of the whole digital music ecosystem.

7. Are the consent decrees serving their intended purpose? Are the concerns that motivated the entry of these decrees still present given modern market conditions and legal developments? Are there alternatives that might be adopted?

A. <u>The consent decrees are serving their intended purpose</u>.

As already noted in our responses to Questions 5 and 6, the ASCAP and BMI consent decrees provide an essential counter-balance to the unique market power of rights owners and are critical to an efficient, properly functioning marketplace for the public performance of musical works.[67]

B. <u>The need for the consent decrees is greater now than ever</u>.

[65] *See Pandora II*, 2014 WL 1088101, at *12 n.30 ("Publishers lobbied for this provision in Congress because they were concerned that the sound recording rates would be set below the public performance rates for compositions and drag down the latter. ASCAP also supported the enactment of the provision, for the same reason.").

[66] *See* Nimmer, *supra* note 4, § 8.22[A][3][a] ("[The] drafters [of the Digital Performance Right in Sound Recordings Act of 1995 (DPRA)] also wished to 'dispel the fear that license fees for sound recording performance may adversely affect music performance royalties.'") (quoting H.R. Rep. No. 104–274, 104th Cong., 1st Sess. 24 (1995)).

[67] If the threat of publishers withdrawing entirely from the PROs were to become a reality, it would upset the delicate balance of the licensing ecosystem, making it necessary to revisit the question of whether the consent decrees are serving their intended purpose.

The concerns that motivated the entry of these consent decrees are still present given modern market conditions and legal developments. In fact, as previously noted in the context of our responses to Questions 5 and 6, the unprecedented concentration of rights in the hands of an increasingly smaller pool of major music publishers makes the processes and protections assured by these consent decrees more important now than ever before. While music publishers have always been free to withdraw their catalogs from ASCAP's or BMI's repertory for all purposes, a right which has been confirmed by the recent decisions in the ASCAP and BMI ratesetting proceedings involving Pandora Media,[68] the practical impossibility of licensing performances nationwide for all purposes, including thousands of radio stations, television stations, bars, restaurants and other public venues, has effectively prevented publishers from exercising its right to do so.[69]

However, if the antitrust consent decrees were to be modified by the Department of Justice to accommodate "limited" withdrawals (such as for certain digital uses, but not for all purposes), the key processes and protections assured by the antitrust consent decrees would be undermined, and the marketplace for musical work public performance rights would be significantly compromised.[70]

The continued need for the processes and protection assured by the consent decrees was well articulated in the March 2014 ASCAP ratesetting decision involving Pandora Media.[71] Specifically, Judge Cote found evidence of closely coordinated conduct by the major music publishers and ASCAP, which was designed to undermine the core processes and protections accorded by these consent decrees that are critical to an efficient, properly functioning marketplace:

- "The publishers believed that [the ASCAP Consent Decree] stood in the way of their closing this gap. They believed that because the two PROs were required under their consent decrees to issue a license to any music user who requested one, they could not adequately leverage their market power to negotiate a significantly higher rate for a license to publically perform a composition."[72]

- "The press coverage focused on Sony's leverage in negotiations due to its outsize market power: 'Look a little closer, and this is ultimately a very lopsided negotiation .... Pandora absolutely needs Sony's catalog to run an effective radio service. And if they don't pay what Sony/ATV wants, they can't use it, by law.'"[73]

- "What is important is that ASCAP, Sony, and UMPG did not act as if they were competitors with each other in their negotiations with Pandora. Because their interests were aligned against Pandora, and they coordinated their activities with respect to Pandora, the very considerable market power that each of them holds individually was magnified."[74]

C. <u>The process for acquiring and administering musical work public performance rights under the consent decrees could be made more effective</u>.

[68] *Pandora II*, 2014 WL 1088101; *Pandora III*, 2013 WL 6697788.
[69] *See* note 62, *supra*.
[70] If the antitrust consent decrees were to be modified in this way, the basic premise for allowing music publishers to withdraw should be revisited, with a view to creating a new statutory license for musical work public performance rights.
[71] The need for the protections of the antitrust consent decrees was also acknowledged by the Southern District of New York in *Meredith Corp.*, No. 09-cv-9177, 2014 WL 812795 (S.D.N.Y. Mar. 3, 2014), and by the Eastern District of Pennsylvania in *RMLC*, No. 12-cv-5807 (E.D. Pa. Dec. 20, 2013).
[72] *Pandora II*, 2014 WL 1088101, at *14.
[73] *Id.*, at *25.
[74] *Id.*, at *35; *see also* note 59 *supra* for additional context regarding SESAC.

While the consent decrees have served their intended purpose and the need for them now is greater than ever before, for the reasons noted in our responses to Questions 1 and 5, the process for acquiring and administering musical work public performance rights would be *greatly enhanced* through the recommended centralized database.

SOUND RECORDINGS

8. Please assess the current need for and effectiveness of the Section 112 and Section 114 statutory licensing process.

A. **<u>There is currently a need for the Section 112 and Section 114 statutory licensing process</u>**.

In contrast to the inefficient and expensive work-by-work licensing process for musical work reproduction and distribution rights under Section 115 (which is discussed in our response to Question 1 above), the statutory licensing process under Sections 112 and 114 provides for a *blanket license* for uses of sound recordings which satisfy the eligibility criteria set forth in Sections 112 and 114. As noted in the context of musical work rights, blanket licenses promote efficiency and reduce transaction costs by making a vast body of sound recordings subject to license coverage immediately upon the service of a single notice.[75]

B. **<u>There are a number of problems with the Section 112 and Section 114 statutory licensing process that limit its effectiveness</u>**.

As noted in Section I.3.B, the statutory license for the performance of sound recordings by means of non-exempt digital audio transmissions under Section 114 (and the corresponding compulsory license for the making of ephemeral recordings used to facilitate non-exempt digital audio transmissions under Section 112) is particularly significant because it reflects a recognition by Congress that a compulsory license is necessary to avoid music licensing complexities that might otherwise deprive the public of the benefits of culturally important digital radio services.[76] However, as noted in our response to Question 2, and as we will discuss further in the context of our answer to Question 9, the intent of Congress has not been fully realized because the “willing buyer, willing seller” standard, which governs the royalty *ratesetting process and standards* applicable to these statutory licenses, has resulted in royalty rates that have been so high and unsustainable that (i) numerous services have exited the business since Congress first established the sound recording public performance right in 1995,[77] and (ii) Congress has had to step

[75] *See* 17 U.S.C. § 114(f)(4)(A) (2012) (“The Copyright Royalty Judges shall also establish requirements by which copyright owners may receive reasonable notice of the use of their sound recordings under this section, and under which records of such use shall be kept and made available by entities performing sound recordings.”); 17 U.S.C. § 114(f)(4)(B) (“Any person who wishes to perform a sound recording publicly by means of a transmission eligible for statutory licensing under this subsection may do so without infringing the exclusive right of the copyright owner of the sound recording—(i) by complying with such notice requirements as the Copyright Royalty Judges shall prescribe by regulation and by paying royalty fees in accordance with this subsection…”).

[76] Prior to implementation of the Digital Performance Right in Sound Recording Act of 1995, digital radio services would not have required sound recording licenses at all

[77] Both AOL and Yahoo! concluded that the resulting high royalty costs were unsustainable for their Internet radio services. In April 2008, AOL reduced its exposure to these fees by entering into an arrangement with CBS Radio to power its Internet radio service (AOL Radio). In February 2009, Yahoo! followed suit by entering into a similar arrangement with CBS Radio to power its Internet radio service (LAUNCHcast). Additional services that have exited the business since Congress established the sound recording public performance right in 1995 include, without limitation, East Village Radio, Turntable.fm, Loudcity, RadioParadise and 3Wk. *See also* Ben Sisario, *East*

in twice to mitigate the substantial economic hardships that the resulting rates imposed on digital music services.[78]

In addition to the applicability of the "willing buyer, willing seller" standard, there are a number of problems with the Section 112 and Section 114 statutory licensing process that *limit its effectiveness*, including the following:

- <u>Expense of participating in ratesetting proceedings before the Copyright Royalty Board</u>. Ratesetting proceedings to establish rates and terms under the Section 112 and Section 114 statutory licenses are long and complex, and the cost for any service to actively participate in this process is very high. This high cost poses a barrier to participation for many smaller digital music services, and, in some cases, larger digital music services as well.

- <u>Evidentiary limitations</u>. The evidentiary rules that govern ratesetting proceedings under the Section 112 and Section 114 statutory licenses prohibit the Copyright Royalty Judges from considering all relevant market data when setting royalty rates. Specifically, Section 114(f)(5)(C) expressly prohibits voluntary agreements between statutory licensees and the receiving agent for the Section 112 and 114 royalties, SoundExchange, from being considered as evidence in ratesetting proceedings, including the royalty rates, rate structure, definition, terms, conditions, or notice and recordkeeping requirements.[79] These voluntary agreements cover the rights actually being granted in the proceeding (non-interactive Internet radio services), unlike the agreements for interactive rights that Copyright Royalty Judges use as proxies to impute non-interactive rates.[80] Copyright Royalty Judges should not be required to consider rates for a *hypothetical marketplace* instead of rates for an *actual marketplace* in this way.

- <u>No pro-ration or apportionment of annual minimum fees based on duration of operation during the applicable calendar year</u>. The rates and terms for many of the service types operating under the Section 112 and Section 114 statutory licenses include an annual minimum fee that is due by

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Village Radio to Close, Citing Licensing Costs, N.Y. Times, May 14, 2014, *available at* http://artsbeat.blogs.nytimes.com/2014/05/14/east-village-radio-to-close-citing-licensing-costs.

[78] *Music Licensing Part I: Legislation in the 112th Congress: Hearing Before the Subcomm. on Intellectual Property, Competition, and the Internet of the H. Comm. on the Judiciary*, 112th Cong. 56 (2012) (statement of Joseph J. Kennedy, Chairman and Chief Executive Officer, Pandora Media, Inc.) ("Two major rate setting decisions and two congressional interventions to undo those decisions - clearly we are dealing with a broken system that needs to be fixed.").

[79] *See* 17 U.S.C. § 114(f)(5)(C). ("Neither subparagraph (A) nor any provisions of any agreement entered into pursuant to subparagraph (A), including any rate structure, fees, terms, conditions, or notice and recordkeeping requirements set forth therein, *shall be admissible as evidence or otherwise taken into account in any administrative, judicial, or other government proceeding involving the setting or adjustment of the royalties payable for the public performance or reproduction in ephemeral phonorecords or copies of sound recordings*, the determination of terms or conditions related thereto, or the establishment of notice or recordkeeping requirements by the Copyright Royalty Judges under paragraph (4) or section 112(e)(4). *It is the intent of Congress that any royalty rates, rate structure, definitions, terms, conditions, or notice and recordkeeping requirements, included in such agreements shall be considered as a compromise motivated by the unique business, economic and political circumstances of webcasters, copyright owners, and performers rather than as matters that would have been negotiated in the marketplace between a willing buyer and a willing seller*, or otherwise meet the objectives set forth in section 801(b). This subparagraph shall not apply to the extent that *the receiving agent and a webcaster that is party to an agreement entered into pursuant to subparagraph (A) expressly authorize the submission of the agreement in a proceeding under this subsection*." (Emphasis added.))

[80] *See* Section II.9.A *infra*.

January 31 of the year covered by the particular Section 112 and Section 114 statutory license.[81] However, not every digital music service has commenced its operations as of January 1 of the year covered by the license. For example, a commercial webcaster that is relying on the "default" rates and terms set forth in 37 C.F.R. § 380.3 and expects to have 100 or more channels would be required to pay an annual minimum fee of $50,000 for that calendar year, even if that commercial webcaster commences making digital audio transmissions and ephemeral recordings on December 1 of that year. The statute (or the implementing regulations promulgated under the statute) should be amended to provide an appropriate pro-ration mechanism for the minimum annual fees.

- No mechanism for recouping royalties under direct licenses from annual minimum fee. For some digital music service providers that rely on the statutory licenses under Sections 112 and 114, it is common practice to concurrently have direct licenses in place with some sound recording rights owners. However, there is no mechanism for reducing or recouping royalties (or pre-payments of royalties) paid directly to sound recording copyright owners under direct licenses from the annual minimum fee. Accordingly, the royalty framework set by the Section 112 and 114 statutory licenses should be amended to allow for recoupment or offset in these circumstances.

- Purging server copies every 6 months. As a condition of eligibility for the Section 112 statutory license, Section 112(e)(1)(C) provides that "unless preserved exclusively for archival purposes, the copy or phonorecord [must be] destroyed within six months from the date the transmission program was first transmitted to the public."[82] In light of technological developments and current practices, this requirement imposes an unnecessary burden on digital music services without any corresponding benefit to rights owners or the public interest. Accordingly, 112(e)(1)(C) should be amended to abolish this requirement.

- Limitations on the number of server copies. Another condition of eligibility for the Section 112 statutory license is that digital music services must make "no more than 1 phonorecord of the sound recording (unless the terms and conditions of the statutory license allow for more)."[83] The intent of this provision is to leave the question of whether more than one phonorecord is permissible to the implementing regulations promulgated under Section 112. In light of technological developments, a limitation of no more than one phonorecord imposes an unnecessary burden on digital music services without any corresponding benefit to rights owners or the public interest. Moreover, there is no benefit for leaving this determination to implementing regulations. Accordingly, Section 112(e) should be amended to allow for the creation of as many phonorecords as are reasonably necessary to facilitate digital audio transmissions under the Section 114 statutory license.

9. Please assess the effectiveness of the royalty ratesetting process and standards applicable to the various types of services subject to statutory licensing under Section 114.

A. The royalty ratesetting standards applicable to the various types of services subject to statutory licensing under Section 114 have been generally ineffective.

[81] 37 C.F.R. §§ 380.4(d), 380.13(d), 380.23(c), 383.3(b), 384.4(d) (2013).
[82] 17 U.S.C. § 112(e)(1)(C).
[83] 17 U.S.C. § 112(e).

