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Digital Music Broadcast Royalties: The Case for a Level Playing Field

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EXECUTIVE SUMMARY

Reuters

Royalty rates play a crucial role in shaping the digital music broadcasting industry. If rates are too high, the ability of digital broadcasters to provide the public with access to music is impeded. If rates are too low, then recording artists do not receive a fair return on their endeavors. And if rates are inconsistent across different delivery mechanisms, then some business models are favored over others.

Today, the playing field in American digital music broadcasting is anything but level. For example, Internet radio companies can be compelled to pay over 60% of their revenue in sound recording performance royalties.[1] By contrast, Sirius XM satellite radio currently pays only 8% of gross revenue.[2] To make matters even more complicated, these rates are evolving over time in complex and sometimes unpredictable ways, making it nearly impossible for digital audio broadcasters to make reliable projections regarding their future content acquisition costs.

The current patchwork of rates reflects a two-tiered system in American copyright law that partitions non-interactive digital audio services into two categories, each with its own standard for statutory performance royalty rate determinations. Services such as Internet radio that have the misfortune of being subject to the more onerous "willing buyer/willing seller" standard can face extremely high rates, while those such as Sirius XM satellite radio that are often associated with the more balanced standard known as "801(b)"[3] enjoy much lower rates. Furthermore, access to the 801(b) standard is limited to certain services that were "preexisting" in 1998, the year that the Digital Millennium Copyright Act was enacted.

In short, the current copyright royalty landscape creates significant inequities among current market participants. It also furnishes a strong disincentive to potential new market entrants and to the introduction of innovative new business models for delivering digital music. The good news is that these shortcomings can be addressed through simple, focused legislation to provide all non-interactive digital music broadcasters – not just a favored few – with access to statutory royalty rates determined according to the 801(b) standard. This would stimulate innovation and growth in a key segment of the broadcasting industry.

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The Two Copyrights for Songs

For most songs, there are two copyrights.[4] The first is for the musical composition, including any accompanying lyrics, and is usually held by a songwriter and music publisher. The second is for the sound recording, and is typically held by an artist or record label.

The holders of musical composition copyrights have long had a "public performance" right that entitles them to a royalty when their songs are broadcast on traditional AM/FM radio or otherwise performed publicly[5] – including, in recent decades, digital broadcasts over the Internet, digital cable, or satellite radio. Historically, it was impractical for songwriters to track all of the public performances of their songs.[6] This led to the creation in first half of the 20th century of the three major American performing rights organizations (PROs), ASCAP,[7] BMI,[8] and SESAC[9] that issue licenses, track performances, and distribute a portion of licensing revenue to songwriters and music publishers.[10]

Today, most broadcasters purchase a "blanket license" from each of the PROs "that provides the rights to use all the music in the catalog of the PRO."[11] Royalties paid by most[12] audio broadcasters for music composition copyrights typically total in the range of 2 to 5% of gross revenue,[13] providing ASCAP, BMI, and SESAC with aggregate annual royalty payments totaling approximately $2 billion.[14] The need to obtain a performance license for musical compositions applies to all broadcasters. With respect to performance rights for musical compositions, U.S. copyright law does not favor one particular technology or company over another.

The same cannot be said for sound recording performance rights. Much of the debate, litigation, and controversy regarding digital music royalties is a direct consequence of the inequities in current copyright law regarding sound recording copyrights. Companies providing non-interactive digital music broadcasts, in particular, face a particularly challenging royalty environment. How much they pay for the