The "willing buyer, willing seller" standard – which only applies to a single class of services (non-interactive Internet radio services) – is codified in Sections 112(e) and 114(f), and provides in relevant part as follows:

> The Copyright Royalty Judges shall establish rates that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller. In determining such rates and terms, the Copyright Royalty Judges shall base their decision on economic, competitive, and programming information presented by the parties, including—
>
> > (A) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise interferes with or enhances the copyright owner's traditional streams of revenue; and
> >
> > (B) the relative roles of the copyright owner and the transmitting organization in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.
>
> In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms under voluntary license agreements described in paragraphs (2) and (3). The Copyright Royalty Judges shall also establish requirements by which copyright owners may receive reasonable notice of the use of their sound recordings under this section, and under which records of such use shall be kept and made available by transmitting organizations entitled to obtain a statutory license under this subsection.[84]

This standard – which has consistently resulted in royalty rates that are disproportionately higher than in contexts that rely on the 801(b) standard – requires judges to set a rate based solely on *marketplace benchmarks*, but there is very little record evidence of market rates for directly licensed Internet radio services that are not tied to a separate rights grant for additional service types and functionalities (such as direct licenses for interactive services). In recognition of this fact, the standard requires the Copyright Royalty Judges to assume a *hypothetical marketplace* for the rights actually being granted, and *impute* the appropriate rate for the rights actually granted (non-interactive Internet radio services) from the royalty rates paid by digital music services for interactive rights that are not eligible for the statutory licenses under Sections 112 and 114. Once secured, the alleged precedents set by these direct licenses are then bootstrapped as the relevant benchmarks for determining the *hypothetical marketplace* assumed by the "willing buyer, willing seller" standard. Moreover, unlike the 801(b) standard, the "willing buyer, willing seller" standard fails to account for the disruptive impact that high royalty rates may have on digital music service providers, and the public interest in maximizing the availability of creative works to the public.

Another problem with the "willing buyer, willing seller" standard has been that a component of the royalty is usually calculated and determined on the basis of the number of performances, even in circumstances where the higher usage does not equate to higher revenues for the digital music service provider. The Internet Radio Fairness Act (which was not enacted) sought to mitigate this fundamental problem by eliminating the ability to use the rates paid by interactive services, or any rates agreed to by

[84] 17 U.S.C. §§ 112(e)(4), 114(f)(2)(B).

major labels, in Section 112 and 114 ratesetting proceedings.[85] As noted previously, the resulting royalty rates have been so high and unsustainable that Congress has had to step in twice to mitigate the substantial economic hardship that the resulting rates imposed on digital music services.[86] By contrast, the 801(b) standard has never required Congressional intervention in the almost half century since it was introduced.

Finally, under the "willing buyer, willing seller" standard, many Internet radio services have had to pay in excess of 50% of their revenue to SoundExchange under the Section 112 and 114 statutory licenses (of course, such royalties are in addition to those that the services must pay to publishers for the use and exploitation of the underlying musical works). By contrast, broadcast radio pays nothing to the labels for their use of sound recordings, and Sirius XM pays less than 10% of its revenue for the same rights for its satellite digital audio radio service (which rate was established under the 801(b) standard). There is no justifiable reason that performance royalties for Internet radio are determined under an inequitable ratesetting standard.

B. <u>**The royalty ratesetting standards applicable to the various types of services subject to statutory licensing under Section 114 could be made more effective**</u>.

As previously discussed, the 801(b) standard has been time-tested to provide fair rates in many contexts, including the ratesetting proceedings set forth in Sections 114(f)(1)(B), 115, and 116. It bears repeating here that the record labels have participated as *licensees* in every proceeding to adjust royalty rates and terms under Section 115,[87] and as a result have benefited from the 801(b) standard that was adopted for such proceedings under the 1976 Act.[88] It is disingenuous for the labels to suggest that a different standard should apply for Internet webcasters.

C. <u>**Additional problems with the royalty ratesetting process and standards applicable to the various types of services subject to statutory licensing under Section 114**</u>.

In addition to the application of the "willing buyer, willing seller" standard, there are a number of problems with the royalty ratesetting process and standards that *limit their effectiveness*, including the following:

- <u>Reversed adjudication process</u>. Under the current procedural rules that apply to ratesetting proceedings under the Section 112 and 114 statutory licenses, parties are required to submit a statement of the case prior to the commencement of discovery.[89] Moreover, the scope of discovery that is permissible is limited to non-privileged material that is the subject matter

[85] H.R. 6480 § 3(a)(2)(D)(v), 112th Cong. (2012).
[86] Congress stepped in first with the Small Webcaster Settlement Act of 2002 and then again with the Webcaster Settlement Acts of 2008 and 2009. *See also* note 78, *supra*.
[87] *See* note 38 *supra*.
[88] *See* note 52 *supra* and accompanying text.
[89] 37 C.F.R. §§ 351.4, 351.5(a) (2013); 17 U.S.C. §§ 801(b)(6)(C)(i)-(ii). Although 37 C.F.R 351.4(c) permits a participant to amend this statement based on new information received during the discovery process, up to 15 days after the close of discovery, the process is nevertheless not efficient and moreover, proves a tactical advantage to rights owners as they are aware of the direct licenses in the market place to a far greater degree than the digital music services, especially the ones who only operate music services under the Section 112 and 114 statutory licenses.

presented in the statement of the case.[90] Accordingly, in preparing a statement of the case, parties are required to *assume* what they will develop during discovery and hope that relevant information will be voluntarily revealed by their opponent in the opponent's written case, which is a significant reversal of the traditional adjudication procedures followed by state and federal courts and prejudicial to the interests of the litigants. The Section 112 and 114 statutory licenses, and the related implementing regulations governing the rate-setting procedures, should be amended to correct this procedural anomaly.

- Compressed time frame for discovery. Litigants have only 60 days in which to complete all discovery – among ALL litigants.[91] Even in the event that the Copyright Royalty Judges see fit to extend the discovery period, they have very little time to do so, after factoring in the time required for mandatory settlement periods,[92] the submission of written statements,[93] settlement conferences,[94] hearings, rebuttal, and proposed findings of fact and conclusions of law. In typical ratesetting proceedings, the schedules issued by the Copyright Royalty Judges mandate that all discovery – among all parties - must be completed in 60 days. This does not provide digital music services enough time to undertake a full discovery process, and advantages labels, who possess the lion's share of the relevant discoverable information.

- Discovery vehicles and limitations. Under the discovery vehicle limitations set forth in 17 U.S.C. § 801(b)(6)(C)(iv) and 17 C.F.R. § 351.5(2), the participants on each side are *collectively* entitled to up to 25 interrogatories and 10 depositions.[95] Because SoundExchange is the sole participant on behalf of sound recording copyright owners, it is entitled to 25 interrogatories and 10 depositions. However, all interested digital music services, collectively, must *share* 25 interrogatories and 10 depositions. In the currently pending proceeding, there are 28 such

[90] 17 U.S.C. § 801(b)(6)(C)(v) ("Any participant under paragraph (2) in a proceeding under this chapter to determine royalty rates may request of an opposing participant *nonprivileged documents directly related to the written direct statement or written rebuttal statement* of that participant." (Emphasis added.)).
[91] 17 U.S.C. § 801(b)(6)(C)(iv) ("Discovery in connection with written direct statements shall be permitted for a period of 60 days, except for discovery ordered by the Copyright Royalty Judges in connection with the resolution of motions, orders, and disputes pending at the end of such period.").
[92] 17 CFR 351.2 (2013) ("After the date for filing petitions to participate in a proceeding, the Copyright Royalty Judges will announce the beginning of a voluntary negotiation period and will make a list of the participants available to the participants in the particular proceeding. *The voluntary negotiation period shall last three months, after which the parties shall notify the Copyright Royalty Judges in writing as to whether a settlement has been reached.*" (Emphasis added.)).
[93] 17 CFR 351.4 (2013) ("All parties who have filed a petition to participate in the hearing must file a written direct statement. The deadline for the filing of the written direct statement will be specified by the Copyright Royalty Judges, *not earlier than 4 months, nor later than 5 months, after the end of the voluntary negotiation period* set forth in §351.2." (Emphasis added.)).
[94] 17 CFR 351.7 (2013) ("A post-discovery settlement conference will be held among the participants, within 21 days after the close of discovery, outside of the presence of the Copyright Royalty Judges. Immediately after this conference the participants shall file with the Copyright Royalty Judges a written Joint Settlement Conference Report indicating the extent to which the participants have reached a settlement.").
[95] 17 U.S.C. § 801(b)(6)(C)(iv); 17 CFR 351.5 (2013) ("In a proceeding to determine royalty rates, the participants entitled to receive royalties shall collectively be permitted to take no more than 10 depositions and secure responses to no more than 25 interrogatories. Similarly, the participants obligated to pay royalties shall collectively be permitted to take no more than 10 depositions and secure responses to no more than 25 interrogatories. Parties may obtain such discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party. Relevant information need not be admissible at hearing if the discovery by means of depositions and interrogatories appears reasonably calculated to lead to the discovery of admissible evidence.").

participating digital music services. This gives a decided tactical and procedural advantage to SoundExchange in discovery matters.

10. Do any recent developments suggest that the music marketplace might benefit by extending federal copyright protection to pre-1972 sound recordings? Are there reasons to continue to withhold such protection? Should pre-1972 sound recordings be included within the Section 112 and 114 statutory licenses?

A. <u>DiMA takes no view on whether the music marketplace might benefit by extending federal copyright protection to pre-1972 sound recordings</u>.

We take *no view* on (i) whether the music marketplace might benefit by extending federal copyright protection to pre-1972 sound recordings, (ii) whether there are reasons to continue to withhold such protection, or (iii) whether pre-1972 sound recordings should be included within the Section 112 and 114 statutory licenses.

B. <u>Any approach taken with respect to the copyright status of pre-1972 sound recordings should be holistic: Pre-1972 sound recordings should either be "all-in" or "all-out" for all purposes, with no exceptions or exclusions</u>.

Although we take no view on whether the music marketplace might benefit from extending federal copyright protection to pre-1972 sound recordings, we strongly believe that pre-1972 sound recordings should either:

> [1] Be covered by federal copyright protection for *all purposes* (including the statutory licenses under Sections 112 and 114, the "safe harbors" under Section 512 and each of the myriad other statutory licenses, exceptions and exemptions set forth elsewhere in U.S. copyright law), *or*
>
> [2] Not be covered by federal copyright protection for *any purposes at all*.

As noted in other places throughout this response, the current legal and regulatory framework for music licensing developed in a piecemeal manner, and is the product of accommodating the needs, goals and desires of special interest groups. We feel that this tradition should not be continued in the area of pre-1972 sound recordings; rather, this issue should be addressed holistically. Recognizing pre-1972 sound recordings for federal copyright protection for select purposes would be confusing, short-sighted, and against the public interest.

11. Is the distinction between interactive and noninteractive services adequately defined for purposes of eligibility for the Section 114 license?

The distinction between interactive and noninteractive services *is adequately defined* for purposes of eligibility for the Section 114 license. The definition of an "interactive service" set forth in Section 114(j)(7), as clarified by the Second Circuit in *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148 (2d Cir. 2009), provides an adequate degree of clarity regarding what constitutes an "interactive service" and a "noninteractive service" for purposes of eligibility for the Section 114 statutory license.

PLATFORM PARITY

12. What is the impact of the varying ratesetting standards applicable to the Section 112, 114, and 115 statutory licenses, including across different music delivery platforms. Do these differences make sense?

Because of the close relationship between Questions 12 and 13, we are consolidating our response to Question 12 under Question 13, below, so that the issues raised can be addressed collectively.

13. How do differences in the applicability of the sound recording public performance right impact music licensing?

A. <u>The varying ratesetting standards applicable to the Section 112, 114, and 115 statutory licenses, including across different music delivery platforms, unfairly tilts competition in favor of some digital music service providers, to the disadvantage of others</u>.

The "playing field" regarding ratesetting standards is not level, and the result is fundamental inequity. The differences between the "willing buyer, willing seller" and 801(b) standards, and their resulting impact on the royalty rates that are established under them, have been discussed in our responses to Questions 2, 8 and 9.

Beyond the inherent inequities associated with the differing ratesetting standards, lawmakers[96] and the recording industry itself[97] have recently cited the absence of a sound recording public performance right for terrestrial AM, FM and HD Radio broadcasts as additional evidence that the current system lacks balance and further tilts the competitive landscape in favor of some music service providers, to the disadvantage of others. In his testimony before the United States Senate Committee on Commerce, Science, and Transportation in support of the merger of the satellite radio services Sirius and XM, the then-CEO of Sirius assured government regulators that a merged Sirius and XM would not create a "monopoly" that could harm competition or new market entrants, because the two satellite radio services do not just compete with each other; they compete head-to-head with a wide variety of other entertainment services and products for the attention of the consumer, including AM and FM terrestrial radio, HD Radio, Internet radio, permanent digital downloads that are sold to consumers and enjoyed on

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[96] Jennifer Martinez, *Nadler Circulates Draft Legislation on Music Royalties*, The Hill, Aug. 20, 2012, *available at* http://thehill.com/policy/technology/244413-nadler-circulates-draft-legislation-on-music-royalties (quoting Nadler as saying, "[t]he lack of a performance royalty for terrestrial radio airplay is a significant inequity and grossly unfair."); *Blackburn, Eshoo Introduce Legislation to Protect Musicians' Creative Content*, official website of Rep. Marsha Blackburn (press release), May 7, 2014, *available at* http://blackburn.house.gov/news/documentsingle.aspx?DocumentID=379223 (last visited May 21, 2014) ("'This is a basic issue of modernizing the law to get rid of a dated loophole that only applies to AM/FM radio,' Blackburn said. … 'When Kenny Rogers "The Gambler" is played on Internet radio or satellite radio, Kenny gets paid, but when it is played on AM/FM radio, he doesn't get anything.'").

[97] *Performance Rights Act (H.R. 848): Hearing Before the H. Comm. on the Judiciary*, 111th Cong. (2009) (statement of Mitch Bainwol, Chairman and CEO, Recording Industry Association Of America); Emily F. Evitt, *Money, That's What I Want: The Long and Winding Road to a Public Performance Right in Sound Recordings*, 21 Intell. Prop. & Tech. L.J. 10 (Aug. 2009); *see also* Bruce A. Lehman, *Intellectual Property and the Nat'l Information Infrastructure: the Report of the Working Group On Intellectual Property Rights* 221-225, Information Infrastructure Task Force of the Commerce Dep't (Sep. 1995), *available at* http://www.uspto.gov/web/offices/com/doc/ipnii/ipnii.pdf.

portable devices and mobile phones that provide access to various types of audio entertainment.[98] The merger was subsequently approved by the Department of Justice and Federal Communications Commission on this basis.[99]

The different ratesetting standards, royalty rates and functionality rules based on platform distinctions do not make sense in the digital environment where the very same consumer electronics devices – such as automobile in-dash receivers – are capable of receiving digital and/or analog transmissions of the same sound recording, yet the sound recording will bear a different royalty rate (or will not be royalty-bearing at all) depending on whether the service that delivered it is considered AM terrestrial radio, FM terrestrial radio, HD Radio, satellite radio or Internet radio under U.S. copyright laws.

B. <u>Fair competition among digital music service providers can be restored by applying the balanced standard under Section 801(b) to all services operating under the Section 112, 114 and 115 statutory licenses</u>.

As previously noted, the royalty standard that applies to Internet radio services (i.e., "willing buyer, willing seller") often results in a royalty rate that is demonstrably higher than the services that operate under the Section 801(b) standard. In lieu of the "willing buyer, willing seller" standard, the balanced standard under Section 801(b) should be adopted to apply to *all services* operating under the Section 112, 114 and 115 statutory licenses. And, as noted above, various lawmakers and the recording industry believe that the lack of a sound recording public performance right for terrestrial AM, FM and HD Radio broadcasts has further tilted the competitive balance in favor of some music service providers, to the disadvantage of others.

CHANGES IN MUSIC LICENSING PRACTICES

14. How prevalent is direct licensing by musical work owners in lieu of licensing through a common agent or PRO? How does direct licensing impact the music marketplace, including the major record labels and music publishers, smaller entities, individual creators, and licensees?

A. <u>Direct licensing by musical work owners in lieu of licensing through a common agent or PRO *is quite prevalent* for musical work *reproduction and distribution rights*, but not for musical work *public performance rights*</u>.

Direct licensing by musical work owners in lieu of licensing through a common agent or PRO is quite prevalent for musical work reproduction and distribution rights covered by the major music publishers, the larger independent music publishers and HFA's publisher-principals. Some digital music services have entered into direct license agreements with smaller independent music publishers, but this practice is the exception rather than the rule. Because there are a vast number of musical works that are not controlled by the major music publishers, the larger independent music publishers or the remainder of

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[98] *XM-Sirius Merger and the Public Interest: Hearing Before the S. Comm. on Commerce, Science, and Transportation*, 110th Cong. (2007) (statement of Melvin Alan Karmazin, CEO, Sirius Satellite Radio).
[99] DOJ, *Statement of the Department of Justice Antitrust Division on its Decision to Close its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc.* (press release) (March 24, 2008), *available at* http://www.justice.gov/opa/pr/2008/March/08_at_226.html; *Applications for Consent to the Transfer of Control of Licenses, XM Satellite Radio Holdings Inc., Transferor, to Sirius Satellite Radio Inc., Transferee*, MB Docket 07-57, 23 F.C.C.R. 12348, 12408, 12410-11, 12434-35, ¶¶ 1, 131, 135 & App. B (July 25, 2008) (Memorandum Opinion and Order and Report and Order).

HFA's publisher-principals, direct licenses are usually supplemented with NOIs under the Section 115 statutory license process, which (as previously discussed) involves substantial administrative costs.

To perform this function, many digital music services engage the Harry Fox Agency or Music Reports, Inc. (the only private businesses that offer musical work mechanical and reproduction rights research, administration and management services in the U.S.) to undertake this NOI process on their behalf for a fee, as the services do not have the in-house resources and infrastructure necessary to undertake this process themselves. Many of the digital music services that enter into direct licenses also use these companies to administer the payment of royalties under their direct licenses, because the administration (not just the acquisition) of publishing licenses requires personnel and infrastructure that many services do not have.

However, direct licensing by musical work owners in lieu of licensing through a common agent or PRO *is not prevalent* for musical work *public performance rights*. The potential withdrawal of repertoires from the PROs would make direct licensing of musical work public performance rights much more prevalent. However, as previous noted,[100] these withdrawals would disrupt the musical work licensing marketplace and cause an array of adverse effects for digital music services and the public interest, including the extraction of unreasonable royalty rates based on a combination of market power and lack of transparency into the catalogs that were the subject of the contemplated withdrawals.[101]

For the reasons noted in the next section, it vitally important that the licensing regime maintain the right of parties to enter into direct license arrangements.

B. How direct licensing impacts the music marketplace.

Direct licensing impacts the music marketplace, including the major record labels and music publishers, smaller entities, individual creators, and licensees, by *facilitating the introduction of new business models* that do not fit squarely into any of the categories covered by the Section 115 licenses. This gives digital music services and rights owners the flexibility to *vary statutory requirements* and the flexibility to agree on *new and innovative license types and royalty rate models*, which ensures the ability of digital music services to license the rights they require to fit the unique needs of their businesses.

While direct licenses offer cost efficiencies and reduced transaction costs, they also pose a number of significant challenges:

- As previously noted, direct licensing results in high transaction costs to secure and administer licenses. The number of licensors is vast because of the fragmentation of rights, and it is often not cost effective to acquire rights under direct licenses from the "long tail" of independent labels and music publishers.

- Most individually negotiated agreements are long and complex. Rights owners do not share the same concerns in each individual negotiation, which protracts the negotiation period and can lead to impasses.

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[100] *See* Sections I.3.C(b), II.5.B, and II.7.B *supra*.

[101] For example, in the ASCAP ratesetting proceeding with Pandora Media, Judge Cote found that a pattern of conduct, including lack of transparency about the musical works involved, was designed by the music publishers to drive up the royalty rate for musical works by 250%. Accordingly, Judge Cote disregarded Sony ATV's direct license with Pandora Media as a relevant benchmark rate for musical work public performance rights. *Pandora II*, 2014 WL 1088101, at *36-*38.

- Direct license negotiations can take a long time, and can delay the time-to-market for innovative products and services.

- Disparate approaches taken by rights owners on key economic terms put upward pressure on royalty rates, and often include unreasonable demands on key economic terms, such as advances and minimum revenue guarantees.

- Many rights owners are concerned with parity vis-à-vis other rights owners, which results in the imposition of so-called "most favored nations" (or "MFN") clauses for the benefit of rights owners. Because there is no counter-balance to the market power of rights owners in the music licensing marketplace, these MFN clauses are usually asymmetrical in their application, and solely benefit the rights owners.

- The negotiation of direct licenses can increase overhead costs and divert key personnel away from other critical operational, marketing or management functions on behalf of the digital music service.

- Since there is no uniform standard for royalty accountings, each rights owner often imposes its own royalty reporting requirements on digital music services, frequently using proprietary reporting specifications unique to that rights owner. This reduces efficiencies, and adds to the administrative burden and expense undertaken by digital music services.

- As the music publishing industry consolidates and reduces its staffing and overhead, rights owners do not have enough personnel and other resources necessary to fully explore and assess licensing opportunities.

- The existence of the statutory rates under Section 115 sometimes serves to inhibit, rather than facilitate, the willingness of rights owners to experiment with innovative approaches on economic terms in order to avoid the possibility of setting "precedents" that would be adverse to their interests in future ratesetting proceedings.

Nevertheless, direct licenses provide a critical function for music licensing in the digital environment, and the legal and regulatory framework provided by U.S. copyright law must preserve the ability of digital music services to enter into direct licenses.

15. Could the government play a role in encouraging the development of alternative licensing models, such as micro-licensing platforms? If so, how and for what types of uses?

DiMA takes *no view* on whether the government could play a role in encouraging the development of alternative licensing models, such as micro-licensing platforms.

16. In general, what innovations have been or are being developed by copyright owners and users to make the process of music licensing more effective?

The innovations to address the complexity of music licensing have generally been undertaken by digital music services, at their expense. In order to secure, administer and retain music licenses, digital music service providers must devote extraordinary time and resources to develop the following:

(i) Information about rights ownership (including building, or funding the building of, redundant, private databases that, for reasons already noted, are often not comprehensive, reliable or accurate);

(ii) Systems to track massive amounts of data related to the usage of content; and

(iii) The complex systems necessary to account to rights owners in a variety of different (and often conflicting) formats and specifications.

In addition to these costs and functions, digital music services must develop content hosting and infrastructure in a way that enables the terms and conditions of myriad music licenses to be satisfied, along with data analytics, management reporting, chart reporting, and enforcement of content access rules (including digital rights management systems for some service types).

17. Would the music marketplace benefit from modifying the scope of the existing statutory licenses?

Other than as discussed in our responses to other questions in this Notice of Inquiry, DiMA takes *no view* on whether the music marketplace would benefit from modifying the scope of the existing statutory licenses,.

REVENUES AND INVESTMENT

18. How have developments in the music marketplace affected the income of songwriters, composers, and recording artists?

The development and deployment of legitimate music services has resulted in *significant royalty payments* by digital music service providers to rights owners for the benefit of songwriters, composers, and recording artists. The legitimate music services represented by DiMA's membership collectively have paid billions of dollars in royalties to content owners in a marketplace where the sale of physical products – long the content owners' primary source of revenue – has continued to decline year-over-year.[102] The various forms of music streaming and so-called "subscription" services are now recognized by rights owners as a "mainstream model."[103] According to IFPI, the recorded music industry's global trade organization, the biggest growth area in recorded music has been in music subscription services, with revenues up 51.3% globally in 2013, while the sale of permanent downloads remains the largest revenue segment from digital music services, at 67% of global revenues.[104] The New York Times recently reported that while the trend for the historical business model is one of decline, streaming services around the world are expected to continue showing substantial growth in the income they generate for songwriters, composers, and recording artists: "The music business has started to see streaming as its salvation. … In 2013, streaming services around the world yielded $1.1 billion in income for the music industry, a number that has been growing fast."[105]

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[102] While the decline in physical music sales was inevitable, legitimate digital music services have created new royalty streams for the benefit of rights holders by monetizing digital music consumption and sharing the revenues with licensors.

[103] Francis Moore, *Introduction*, IFPI Digital Music Report 2014, at 5 (2014), *available at* http://www.ifpi.org/downloads/Digital-Music-Report-2014.pdf.

[104] IFPI Digital Music Report 2014, at 17 (2014), *available at* http://www.ifpi.org/downloads/Digital-Music-Report-2014.pdf.

[105] Sisario, *supra* note 1.

With respect to recording artists, SoundExchange recently reported a 312% increase in the total sum of royalties it paid to recording artists and labels in 2012 versus 2008.[106] Digital radio alone paid out $590.4 million in royalties to artists and rightsholders last year.[107] And according to a report recently released by the Recording Industry Association of America ("RIAA"), the recorded music industry's trade organization in the United States, payments to rights owners in connection with on-demand streaming services have also substantially risen, totaling $220 million in 2013.[108] The substantial royalties generated by the combination of statutory and direct licenses for the use of sound recordings has brought stability to the recording industry, which until recently had witnessed a constant decline in revenues.[109] With respect to songwriter income, royalties paid by digital music services for musical work public performance rights provide the lifeblood for most songwriters. Both ASCAP and BMI reported record high royalty payments of $851.2 million and $814 million, respectively, to their songwriter, composer and publisher members on revenues of $944 million each.[110] SESAC's revenues have grown from just $9 million in 1994 to $167 million in 2013.[111]

The substantial royalties paid by digital music services constitute new revenue streams that were unimagined just a few decades ago. The legitimate music services represented by DiMA's membership make significant royalty payments to content owners. These royalty payments are, in turn, shared with songwriters, composers, and recording artists in accordance with the terms of their respective agreements music publishers, record companies and other rights administrators. Although licensed digital music services have no control over, or insight into, the manner in which content owners share proceeds with songwriters, composers, and recording artists, it is worth noting that the current system, which is based on overlapping copyright rights recognized under U.S. copyright law – sometimes for the same uses of the same works – causes licensing inefficiencies and operational redundancies which add to the expense of administering rights on behalf of rights owners, and correspondingly diminishes the income of songwriters, composers and recording artists.[112]

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[106] *2012 Annual Review* 1, SoundExchange, http://www.soundexchange.com/wp-content/uploads/2014/01/2012-Annual-Review.pdf. Between 2012 and 2013, SoundExchange reported a 19% increase in payments to artists; *Year End Recap 2013*, SoundExchange, http://www.soundexchange.com/wp-content/uploads/2014/02/year-end-recap-2013.pdf.

[107] *Music Industry Leader SoundExchange Celebrates Year of Milestones with 2013 Total Distributions Reaching $590 Million*, SoundExchange (press release), Feb. 4, 2014, http://www.soundexchange.com/pr/music-industry-leader-soundexchange-celebrates-year-of-milestones-with-2013-total-distributions-reaching-590-million/; *see also* Alex Pham, *Streaming Made Up One-Fifth of U.S. Recorded Music Revenue in 2013*, Billboard, Mar. 18, 2014, *available at* http://www.billboard.com/biz/articles/news/digital-and-mobile/5937634/streaming-made-up-one-fifth-of-us-recorded-music (last viewed May 9, 2014).

[108] Joshua P. Friedlander, *News and Notes on 2013 RIAA Music Industry Shipment and Revenue Statistics*, RIAA, *available at* http://76.74.24.142/2463566A-FF96-E0CA-2766-72779A364D01.pdf.

[109] According to the RIAA, total music industry revenues have been stable at about $7 billion for the past four years, but had been on a steady decline before that, dropping from $8.8 billion in 2008 to $7.8 billion in 2009 to the current level of $7 billion in 2010. *Id.*

[110] *ASCAP Reports Strong Revenues in 2013*, Am. Soc'y of Composers, Authors, and Publishers (press release), Feb. 12, 2014, http://www.ascap.com/press/2014/0213-2013-financials.aspx; *Broadcast Music Inc. Reports Record-Breaking Revenues of $944 Million*, Broadcast Music Inc. (press release), Sept. 23, 2013, http://www.bmi.com/press/entry/563077.

[111] Ed Christman, *SESAC Refinances Debt to Cut Interest Payments*, Billboard, Apr. 8, 2014, *available at* http://www.billboard.com/biz/articles/news/legal-and-management/6042238/sesac-refinances-debt-to-cut-interest-payments (last viewed May 9, 2014).

[112] For example, in the context of ASCAP and BMI, each PRO retains administration fees of approximately 12% of the gross royalties paid by digital music services. Based on the 2013 royalties noted above, DiMA estimates that approximately $200 million of the royalties paid by digital music services in 2013 was redirected from songwriters

19. Are revenues attributable to the performance and sale of music fairly divided between creators and distributors of musical works and sound recordings?

Revenues attributable to the performance and sale of music are *not* fairly divided between creators and distributors of musical works and sound recordings. Distributors bear a *disproportionate percentage* of the costs, expenses and related risks for the investment in and operation of digital music services, relative to the share of revenues they generally retain (after making royalty payments for the use of musical works and sound recordings). In addition to the cost of royalty payments, digital music services must bear the costs of acquiring and administering the licenses for musical works and sound recordings, as well as many other operational costs, such as those related to engineering; content hosting, delivery, and billing infrastructure; financial clearing; bandwidth; reporting; marketing; and technology, software, services, and backend infrastructure. As was made plain by the testimony of the record labels' expert witness in the last ratesetting proceeding for the satellite radio and preexisting subscription services under the Section 112 and 114 statutory licenses, digital music services pay the lion's share of their revenues over to rights owners at roughly the following rates:[113]

Digital Product Type	**% of Gross Revenues Rate** ***Sound Recording Rights Only***	**% of Gross Revenues Rate** ***Inclusive of Sound Recording and Musical Work Rights***
Permanent Audio Download	N/A	70%
Interactive Subscription (Non-Portable)	50% - 60%	60% - 72%
Interactive Subscription (Portable)	60% - 65%	70% - 78%

Unfortunately, the public discourse around the compensation of creators is quite misleading. For example, much publicity was recently generated about a tweet from Bette Midler, where she observed that after more than four million plays on Pandora's Internet radio service, she only received $144.21 in royalties.[114] What this publicity failed to take into account is that four million plays on Pandora's service represents the equivalent number of "impressions" (public performances) as just twenty spins on a terrestrial FM radio station that averages 200,000 simultaneous listeners. Even more significantly, this publicity ignores the fact that terrestrial FM broadcasters do not pay *any* royalties to creators for the public performance of sound recordings. Of course, there is little transparency about what happens to the significant royalties generated from digital music services *after they are paid* to record labels, music

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and retained to cover administrative expenses. *See ASCAP CEO John LoFrumento's Remarks from the 2014 ASCAP General Annual Membership Meeting*, Official Website of Am. Soc'y of Composers, Authors, and Publishers, Apr. 24, 2014, *available at* http://www.ascap.com/playback/2014/04/action/john-lofrumento-membership-meeting-remarks.aspx ("2013's operating ratio stood at 12.4%."); *FAQs*, official website of Broadcast Music, Inc., *available at* http://www.bmi.com/faq/entry/what_happens_to_the_fees_that_businesses_pay_and_how_much_profit_does_bmi_m (last visited May 21, 2014) ("Currently, more than eighty-seven cents of every dollar of your licensing fee goes to our affiliated copyright owners.").

[113] *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, SoundExchange Witness Direct Statements, Docket No. 2011-1 CRB PSS/Satellite II, at 15 (Nov. 29, 2011) (expert witness statement of George S. Ford, President, Applied Economic Studies).

[114] *See, e.g.*, Paul Resnikoff, *After 4,175,149 Plays, Pandora Pays Bette Midler $144.21*, Digital Music News, Apr. 6, 2014, http://www.digitalmusicnews.com/permalink/2014/04/06/bettemidler.

publishers and PROs, and processed under the financial terms of recording artists' and songwriters' own private arrangements with rights owners. As might be imagined, a significant portion of the royalties received are retained by these rights owners for their own account, or applied toward the recoupment of advances paid to recording artists and songwriters.

While the public is led to believe through the aforementioned sorts of publicity that digital music services do not pay significant royalties, nothing could be further from the truth. In fact, digital music services are paying more in royalties and wholesale proceeds, as a percentage of their gross revenue, than any music distributors under the historical business model.

20. In what ways are investment decisions by creators, music publishers, and record labels, including the investment in the development of new projects and talent, impacted by music licensing issues?

DiMA takes *no view* on what ways investment decisions by creators, music publishers, and record labels, including the investment in the development of new projects and talent, are impacted by music licensing issues. Although DiMA's members have significant intellectual property portfolios of their own and have great respect for the investments made by content creators, DiMA's members do not generally perform the functions of music creators, record labels or music publishers.

21. How do licensing concerns impact the ability to invest in new distribution models?

As we have noted elsewhere in our responses to the other specific questions posed in this Notice of Inquiry, the current legal and regulatory framework provided by U.S. copyright law for music licensing has created a "perfect storm" of issues and areas of concern that have led many potential investors *to refrain from investing* in new distribution models. Such issues and areas of concern include: the complexity of music licensing caused by the fragmented nature of rights ownership; unsustainable royalty rates; the cost of acquiring and administering licenses; lack of transparency regarding rights ownership; and substantial legal risks, such as the potential liability for statutory damages for "mistakes," however innocent or unavoidable they may be.

In testimony before the U.S. House of Representatives Subcommittee on Intellectual Property, Competition and the Internet of the Committee on the Judiciary in 2012, one investor noted the following about the chilling effect that music licensing issues have had on entrepreneurship and investment in new business models:

> As venture capitalists we evaluate new companies largely based on three criteria: The abilities of the team, the size and conditions of the market the company aims to enter, and the quality of the product. Although we've met many great entrepreneurs with great product ideas, we have resisted investing in digital music largely for one reason: The complications and conditions of the state of music licensing. The digital music business is one of the most perilous of all Internet businesses. We are skeptical under the current licensing regime that profitable standalone digital music companies can be built. In fact, hundreds of millions of dollars of venture capital have been lost in failed attempts to launch sustainable companies in this market. While our industry is used to failure, the failure rate of digital music companies is among the highest of any industry we have evaluated. This is solely due to the overburdensome royalty requirements imposed upon digital-music licensees by record companies under both voluntary and compulsory rate structures. The compulsory royalty rates imposed upon

> Internet radio companies render them noninvestible businesses from the perspective of many VCs.[115]

Addressing these concerns and problems through a comprehensive modernization of U.S. copyright law for the digital environment will go a long way toward stimulating a new wave of investment in new distribution models.

DATA STANDARDS

22. Are there ways the federal government could encourage the adoption of universal standards for the identification of musical works and sound recordings to facilitate the music licensing process?

As noted in our responses to Questions 1, 3, 5 and 8, the lack of transparency around rights ownership information for musical works and sound recordings makes it difficult if not impossible for digital music services to determine what rights they do and do not possess at any given time, which presents many adverse consequences. A publicly available, centralized database for musical works and sound recordings would go a long way toward resolving many of the problems identified in our response to this Notice of Inquiry.

The federal government *could encourage* the adoption of universal standards for the identification of musical works and sound recordings to facilitate the music licensing process by establishing a set of best practices, database standards, and a regime for enforcing participation and compliance. At a minimum, this regime could encourage adoption by incorporating the following key elements:

- Statutory damages. Without limiting the concept of a "safe harbor" from statutory damages previously suggested (i.e., one that shields copyright users from infringement liability if they have acted diligently and in good faith based on the best information available, such as the centralized database), eligibility to seek statutory damages in general should be conditioned on participation in the centralized database, utilizing the universal standards.

- Attorneys' fees. As a further incentive for participation, like the registration of copyrighted works with the Copyright Office,[116] eligibility to seek attorneys' fees in infringement cases in general should be conditioned on the registration of accurate rights ownership information in the centralized database, utilizing the universal standards.

- Economic incentives. The federal government should also encourage the adoption of universal standards by creating other economic incentives for rights owners to participate.

The federal government should develop these standards, practices and compliance regulations in conjunction with interested parties from the private sector, as much of the information required is already controlled by private parties in disparate private databases, and there are many different data standards utilized by digital music service providers and rights owners today that would need to be harmonized. However, as the experience with the development of the GRD has shown (and as previously noted), if left

[115] *Music Licensing Part I: Legislation in the 112th Congress: Hearing Before the Subcomm. on Intellectual Property, Competition, and the Internet of the H. Comm. on the Judiciary*, 112th Cong. 71 (2012) (statement of David B. Pakman, Partner, Venrock).
[116] 17 U.S.C. § 412 (2012).

entirely to private industry without oversight from the federal government, these universal standards – and the centralized database itself – are unlikely to get implemented.

OTHER ISSUES

23. Please supply or identify data or economic studies that measure or quantify the effect of technological or other developments on the music licensing marketplace, including the revenues attributable to the consumption of music in different formats and through different distribution channels, and the income earned by copyright owners.

DiMA believes that the following data and economic studies measure or quantify the effect of technological or other developments on the music licensing marketplace:

- Michael Masnick and Michael Ho, *The Sky is Rising*, Computer and Communications Industry Ass'n, Engine Advocacy and Floor 64, Jan. 2012, *available at* http://www.techdirt.com/skyisrising/.

- Brett Danaher, Samita Dhanasobhon, Michael D. Smith and Rahul Telang, *Understanding Media Markets in the Digital Age: Economics and Methodology* (Apr. 2014), *available at* http://www.nber.org/chapters/c12999.pdf.

- *Adventures in the Netherlands: Spotify, Piracy and the New Dutch Experience*, Spotify, Jul. 17, 2013, *available at* https://spotify.box.com/shared/static/nbktls3leeb0rcyh41sr.pdf.

- *IFPI Digital Music Report 2014*, IFPI, *available at* http://www.ifpi.org/downloads/Digital-Music-Report-2014.pdf.

- Joshua P. Friedlander, *News and Notes on 2013 RIAA Music Industry Shipment and Revenue Statistics*, RIAA, *available at* http://76.74.24.142/2463566A-FF96-E0CA-2766-72779A364D01.pdf.

- Jean-Manuel Izaret, John Rose, Neal Zuckerman and Paul Zwillenberg, *Follow the Surplus: How U.S. Consumers Value Online Media*, Boston Consulting Group (Feb. 2013), *available at* http://www.bcgtelaviv.com/documents/file127046.pdf.

- Thomas Künstner, Matthew Le Merle, Hannes Gmelin and Christian Dietsche, *The Digital Future of Creative Europe: The Economic Impact of Digitization and the Internet on the Creative Sector in Europe*, Booz & Co. (Mar. 24, 2013), *available at* http://www.strategyand.pwc.com/global/home/what-we-think/reports-white-papers/article-display/digital-future-creative-europe.

24. Please identify any pertinent issues not referenced above that the Copyright Office should consider in conducting its study.

As noted in our response to Questions 12 and 13, the digital music services that operate under the Section 112 and 114 statutory licenses not only compete against each other without regard to these platform distinctions, they also compete with a wide variety of other entertainment services and products for the attention of the consumer, including AM and FM terrestrial radio, HD Radio and permanent digital downloads. Just as there is no rational basis for different ratesetting standards applicable to each of these competing services, there is no rational basis for there to be discriminatory standards for applying *the programming rules and restrictions* to these services that compete for the same users, time spent listening, advertising dollars and subscription dollars. Yet, the standards under Section 114(d)(2), are applied in such a way as to advantage some competitors (e.g., satellite radio and digital radio that is bundled with cable and satellite television services) over others (e.g., Internet radio). For example, the following five rules apply to Internet radio services, but not any of the other service types operating under the Section 112 and 114 statutory licenses:[117]

- The service cannot "knowingly perform the sound recording…in a manner that is likely to cause confusion, to cause mistake, or to deceive, as to the affiliation, connection, or association of the copyright owner or featured recording artist with the transmitting entity or a particular product or service advertised by the transmitting entity…"[118]

- The service must cooperate in order to prevent technology from "automatically scanning… transmissions…in order to [allow the user to] select a particular sound recording;"[119]

- The service must not take "affirmative steps to cause or induce the making of a phonorecord by the transmission recipient" and must enable its own technology to the fullest extent possible "to limit the making by the transmission recipient of phonorecords of the transmission directly in a digital format;"[120]

- The service must accommodate technical anti-circumvention measures for the identification and protection of copyrighted works;[121] and

- The service must ensure that the title of the sound recording, the album, and the artist "can easily be seen by the transmission recipient in visual form" during the performance.[122]

Fair competition among digital music service providers can be restored by applying the same programming rules and restrictions under Section 114(d)(2) to all services operating under the Section 112 and 114 statutory licenses. The programming rules and restrictions under Section 114(d)(2) should apply to *all service types* that rely on Section 114 statutory licenses, such that the law creates a "level playing field" for all parties.

III. CONCLUSION

In making its recommendations to Congress regarding potential areas for the modernization of U.S. copyright law in the area of music licensing, DiMA urges the Copyright Office to take a holistic view of the entire music licensing ecosystem, and provide a framework for the new digital era that is based on the six essential pillars outlined in Section I of this Notice of Inquiry response. Because of the importance and technical complexity of the various issue involved, we respectfully suggest that the Copyright Office conduct further analysis into the current landscape with a view to [1] achieving a better understanding of the "perfect storm" of music licensing issues and problems that has created systemic failure in the music licensing marketplace, and [2] determining how the issues, problems and inefficiencies discussed in this Notice of Inquiry response may be addressed through appropriate legislative changes.

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[117] 17 U.S.C. § 114(d)(2)(C); *see* Nimmer, *supra* note 4, § 8.22[D][1][c] (2013).
[118] 17 U.S.C. § 114(d)(2)(C)(iv).
[119] 17 U.S.C. § 114(d)(2)(C)(v).
[120] 17 U.S.C. § 114(d)(2)(C)(vi).
[121] 17 U.S.C. § 114(d)(2)(C)(viii).
[122] Nimmer, *supra* note 4, § 8.22[D][1][c] (2013) (describing the requirements of 17 U.S.C. § 114(d)(2)(C)(ix)).

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ARTICLE: Intellectual Property and Antitrust: Music Performing Rights in Broadcasting

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SUMMARY:
... Since 1934, the Antitrust Division of the U.S. Department of Justice (DOJ) has concerned itself with competitive issues in the licensing of music performance rights by the nation's two major performance rights organizations (PROs), the American Society of Composers, Authors, and Publishers (ASCAP) and Broadcast Music Inc. (BMI).... To license alternative content to enable a radio boycott of ASCAP in 1940, the radio industry established a third organization, BMI, which picked up many country, blues, and early rock writers that ASCAP did not admit. ... The modified Consent Decree served ASCAP well in 1967, when the organization brought suit against a radio station in Washington that contended that ASCAP's blanket license was an unlawful combination in violation of the Sherman Act. ... ASCAP's blanket license for major radio stations is 1.615 percent of adjusted gross revenue.... Notwithstanding the clear requirement ... that ASCAP offer broadcasters a genuine choice between a per-program and a blanket license, ASCAP has consistently resisted offering broadcasters a realistic opportunity to take a per-program license. Among other things, ASCAP has sought rates for the per-program license that have been substantially higher than the rates it has offered for the blanket license, and it has sought to impose substantial administrative and incidental music use fees and unjustifiable and burdensome reporting requirements on users taking a per-program license [including the costs of protracted litigation].... This statement contrasts with Magistrate Dolinger's stated intent to limit exit from the ASCAP blanket license....

TEXT:
[*349] 1. INTRODUCTION

Since 1934, the Antitrust Division of the U.S. Department of Justice (DOJ) has concerned itself with competitive issues in the licensing of music performance rights by the nation's two major performance rights organizations (PROs), the American Society of Composers, Authors, and Publishers (ASCAP) and Broadcast Music Inc. (BMI). DOJ concerns about ASCAP and BMI led to two Consent Decrees in 1941, n1 two more in 1950 n2 and 1966, n3 and key modifications in 1960 n4 and 1994. n5 In June 2001, the DOJ and ASCAP entered into a modified Consent Decree, the Second Amended Final Judgment (AFJ2), that attempted to resolve some competitive concerns. n6 This paper reviews the improvements and possible difficulties of the new Consent Decree and its underlying rationale, as described by an accompanying memorandum released by the Department. n7

ASCAP and BMI license the rights to publicly perform musical compositions in non-dramatic settings in the United States. Licensees together now pay over one billion dollars to the two organizations for the right to use their catalogued material, [*350] which together includes roughly 97 percent of all American compositions. Television and radio broadcasters, which are the major revenue contributors and prime focus of this paper respectively account for approximately 45 and 36 percent of total license revenues. at ASCAP. n8 Broadcast licensees include the three full-time television networks, the Public Broadcasting System, Univision, affiliated and independent local television stations, cable operators, cable programmers, and commercial and noncommercial radio stations. This group is increasingly joined by digital transmitters, which include music subscription services, digital satellite radio, and station-owned and independent webcasters now based on the Internet. General non-broadcast licensees include colleges and universities, symphony orchestras, concert presenters, and individual establishments for eating, drinking, sports, and amusement.

Performance rights organizations (PROs) provide a key administrative service for music users, who might otherwise need to deal directly with songwriters and composers to obtain the rights to perform copyrighted music. n9 PROs negotiate and establish license contracts, collect revenue, deduct overhead, and pay remaining amounts to songwriters and publishers. As the grande dame of the business, ASCAP historically has offered the larger and more prestigious catalogue, including the greatest names in American music -- Aaron Copland, Duke Ellington, Irving Berlin, Leonard Bernstein, Harold Arlen, Cole Porter, and George Gershwin, to name a few.

Since ASCAP's inception in 1914, the PROs have made pooled performance rights for catalogued works available to music users mostly through blanket licenses. Blanket licensees may perform, or convey the rights to perform, on their premises all the catalogued works of a PRO without limit. During the length of a contract, blanket fees do not vary with customer usage. Rather, blanket payments are generally fixed as an inflation-adjusted flat fee, a percentage of revenue, or a multiple of square footage, seating capacity, or some other measure of physical space. Blanket licenses economize on transaction costs, insure against involuntary infringement, and efficiently price each additional performance unit at zero, which is the immediate marginal cost of provision.

However, blanket licenses can also be deployed as anticompetitive arrangements [*351] that have attracted Justice Department attention since 1934. nlO These licenses, which had been ASCAP's sole license offer until 1941, would compel each user to make an "all or nothing" choice that would practically force acceptance of a full license contract. By limiting user choice, blanket licenses also reduced the incentive and ability of music users to choose from alternative arrangements that might otherwise decrease payments to the PRO.

The Antitrust Division of the Justice Department negotiated Consent Decrees regarding competitive practices with ASCAP in 1941 nil and 1951, nl2 and with BMI in 1941 nl3 and 1966. nl4 Per the terms of these Consent Decrees, ASCAP and BMI must offer to radio and television stations program licenses that make the full catalogue available on an individual program basis. The Consent Decrees specify that program licenses must provide a "genuine choice" to the blanket. Despite the stipulation, television and radio broadcasters subsequently continued to allege that ASCAP and BMI program licenses were priced anticompetitively.

On June 11, 2001, the Antitrust Division and ASCAP entered in the federal district court of the Southern District of New York a Joint Motion to enter a newly negotiated Second Amended Final Judgment (AFJ2) that resolves many outstanding issues in performance rights. n15 As discussed in an accompanying memorandum, AFJ2 generally expands and clarifies ASCAP's obligation to offer genuine license alternatives to more user groups, such as background music providers and Internet companies. nl6 It also streamlines administrative provisions for resolving rate disputes and modifies or eliminates restrictions that now govern ASCAP's relations with its members.

This article reviews the economics and history of the market for performance rights and the recent Amended Final Judgment that ASCAP and the Justice Department entered. It is organized as follows. Section 2 provides an overview of the legal nature of the performance right in musical compositions and the means of its enforcement. Section 3 introduces blanket licensing and the historic Consent Decrees that the U.S. Department of Justice negotiated with ASCAP and BMI. Section 4 discusses the antitrust cases that upheld, with restrictions, the legality of blanket licensing, while section 5 considers ratemaking matters that subsequently resulted in important rulemakings in U.S. District Court. Sections 6-8 discuss AFJ2, particularly as it concerns competitive licensing and writer relations. Section 9 concludes the article.

[*352] 2. THE PERFORMANCE RIGHT AND ITS ENFORCEMENT

Copyright for the words and lyrics embedded in musical compositions is now protected by the Copyright Act of 1976, which became effective on January 1, 1978, and is codified in Title 17 of the U.S. Code. n17 Section 106 grants five exclusive rights to composers/writers who create musical works. These rights include:

1. The right to reproduce the work in copies or phonorecords,

2. The right to prepare derivative works based upon the work,

3. The right to distribute copies or phonorecords of the work,

4. The right to perform the work publicly,

5. The right to display the work publicly. n18

The fourth right, embedded in § 106(4), represents the public performance right for musical compositions that is the topic of this article. n19

Public performance rights in musical compositions should not be confused with previous rights to physically reproduce, derive, and distribute the music or lyrics of a musical composition. These rights together compose the mechanical right or, when applied to video soundtracks, the synchronization right. Writer copyright in musical compositions also should not be confused with copyrights in the actual [*353] sound recordings that are made by singers and instrumentalists and owned by their recording labels. Sound recording rights are now protected in the United States only for non-broadcast digital audio transmissions. n20

There are two general categories of performance rights. Small or non-dramatic rights pertain to compositions (including popular songs) that are performed independently of a created story (or dramatic or concert excerpt thereof). Since use here may be spontaneous, bilateral licensing between user and writer is often impractical. Consequently, the PROs reasonably act as transactions agents for licensing material, monitoring performances, and collecting royalties on behalf of their members or affiliates. By contrast, grand or dramatic rights pertain to musical compositions that are performed as part of a larger theatrical production or concert excerpt thereof. Because dramatic rights can be negotiated in advance of actual performance, PROs do not license them.

ASCAP and BMI are the two major American PROs that license non-dramatic public performances of copyrighted musical compositions. After composing a song, a writer will enlist one of the PROs to act as her collecting agent. n21 Once affiliated, a writer will enlist the services of a PRO-affiliated music publisher, to whom she passes the copyright. n22 The PROs distribute license revenues evenly to publishers and writers based on estimated number of performances. n23

Fees for broadcast licensees are negotiated periodically with individual networks/stations or their collective agents (such as the Radio Music Licensing Committee and Television Music Licensing Committee). Each radio station generally pays a fixed percentage of its adjusted advertising revenue for a blanket license. Cable channels pay blanket fees based on advertising revenues or numbers of subscribers. The three full-time television networks pay fixed fees that are adjusted annually for inflation. Local television station fees are negotiated for the industry as a whole and subsequently apportioned to each station based on estimated viewership.

In addition to blanket licenses, broadcasters have other ways of "clearing" music used on television programs. Per the terms of the relevant Consent Decrees, PRO license arrangements must be non-exclusive; i.e., licensees may directly contract with writers and publishers for usage rights for particular compositions. Direct licensing entails contracts between broadcast stations and writers for individual musical works that may be performed on station-produced shows, such as themes for local news and talk shows. Source licensing entails deals between copyright [*354] owners and program producers who hire music for prerecorded soundtracks used on network and syndicated programs. Once secured by a producer, performance rights can be conveyed with the program to station buyers. n24

Finally, each PRO must offer a program license, which is a "mini-blanket" that confers full usage rights for all catalogue music used during the presentation (i.e., non-commercial) of specified programs or day parts. Total payments for a particular licensee depend upon the total number of programs in which catalogued music is used. Program licenses should not be confused with per use licenses that would price each individual performance. As program fees can be reduced as more programs are "cleared" through source or direct-licensing, a station can save licensing revenues if it can source- or direct-license its music at a rate that is below the prevailing program fee. Program licenses are augmented with separate commercial “mini-blankets" thalllicense off-program uses that surround the feature presentations.

A broadcast station or network can then obtain the same rights with a blanket license or a combination of direct, source, program, and commercial licenses. The licensee will then choose its most preferred licensing system by comparing blanket fees with amounts due from a modular alternative. If the market were perfectly competitive, the fee for each program license would equal the rate of the best direct- or source-license alternative, and blanket fees would differ from the sum of the composites only by the incremental administration costs that the providing PRO would save by implementing the blanket.

3. BLANKET LICENSING AND CONSENT DECREES

The U.S. Congress first extended copyright to theater music in 1856 n25 and to non-dramatic performances in 1897. n26 Since music uses in non-dramatic settings were exclusively live and often spontaneous, performance rights were difficult to enforce and unauthorized performances were frequent. Consequently, several prominent composers (including Victor Herbert, Irving Berlin, John Philip Sousa, and James Weldon Johnson) established ASCAP, the first American PRO, in order to protect the performance rights of writers and publishers in non-dramatic settings. An unincorporated collective owned and governed by its songwriters and publisher members, ASCAP instituted a system of blanket licenses that enabled music halls, movie theaters, and other licensees to perform, without infringement, any registered composition in its entire catalogue for a specified contract period. ASCAP distributed blanket revenues to its members based on a monitored count of public performances.

ASCAP's license revenues grew substantially in the 1920s, as music made its way to broadcast radio. A second PRO in the United States, SESAC, was formed [*355]in 1930. n27 Relatively small, privately owned, and for-profit, SESAC has always operated without Justice Department and court involvement. To license alternative content to enable a radio boycott of ASCAP in 1940, the radio industry established a third organization, BMI, which picked up many country, blues, and early rock writers that ASCAP did not admit. Owned by private broadcast stations, BMI is a nonprofit corporation that counts songwriters and publishers as affiliates.

Licensing 80 percent of all music performed on the radio, ASCAP attracted its first antitrust suit from the Antitrust Division in 1934. The Department contended that ASCAP dominated the radio industry and should be dissolved. n28 The case became dormant after the government received a continuance after a two-week trial. In 1941, the Department sued both ASCAP and BMI on the principal ground that their blanket licenses, which were their sole offerings, were in restraint of trade. Consent decrees quickly followed that specified, among other things, that licensing practices must be non-exclusive and that licensees and individual members/affiliates should be allowed to directly contract with one another. n29

ASCAP's Consent Decree specified that ASCAP could not discriminate in prices or terms charged to similar users, n30 stipulated that ASCAP must offer a per program alternative to the blanket license, n31 required that radio network licenses cover the downstream broadcast by local radio stations, n32 and imposed a number of membership obligations. n33 A related criminal action against ASCAP was settled immediately afterward, when ASCAP, its president, and its entire board of directors were convicted of criminal acts on pleas of nolo contendere. After signing the Decree, ASCAP immediately moved to require that all direct license revenues be pooled, thereby negating any writer incentive to pursue the alternative licenses that the Department had envisioned.

Despite the fact that accompanying music on movies had moved after 1929 from live theater instruments to pre-recorded soundtrack, ASCAP continued to license soundtrack music in movie theaters in the subsequent years. In 1948, 164 cinema owners sued ASCAP for violations of sections 1 and 2 of the Sherman Act regarding its requirement that movie producers contract only with theaters that purchased ASCAP licenses. In a key district court decision, ASCAP was found to be a combination in restraint of trade because all members were required to license works at pooled rates and could not therefore compete against one another in marketing their performance rights. n34 The district court issued an injunction against the practice. n35

[*356] With the advent of television, the Justice Department negotiated a new Consent Decree with ASCAP in 1950. n36 Under sections VII and VIII, ASCAP agreed to extend to television broadcasters the program license and to avoid any "discrimination among the respective fees fixed for the various types of licenses which would deprive the licensees ... of a genuine choice from among such various types of licenses." n37 The Consent Decree also reaffirmed the need for license non-exclusivity (sections IV(A-B), VI), n38 banned price discrimination between "similarly situated" licensees (section IV(C)), n39 and restricted the length of each non-motion picture performance license to five years or less (section IV(D)). n40 The Decree foreclosed ASCAP from movie soundtracks by requiring that synchronization and performance rights be licensed at the same time (i.e., by the composer) (sections IV(E), V(C)). A fee-setting Rate Court was established in the U.S. District Court for the Southern District of New York for hearing license disputes, with the burden of proof upon ASCAP to show reasonableness (section IX). n41 The Justice Department and BMI modified their respective Decree in a similar fashion in 1966 n42 and instituted a Rate Court provision in 1994. n43 BMI is now litigating its first major radio license matter before its Rate Court.

The modified Consent Decree served ASCAP well in 1967, when the organization brought suit against a radio station in Washington that contended that ASCAP's blanket license was an unlawful combination in violation ofthe Sherman Act. The Ninth Circuit Court of Appeals affirmed a district court decision that upheld ASCAP because its blanket licenses were non-exclusive and its license fees were under the surveillance of the Rate Court. n44 The U.S. Solicitor General supported the decision n45 and the Supreme Court denied certiorari. n46

4. PERFORMANCE RIGHTS AND ANTITRUST

Music use on broadcast television in the 1940s and early 1950s was much as it had been on radio--spontaneous use on popular variety shows. Consequently, a blanket license here was as useful as it had been to radio stations. However, with the advent of pre-recorded programs and music soundtracks, spontaneous use declined considerably. Over 95 percent of usage minutes on television now appear on pre-recorded soundtrack. n47 Like movie producers, television producers can [*357] reasonably consider source-licenses for soundtrack music that combine synchronization and performance rights.

However, this cost-saving exercise is pointless unless reductions are made possible in the licensing fees that ASCAP and BMI charge to television stations. As soundtrack prerecording became more prevalent in the 1950s, television networks and stations came to challenge blanket licenses more aggressively than had their radio predecessors. In 1961, local station plaintiffs sued in the ASCAP Rate Court to compel a modified blanket license that would have allowed stations to carve out syndicated programs with pre-recorded soundtracks. After the district court narrowly interpreted its rulemaking authority under the Consent Decree and denie:d the request, the Second Circuit affirmed the denial. n48 In denying this application, the district court suggested that applicants initiate a private antitrust suit or urge the Justice Department to attempt to modify the Decree. This threw down the gauntlet for the antitrust action that would follow.

Following a fee dispute with BMI, CBS brought an action against both PROs in 1969. The plaintiff argued that blanket licensing embodied illegal price-fixing, unlawful tying, a refusal to deal, and a misuse of copyright. It therefore sought a declaratory judgment n49 that blanket licensing was per se illegal under both sections 1 and 2 of the Sherman Act. n50 The complainants sought a ruling to require ASCAP and BMI to offer a system of direct licenses where licensees and members/affiliates would individually contract with one another.

A 1972 district court ruling dismissed the tie-in and block-booking charges since PRO licenses were non-exclusive. n51 In 1977, the Second Circuit Court of Appeals reversed, holding that BMI was engaging in per se illegal price-fixing, and remanded the matter. n52 Supported by an amicus brief from the Justice Department, ASCAP and BMI appealed the decision to the U.S. Supreme Court in 1979.

In an oft-cited decision, Justice White ruled that blanket licenses were properly examined under a rule of reason that generally applied to Sherman Act cases. n53 The proper inquiry must focus on whether the effect is designed to "increase economic efficiency and render markets more, rather than less, competitive." n54 In [*358] this context, the blanket license is not a "naked restraint of trade with no purpose except stifling of competition." n55 Rather, it is greater than the sum of its parts [and] to some extent, a different producer [with] certain unique characteristics. It allows the licensee immediate use of covered compositions, without the delay of prior individual negotiations, and great flexibility in the choice of musical material." n56 Continuing, the blanket is a distinct good "of which the individual compositions are raw material" and enables a market "in which individual composers are inherently unable to compete fully effectively." n57 On remand, the circuit court affirmed the original district court decision, finding that the blanket licenses were non-exclusive. n58

Antitrust issues reemerged in 1981 when five owners of local television stations, representing a class of 450 owners of 750 stations, sought to preclude ASCAP and BMI from issuing blanket licenses. The complainants argued that the program license was uneconomically priced. Blanket licensing was alleged to be a violation of section 1 of the Sherman Act n59 and a misuse of copyright.

The district court concurred, noting that the percentage-of-revenue in the ASCAP program license exceeded sevenfold its blanket counterpart and that only two stations conseqw ntly had chosen an ASCAP program license. n60 With this comparison, the court concluded "that the per program license was too costly and burdensome to be a realistic alternative to the blanket license." n61 The court then issued an injunction that prohibited the practice of blanket licensing.

Influenced by a seminal law review article, n62 the Second Circuit in 1984 reversed the district court, finding that blanket arrangements do not restrain trade if alternative means of acquiring performance rights are "realistically available." n63 Judge Newman ruled that the "only valid test of whether the program license is 'too costly' to be a realistic alternative is whether the price for such a license ... is higher than the value of the rights obtained." n64 The sevenfold markup of program licenses was held to be reasonable because the respective program and blanket percentages were based on different revenue bases.

5. THE ASCAP RATE COURT

The matter of rate determination for program licenses moved in 1990-91 to the ASCAP Rate Court, which conducted an administrative hearing in which 963 [*359]independent and 20 network-owned stations sought final determination of blanket and program fees for historic periods in which interim license fees had prevailed. These local stations were attempting to negotiate with ASCAP an all-industry fee aggregate that could be subsequently assigned to individual stations based on respective audience size, day part ratings, and program clearance. Hearing Magistrate Michael Dolinger issued a decision in 1993. n65

Consolidating testimony from two opposing testifying economists, the magistrate found that there is no applicable economic theory for determining blanket rates for performance licenses. Previous fee levels -- tempered by the recognition of changing circumstances-- were the only reasonable starting points for subsequently administered fee-setting. n66 The magistrate then applied -- with adjustments for annual inflation and station growth -- fee levels from a prior blanket license in 1972. This produced a serious reduction from ASCAP's requested amount for the blanket percentage.

ASCAP had urged the court to set the percentage-of-revenue for program licenses at a fourfold multiple of any blanket fee amount, together with an unspecified increment to cover additional expenses that it would have incurred in administering and monitoring the program. The magistrat•held that this proposal was designed to render the program arrangement "technically available, but practically illusory for virtually all stations." n67 It "would trivialize what was plainly not intended to be a trivial set of provisions" in the Consent Decree. n68

To resolve the problem, Magistrate Dolinger designed the program fee in a manner where the typical local television station would pay to ASCAP equal amounts under the blanket and program alternatives, exclusive of additional administration costs. To do this, the magistrate estimated that the typical local station used the ASCAP program license in roughly 75 percent of its programming. Magistrate Dolinger set the percentage-of-revenue in the program license at a 1.33 multiple of the blanket rate. This roughly ensured "revenue equivalence" between program and blanket revenues for the typical station (i.e., 1.33 x .75 = 1). n69 A 7 percent increment was then added to compensate ASCAP for the additional inefficiencies and administrative costs that inhere in program licensing. n70 Facing the retroactive application of his formula to eleven historical years, the magistrate's stated intent for the implemented program licensing system was to limit switching from blanket to program licensing. n71

[*360] ASCAP and its licensees subsequently agreed to an additionallO percent increment on the program license amount to provide a separate "mini-blanket" to cover all commercial music used during the day. This modification enabled stations to clear individual programs simply by attending to music within the actual content of the show, rather

than the more difficult process of clearing both content and commercial music. n72 However, this second rider added yet another cost to the program license compared with the blanket alternative, which automatically covers commercial uses at no additional cost.

ASCAP's present fees for program licenses for radio stations, which were established outside of Rate Court and designed with no reference to the revenue equivalence relationship, now offer even less of a "genuine choice." Commercial radio stations pay fees that are based on a percentage of adjusted station revenue; the percent fees can be negotiated individually or by an all-industry licensing committee. ASCAP's blanket license for major radio stations is 1.615 percent of adjusted gross revenue. n73 For program users, percentage fees per licensed program are set at 4.22 percent of the first 10 percent of weighted program hours where feature music is used. n74 Fees for all additional hours with feature music are set at 2.135 percent. ASCAP then adds an additional 0.24 percent for a "mini-blanket" to cover all music used on radio commercials. n75 Depending on the number of weighted hours, the markup of the program percentage above the blanket rate may range from 60 to 177 percent. The matter took a turn in 1995 when a group of radio stations unsuccessfully sought to apply Magistrate Dolinger's equivalence formula to obtain a better program license for their particular situation. n76 ASCAP's licenses for webcasters now incorporate similar discounts for blanket users. n77

[*361] 6. SECOND AMENDED FINAL JUDGMENT

Faced with the ongoing responsibility generally to enforce the nation's antitrust laws and specifically to afford to music licensees a "genuine choice" between blanket and program licenses, the Antitrust Division targeted ASCAP's licensing practices as a necessary first step to reform licensing in the performance rights industry:

Notwithstanding the clear requirement ... that ASCAP offer broadcasters a genuine choice between a per-program and a blanket license, ASCAP has consistently resisted offering broadcasters a realistic opportunity to take a per-program license. Among other things, ASCAP has sought rates for the per-program license that have been substantially higher than the rates it has offered for the blanket license, and it has sought to impose substantial administrative and incidental music use fees and unjustifiable and burdensome reporting requirements on users taking a per-program license [including the costs of protracted litigation]. In addition, ASCAP has refused to offer a per-program or per-program-like license to users other than those explicitly named in the decree, although, over time, such licenses would be practical for more and more types of users. n78

The Justice Department negotiated a second version of the Amended Final Judgment, AFJ2, which is designed to enhance competition between ASCAP and providers of direct- and source-licenses. n79

The objective is to ensure that a substantial number of users within a similarly situated group will have an opportunity to substitute enough of their music licensing needs away from ASCAP to provide some competitive constraint on ASCAP's ability to exercise market power with respect to that group's license fees. n80

This statement contrasts with Magistrate Dolinger's stated intent to limit exit from the ASCAP blanket license. n81 The Department is now negotiating a similar decree with BMI that concerns comparable perceived anti-trust difficulties.

In this pro-competitive context, Subpart VII(A)(l) of AFJ2 would oblige ASCAP to offer per-program licenses, upon request, to any requesting broadcaster. Subpart VII(A)(2) extends the application of program licenses to segment licenses that may implicate day parts (on radio), page links (on Web sites), broadcast channels (on music subscription services), or other means of breaking down music usage by time or location. With details for the Rate Court to work out, segment licenses must be offered to background/foreground music services and on-line music users. The per- segment license aims to ensure that users that do not transmit "programs" may nonetheless have access to a license that varies with music use. Accordingly, AFJ2 would allow the Rate Court magistrate great flexibility in its implementation. n82

[*362] The new segment license conceivably could enable stronger competition between ASCAP and BMI. Because music licensees generally require catalogue from both organizations, the two PROs do not compete against one another to sell blanket licenses and have no incentive to undercut the other's blanket fee. However, the two organizations could be given incentive to compete in the sale of segment licenses to broadcast and webcast radio users, who can readily bunch songs from different writers to provide exclusive "all-BMI" or "all-ASCAP" segments. In a competitive market

where license revenues depend on the number of segments actually sold, each PRO would have financial incentive to sell more exclusive licenses by cutting license fees and assisting with material designed to extend the length of the segment.

Net of a surcharge that is designed to cover the additional costs of administering the program license, AFJ2 aims to ensure that the "total license fee [including commercial uses] for a per-program or per-segment license approximate the fee for a blanket license" for a typical user. n83 Music licensees are then to be categorized in groups of similarly situated customers that operate comparable businesses and use music in analogous manners. n84 Each category must have a court-approved "representative music user"; i.e., a hypothetical licensee whose frequency and intensity of usage are typical of the license group-at-large. n85

For this representative user, the total expected payment for a necessary slate of ASCAP-program licenses should approximate its fee for the blanket alternative. n86 That is, if 50 percent of a representative station's programs use ASCAP music (defined as any music written by an *ASCiu>* composer regardless of how it is eventually licensed), the appropriate percentage multiple for the program license should be 2 (i.e., 1/.5) times the percent rate for the blanket. The representative station may pay a blanket fee of 1 percent of its total advertising revenues, or a program fee of 2 percent of advertising revenues for the particular programs that it actually licenses. Once derived, the multiple is then extended to all stations in the user group. If ASCAP were actually able to license all the programs where its music was used, payments of the representative user would be identical under the blanket and program alternative licensing systems. However, payments to ASCAP diminish as more programs migrate to competitive alternatives.

There is a significant difference between the formula described above and the Dolinger formula set out in Buffalo Broadcasting. In AFJ2, all of the station's programs that contain performances of music written by ASCAP members are to be counted as part of the 50 percent that use ASCAP music, regardless of eventual license source. This contrasts with Magistrate Dolinger's section 5 formula (supra), which bases a program multiple on the fraction of station programs for [*363] which the ASCAP program license was actually deployed. n87

To further illustrate the difference, suppose in the above example that the representative station was able to source- or direct-license music requirements in 60 percent of its music-using programs, reducing the need for the ASCAP program license to 20 percent of all programs (i.e., .50 x (1 - .6)). Dolinger's per program rate for the representative station and all users in its group would, thus, have increased to 5 percent (i.e., 1/.2), a rate that takes into account the fact that ASCAP program licenses were actually deployed in 20 percent of all programs. However, the revised fee percentage under AFJ2 would be just 2 percent (i.e., 11.5), since 50 percent of all programs continue to use ASCAP music under one license or another. Substantial savings are evidently possible in the latter system and ASCAP can no longer increase the program rate as usage of its program license declines.

As another pro-competitive gain, AFJ2 permits to each program licensee a full offsetting allowance for the "mini-blanket" fees for commercial and promotional music that is now used outside of the program. This amendment contrasts with previous procedures (see section 5, supra) that fixed charges for the commercial “mini-blanket" as an addition to the program total. As previously mentioned, ASCAP may also fix a surcharge to compensate for its additional costs of administering the program license. n88

As an important economic matter, AFJ2 does not clearly specify whether the program/blanket multiple that is used to derive a particular station's program percent rate must be used to establish equal percent rates for each ASCAP-licensed program in the station's portfolio, or merely establish an average percent rate. Under strict nondiscrimination, the percent rate for each program licensed through ASCAP would necessarily be equal to one another. Alternatively, only the aggregate amount of program fees could be restrained as a percent of underlying program revenues, with individual discounts and upgrades permitted around the average for licenses charged to single programs. Enforced equality has been the case, but AFJ2 seems ambiguous. n89 However, to provide to ASCAP the greatest ability to match competitive providers of source and direct licenses, this strict equality should be relaxed. This point is discussed further in a technical memorandum soon to be made available by this author.

While AFJ2 provides economic incentives for a station licensee to substitute a source- or direct- alternative for an ASCAP program, the new Decree is somewhat more protective against license exit, as would result when radio stations switch from music to talk formats. In the latter case, no license would be needed at all. However, if the representative user were able to reduce its usage of ASCAP material (program, source, and direct) from 75 percent to 50 percent of all segments [*364] in the day, its program multiple would be adjusted in AFJ2 to restore its original revenue level. n90 Upward adjustments of this nature would limit ASCAP's 1incentives to lower prices aggressively to maintain a program or segment license against exit threats. A related competitive problem will occur in the market for exclusive segment licenses (discussed above), where rate adjustments will protect ASCAP from segment shifts to BMI, and vice versa.

7. WRITER RELATIONS

As a second key modification, section XI of AFJ2 entirely dispenses with an amendment to the original Decree known as the "1960 Order." n91 Recognizing ASCAP's then-control over 85 percent of all catalogued music compositions, the "1960 Order" was designed to govern ASCAP's arrangements and operating procedures with regard to its member writers. The Order constrained principally the weights used to divide ASCAP's royalty pool among its membership for different uses of music (e.g., feature vs. commercial), but also prescribed rules for voting, performance surveys, and mechanisms for resolving disputes among members. n92 These rules were to be made public and changes submitted to the Department or Rate Court for approval. Nonetheless, ASCAP's relations with its soundtrack and commercial writers have been quite contentious and the Rate Court has often declined jurisdiction. n93

In moving to vacate the "1960 Order," the Department contended that there are no practical economic standards useful in judging the relative worth of different kinds of performance minutes and expressed clear discomfort that ASCAP claimed a Department imprimatur on the fairness of its rates. n94 Rather, section XI(B)(l) [*365] would allow ASCAP to distribute, without DOJ oversight, collected monies (less costs) to writers based on the number of ASCAP-licensed performances of their works, with varying weights for different kinds of music based on ASCAP's subjective assessment of the value. Special awards are permitted to writers of material with particular prestige value. The chosen weighting method must be consistently applied and made public; upon request, a writer may learn exactly how her resulting royalty check was determined.

For members who contend that ASCAP's payment system is unfair, AFJ2 greatly restricts ASCAP's existing ability to impede writer exit. Contingent upon the entry of a similar rule in the BMI Consent Decree (which is yet to be negotiated), Section XI(B)(3) would enable writers to leave at the end of each calendar year without penalty. The Department suggests that its surveillance of ASCAP payments can be vacated because BMI, with a market share now roughly equal to ASCAP's, and SESAC now present more substantial competitive alternatives than they did in 1960. Presumably, any ASCAP member dissatisfied with its royalty system would willingly move to another PRO having the financial means to compensate her. n95

The Department may nonetheless be relying here on untested economic theory and ignoring some important administrative considerations that now limit the financial ability of ASCAP and BMI to compete. BMI's considerable increase in market share in 1960-1994 resulted in large part from the fact that ASCAP was fee-regulated while BMI was not. Moreover, ASCAP maintained-- but subsequently abandoned-- a payment system that disproportionately favored legacy writers. The world has changed; ASCAP modified its payments system and BMI now has a Rate Court.

Despite a 1993 district court ruling that blanket fees paid to a PRO should be tied primarily to changes in usage of its particular catalogue, as adjusted for revenue growth and inflation, n96 subsequent actions have not granted to ASCAP and BMI the financial ability to compete across-the-board to attract talent from one another. In the short run, there is no administrative procedure by which either organization can adjust blanket licenses for quarterly or annual changes in catalogue size or usage. Moreover, the Rate Courts have no objective measure of "prestige" upon which contract fees can be negotiated up or down. Consequently, royalties for acquisitions of new writers and material covered by a blanket license [*366] can only be distributed by reducing payments to other writers. n97 Writers who exit from a particular PRO free up revenues that can be used to attract others. With no immediate correspondence between license fees and usage levels, a legally administered "zero sum game" of this nature evidently inhibits the players who might otherwise vigorously compete.

Presumably, ASCAP can earn more at its next major negotiation if it can attract talent from BMI. Here too there is no demonstrated dependence of contract fees upon catalogue size. Though each may pursue a limited number of "star" writers who enhance the prestige of their catalogue, the connection between catalogue prestige and actual negotiated amounts is also quite tenuous.

Aggressive competition for migrating writers would be conceivable if license payments could be adjusted immediately for changes in PRO market share. For example, if blanket licenses were adjustable for quarterly changes in market share, license amounts due to ASCAP and BMI would change periodically in appropriate and opposite directions. However, unless overall usage increased, the combined amount paid to the PROs would not change.

However, usage-based pricing would be difficult to implement for a number of practical reasons. First, under a system with two different Rate Courts, there is no single legal authority to tie ASCAP and BMI blanket rates to changes in their respective market shares. Second, there is no objective way to weigh and aggregate different music usage types. Attempts to do so introduce an arbitrary judgment element, as each advocate is likely to produce a weighting scheme that is particularly favorable to its own market position. Adjudicating between them would be a difficult administrative task.

8. OTHER SAFEGUARDS

There are a number of other provisions in AFJ2 that will also enhance the power of users to achieve a more efficient outcome.

Collective Licensing: Under section IV(B), ASCAP may not interfere with the right of its members to license compositions directly or through any agent other than another PRO. This extends member rights from the direct licensing of individually controlled compositions to contracting with agents, such as music libraries, that can negotiate and contract on behalf of a group of writers.

"Through to the Audience": Under the terms of AFJ2, ASCAP must offer to each broadcaster, background music provider, or on-line transmitter a "through to the audience:" license that automatically conveys performance rights from licensee to a secondary user; e.g., from cable network to cable operator. n98 This would allow the original entity, which controls decisions regarding the deployment and licensing of musical content, to make competitive choices and to convey savings to downstream users. "Through to the audience" licensing can represent a major [*367] competitive gain for Internet transmitters, who had no previous right under the present Consent Decree to request and contract for such licenses.

First Time Rules: Under the terms of AFJ2, ASCAP may not use license fees negotiated during the first five years that it licenses a particular industry as a benchmark for subsequent fees that it may seek later. n99 AFJ2 presumes that music users in a new industry are fragmented, inexperienced, lacking in resources, and unduly willing to acquiesce.

Digital licensing: Recognizing the potential of digital rights management to supplant the need for ASCAP monitoring and protection of digital rights, the DOJ's memorandum accompanying AFJ2 states:

Technologies that allow rights holders and music users to easily and inexpensively monitor and track music usage are evolving rapidly. Eventually, as it becomes less and less costly to identify and report performances of compositions and to obtain licenses for individual works or collections of works, these technologies may erode many of the justifications for collective licensing of performance rights by PROs. The Department is continuing to investigate the extent to which the growth of these technologies warrants additional changes to the antitrust decrees against ASCAP and BMI, including the possibility that the PROs should be prohibited from collectively licensing certain types of users or performances. nlOO

9. CONCLUSION

The Department of Justice and ASCAP have entered into a new Consent Decree that promises improvement in a long problematic area for television and radio broadcasters: th<presence-or lack--of a "genuine choice" between blanket and program licenses charged for the right to publicly perform music in non-dramatic settings. Extended to BMI, AFJ2 would provide broadcast licensees with a reasonable opportunity to use a system of program, direct, and source-contracts as a means of avoiding "all-or-nothing" blanket licenses that they may find overpriced. Consequently, broadcast licensees increasingly will be able to contract directly with composers rather than being required to enter into licenses with their respective performance rights organizations. ASCAP and BMI will have to offer program licenses that compete with their own members and affiliates, and broadcasters, advertisers, and the public-at-large will benefit from the outcome.

However, AFJ2 and the Rate Courts may be lacking in their governance of the competitive market between ASCAP and BMI. As all protections for payouts to ASCAP members are vacated, the DOJ now relies on head-to-head competition between the two organizations for new writers to ensure fairness and market efficiency. As explained above, ASCAP and BMI do not currently operate under administrative rules that can consistently adjust blanket license fees in response to changes in usage or catalogue size. Consequently, they do not have the financial ability to engage in the competition that the Department envisions. A technical [*368] memorandum available from the author also suggests that the competitive rules of AFJ2 are lacking with regard to selective discounting, cross-subsidization, and license avoidance.

If the courts cannot establish rules to enable vigorous across-the-board competition for songwriters and composers, the Antitrust Division might tell us what purpose is served by having two (or three) PROs, as opposed to one PRO. At the dawn of the Internet era, this is a timely issue that broadcasters, webcasters, artists, legislators, and regulators need to resolve in short order. With administrative difficulties in systematically relating blanket fees to music use and catalogue size, the most efficient means of providing a blanket license for radio and television broadcasting now appears to be an administered monopoly. Writers and publishers may benefit considerably from scale economies in litigation and administration costs that could be achieved if the blanket license for musical compositions were so operated, as is now the case in every nation except Brazil. n101 The combined overhead, negotiation, and administrative costs of ASCAP and BMI might reasonably be halved if blanket licensing of performance rights were consolidated. Legislators could then reasonably call upon the Department to state exactly where it sees workable competition emerging between ASCAP and BMI and the ways in which its new Consent Decrees will facilitate that competition.

FOOTNOTES:

n1 *United States v. ASCAP, 1941-1943 Trade Cas. (CCH) P56, 104 (S.D.N.Y. 1941); United States v. BM1, 1940-1943 Trade Cas. (CCH) P56, 096 (E.D. Wise. 1941).*

n2 *United States v. ASCAP, 1950-1951 Trade Cas. (CCH) P62, 595 (S.D.N.Y. 1950).*

n3 *United States v. BMI, 1966 Trade Cas. (CCH) P71, 941 (S.D.N.Y. 1966).*

n4 *United States v. ASCAP, 1960 Trade Cas. (CCH) P69, 612 (S.D.N.Y. 1960).*

n5 *United States v. BM1, 1996-1 Trade Cas. (CCH) P71', 378 (S.D.N.Y. 1994).*

n6 Second Amended Final Judgment, United States v. ASCAP, No. 41-1395 (S.D.N.Y. 2001) (entered June 11, 2001), http://www.usdoj.gov/atr/cases/f6300/6396.pdf (last visited Feb. 19, 2001) [hereinafter AFJ2].

n7 Memorandum of the United States in Support of the Joint Motion to Enter Second Amended Final Judgment, United States v. ASCAP, No. 41-1395 (S.D.N.Y. 2000), http://www.usdoj.gov/atr/cases/f6300/6395.pdf (last visited Feb. 19, 2001) [hereinafter AFJ2 Memorandum].

n8 In millions of dollars, a recent publicly available breakdown for the domestic aggregate is television and cable ($165.8), radio ($133.1), general ($68.0), and symphonic and concert performances ($4.3). ASCAP, ANNUAL REPORT (1999).

n9 The U.S. Solicitor General in 1967 made the case for centralized licensing.

The extraordinary number of users spread across the land,. the ease with which a performance may be broadcast, the sheer volume of copyrighted compositions, the enormous quantity of separate performances each year, the impracticality of negotiating individual licenses for each composition, and the ephemeral nature of each performance all combine to create unique market conditions for performance rights to recorded music. If this market is to function at all, there must be ... some kind of central licensing agency by which copyright holders may offer their works in a common pool to all who wish to use them.

Memorandum of the United States as Amicus Curiae on Petition for Writ of Certiorari in the *Supreme Court of the United States at 10-11, K-91, Inc. v. Gershwin Publishing Corp., 389 U.S. 1045 (1968)* (mem.) (No. 67-147), denying cert. to *372 F.2d 1 (9th Cir. 1967)* [hereinafter K-91 Amicus Brief].

n10 See United States v. ASCAP, Equity No. 78-388 (S.D.N.Y., filed Aug. 30, 1934).

n11 *United States v. ASCAP, 1941-1943 Trade Cas. (CCH) P56, 104 (S.D.N.Y. 1941).*

n12 *United States v. ASCAP, 1950-1951 Trade Cas. (CCH) P62, 595 (S.D.N.Y. 1950).*

nl3 *United States v. BMJ, 1940-1943 Trade Cas. (CCH) P56, 096 (E.D. Wis. 1941).*

n14 *United States v. BMJ, 1966 Trade Cas. (CCH) P71, 941 (S.D.N.Y. 1966).*

n15 AFJ2, supra note 6.

n16 AFJ2 Memorandum, supra note 7, at 3-4.

n17 Copyright Act of 1976, Pub. L. No. 94-553,90 Stat. 2591 (1976) (codified as amended at *17 U.S.C.§§ 101-* 1101). As extended in 1998, all audio or visual works completed in the U.S. after the Act's 1978 effective date are now copyrighted for 70 years after the creator's death. *17 U.S.C.A. §* 302(a) (West Supp. 2000). Anonymous works, pseudonymous works, and works made for hire are protected until the earlier of 95 years after publication, or 120 years after creation. § 302(c). Prior to the passage ofthe new act, the previous 1909 Copyright Act protected works for a period of 28 years after publication. Copyright Act of 1909, ch. 320, § 23, 35 Stat. 1075, 1080. Copyright was renewable for an additional 28 year term. Id. Through subsequent amendments, the renewal period for works completed between 1964 and 1977 was extended to 47 years and renewal for a second term was made automatic. *17 U.S.C. §§ 303-304.* In eliminating the need for renewal, the United States first adopted existing international standards established in Article 7 of the Berne Convention for the Protection of Literary and Artistic Works, revised July 24, 1971, amended Sept. 28, 1979, S. TREATY DOC. NO. 99-27 (1986).

n18 Copyright Act of 1976, *17 U.S.C. § 106* (1994).

n19 Per§ 101 of the Copyright Act, to "perform a work" means to "recite, render, play, dance, or act it, either directly or by means of any device or process, or, in the case of a motion picture or other audiovisual work, to show its images in any sequence or to make the sounds accompanying it audible." *17 U.S.C. § 101.*
To perform or display a work "publicly" means:

(1) To perform or display it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered; or

(2) The right to transmit or otherwise communicate a per£ormance or display of the work to a place specified by clause (1) or to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.
Id.

n20 See *17 U.S.C.A. §* 106(a) (effective Feb. 1, 1996); *17 U.S.C.A. § 114(d)* (West Supp. 2000) (exempting certain broadcast transmissions from the provisions of§ 106(6) and providing statutory licensing for others).

n21 Dual affiliation of an individual is not permitted, but different members of a writing team may belong to different PROs.

n22 A publisher markets songs to record labels, administers the copyright, collects mechanical royalties, and sometimes edits the song.

n23 Each organization compensates its writers based on censuses or samples of broadcast airtime. Performances on TV networks, syndicated shows, and cable programs are practically surveyed by universal census, while radio and local TV stations are monitored through scientific samples of program logs, cue sheets, or off-the-air tapes.

n24 The wide majority of this material is commissioned work-for-hire. The remainder consists of prerecorded songs that may add to the background of the program.

n25 Act of Aug. 18, 1856, ch. 169, 11 Stat. 138, 139.

n26 Act of Jan. 6, 1897, ch. 4, 29 Stat. 481,482.

n27 The full organization name, Society of European State Authors and Composers, is not relevant. The organization is quite small, numbering little more than 2000 affiliates.

n28 United States v. ASCAP, Equity No. 78-388 (S.D.N.Y., filed Aug. 30, 1934).

n29 *United States v. ASCAP, 1941-1943 Trade Cas. (CCH) P56, 104 (S.D.N.Y. 1941); United States v. BMJ, 1940-1943 Trade Cas. (CCH) P56, 096 (E.D. Wise. 1941).*

n30 Act of Jan. 6, 1897, ch. 4, 29 Stat. 481,482.

n31 ld. at 404.

n32 Id.

n33 Id. at 405.

n34 *Alden-Rochelle, Inc. v. ASCAP, 80 F. Supp. 888, 894 (S.D.N.Y. 1948).*

n35 Id. See also *M. Witmark & Sons v. Jensen, 80 F. Supp. 843 (D. Minn. 1948).*

n36 *United States v. ASCAP, 1950-1951 Trade Cas. (CCH) P62, 595 (S.D.N.Y. 1950).*

n37 *Jd. at 63, 754.*

n38 *Jd. at 63, 752-53.*

n39 *!d. at 63,* 752.

n40 Id.

n41 *!d. at 63, 754.*

n42 *United States v. BMI, 1966 Trade Cas. (CCH) P71, 941 (S.D.N.Y. 1966).*

n43 *United States v. BMI, 1996-1 Trade Cas. (CCH) P71, 378 (S.D.N.Y. 1994).*

n44 *K-91, Inc. v. Gershwin Publ'g Corp., 372 F.2d 1 (9th Cir. 1967).*

n45 K-91 Amicus Brief, supra note 9.

n46 *K-91, Inc. v. Gershwin Publ'g Corp., 389 U.S. 1045 (1968)* (mem.), denying cert. to *372 F.2d 1 (9th Cir. 1967).*

n47 Usage minutes can now be categorized as feature (1.4%), theme (3.2%), background instrumental (41.4%), and commercial (54.0%). M. Holden, ASCAP and BMI Usage Weightings --Out-of-Step with the World? 3 FILM MUSIC MAGAZINE, 345 (2000). Feature music includes compositions that are the primary focus of audience attention, theme music is used to open and close programs, background music is used to complement screen action, and commercial music includes advertising jingles, public service announcements, and promotional music that pitch other programs. Theme, background, and commercial music invariably entail pre-recorded soundtrack.

n48 "A consent decree, though it is a judicial decree, is principally an agreement between the parties ... and must be interpreted consistently with 'plain meaning' or 'explicit language'"-- *United States v. Atlantic Refining Co., 360 U.S. 19, 22-23 (1959); Suarez v. Ward, 896 F.2d 28, 30 (2d Cir. 1990); Bergerv. Heckler, 771 F. 2d 1556, 1568 (2d Cir. 1985)* -- "and not by reference to what might satisfy the purposes of one of the parties to it." *Firefighters Local Union No. 1784 v. Stotts, 467 U.S. 561, 574 (1984)* (quoting *United States v. Armour & Co., 402 U.S. 673, 681-682 (1971)).*

n49 *28 U.S.C.§§ 2201,* 2202 (1994)

n50 *15 U.S.C. §§ 1,* 2 (1994)

n51 *CBS v. ASCAP, 337 F. Supp. 394 (S.D.N.Y. 1972).*

n52 *CBS v. ASCAP, 562 F.2d 130 (2d Cir. 1977).*

n53 *BM1 v. CBS, 441 U.S. 1 (1979).*

n541d. at 20 (quoting *United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978)).*

n55 ld. (quoting *White Motor Co. v. United States, 372 U.S. 253, 263 (1963)).*

n56 ld. at 22.

n57 Id.

n58 *CBS v. ASCAP, 620 F.2d 930 (2d Cir. 1980),* cert. denied, *450 U.S. 970 (1981).*

n59 *15 U.S.C. § 1.*

n60 *Buffalo Broad. Co. v. ASCAP, 546 F. Supp. 274, 289 (S.D.N.Y. 1982).*

n61 Id.

n62 Lionel S. Sobel, The Music Business and the Sherman Act: An Analysis of the "Economic Realities" of Blanket Licensing, *3 LOY. L.A. ENT. L. REV. 1 (1983).*

n63 *Buffalo Broad. Co. v. ASCAP, 744 F.2d 917 (2d Cir. 1984).*

n64 *1d. at 926.*

n65 United States v. ASCAP (In re Buffalo Broad. Co.)., 1992-1994 *Copyright L. Rep. (CCH) P27, 088 (S.D.N.Y. I993).*

n66 Id. at 26, 370.

n67 ld. at 26, 383.

n68 Id. at 26, 385.

n69 ld. at 26, 391.

n70 Id. at 26, 395.

n71 "The hypothetical average station will find the blanket license somewhat less expensive than the per-program license, unless the station undertakes to clear some amount of its programming either by source or direct licensing, or by other methods, all of which involve their own costs. Under these circumstances, we are unlikely to see such a rush of stations seeking to utilize this license as to impose undesirable burdens and inefficiencies on the functioning of the music license market." Id. at 26, 392 (emphasis added).

n72 This "mini-blanket" was actually part of Dolinger's original decision. However, a subsequent district court disallowed Dolinger's commercial license as beyond the wording of the 1950 *Consent Decree. United States v. ASCAP (In re Capital Cities/ABC, Inc.), I57 F.R.D. I73, 204 (S.D.N.Y. I994).*

n73 Frequently Asked Questions About Licensing, at http://www.ascap.com/licensing/licensingfaq.html (last visited Feb. 22, 2001).

n74 Id.

n75 Id.

n76 The applicants, Salem Media and New England Continental Media, included 429 local radio stations that broadcast a largely religious format featuring mixed talk and music. They argued that music use in their station group was substantially below the all-music format of most radio stations and pressed for a "genuine choice" in a per program alternative. The applicants acknowledged that ASCAP's offered blanket fee, 1.615 percent (which was based on net advertising revenue), was reasonable. However, the applicants contended that the per-program fee of 4.22 percent was useful only to a station that used music in 33 percent or less of its programming. They felt that the per program license fee to their member stations should reflect a true percent equivalent for daily music usage for their particular station group, as in Dolinger's decision. However, the application of the equivalence formula was rejected in district court, which found that the station group was not typical of the radio group as a whole and not entitled to a separate license. *United States v. ASCAP (In re Salem Media of California, Inc.), 902 F. Supp. 411 (S.D.N.Y. 1995);* see also *United States v. ASCAP (In re Salem Media of California, Inc.), 981 F. Supp. 199 (S.D.N.Y. 1997).*

n77 Publicly available information for webcaster licenses for ASCAP and BMI are found at http://www.ascap.com/weblicense/webfaq.html and http://www.bmi.com/iamalwebcaster/faq.asp, respectively (last visited Feb. 22, 2001).

n78 AFJ2 Memorandum, supra note 7, at 24-25.

n79 AFJ2, supra note 6.

n80 AFJ2 Memorandum, supra note 7, at 32 (emphasis added).

n81 See *BMI v. CBS, supra* note 53.

n82 AFJ2 Memorandum, supra note 7, at 26.

n83 AFJ2, supra note 6, at 6; AFJ2 Memorandum, supra note 7, at 29.

n84 Among others, classifying factors include nature and frequency of performances, ASCAP's administration cost, competition among licensees, and licensee revenue source. AFJ2, supra note 6, at 5-6.

n85 */d. at 5.*

n86 */d. at 11.*

n87 Although AFJ2 does not specify it, program counts and proportions can be weighted by advertising revenue, which is the instrument upon which licenses are based.

n88 AFJ2, supra note 6, at 10.

n89 A clause against discrimination in Section IV(C) may be applicable to customer discrimination, program discrimination, or both. ASCAP is enjoined from "entering into, recognizing, enforcing, or claiming any rights ... of public performance which discriminates in license fees or other terms and conditions between licensees similarly situated." *!d. at* 7.

n90 The original amount of program revenue can be resltored by adjusting the program/blanket multiple from 1.33 = 1/.75 to 1.5 = 1/.67

n91 *United States v. ASCAP, 1960 Trade Cas. (CCH) P69, 612 (S.D.N.Y. 1960).*

n92 The ASCAP royalty pool is divided over sampled performances that are weighted based primarily on broadcast type, time of day, and usage category (feature, background, theme, advertising, and promotional). The weights assigned to different music uses are based upon judgments of relative worth that have no comparable market benchmarks. The ratio of most valued (i.e., feature) to least valued (i.e., commercial) music is 1:1 in the U.K., 3:1 in France, 4.5:1 in Germany, and 33.3:1 at ASCAP. Holden, supra note 47.

Because of the difficulty in assessing composer's investment and opportunity costs, a true regulatory price for musical compositions could probably not be determined .... The investment in musical compositions, however, cannot be estimated accurately .... Even if the investment could be assessed, however, a fair rate of return, or opportunity cost, for composers could probably not be gauged because of the difference in quality and popularity of various musical compositions.
John Cirace, CBS v. ASCAP: An Economic Analysis of a Political Problem, *47 FORDHAM L. REV.* 277, *305 (1978).*

n93 See *United States v. ASCAP (In re Karmen), 914 F. Supp. 52 (S.D.N.Y. 1996); United States v. ASCAP (In re Salem Media of Cal., Inc.), 739 F. Supp. 177 (S.D.N.Y. 1990).*

n94 "The Department has been unable to identify any principled way to evaluate whether the changes are appropriate and therefore has almost never objected to the changes. The requirements ... thus impose costs on ASCAP (and consequently its members), on the Department, and on the Court, but provide little if any protection to members. Yet ironically, when members do object to ASCAP's distribution practices, ASCAP frequently invokes the Department's review of its formula and rules as demonstrating that its diistribution practices are fair and appropriate." AFJ2 Memorandum, supra note 7, at 41-42.

n95 Id. at 42.

n96 "Surveying the fluctuations in the amount of music used by a network over time provides an adequate proxy by which to gauge whether the significance of music to network programming has changed relative to prior years; assuming all other factors remain constant, the direction in which a network's music use has headed should chart the course for the music licensing fees owed to ASCAP." *United States v. ASCAP (In re Capital Cities/ABC, Inc.), 83I F. Supp. 137, I56 (S.D.N.Y. I993).* "It appears to the Court that a formula that factors into the calculation of a royalty . . . the changes in both the levels of gross income earned by a network and the degree to which music is used by a network, provides an approach that addresses many of the concerns raised by the parties." */d. at I58.*

n97 To a degree, some additional savings may be made possible by reducing overheads.

n98 *United States v. ASCAP (In reTurner Broad. Sys., lnc.), 782 F. Supp. 778 (S.D.N.Y. 1991),* aff'd, *956 F.2d 21 (2d Cir. 1992).*

n99 AFJ2, supra note 6, at 13-14.

nlOO AFJ2 Memorandum, supra note 7, at 9 n.lO (emphasis added).

n101 A monopoly in performance rights, the Performing Rights Society in the U.K. shares administrative costs with the Mechanical Copyright Protection Society and most recently retained 16.9 cents from every paid out pound. PRS Year End Results 1999, at http://www.prs.co.uk/prs.nsf/sitepages/press_resuls99 (last visited Feb. 22, 2001). The organization has a long run target of 14.5 percent. In Germany, GEMA economizes by collecting royalties for both performance rights and mechanical reproductions.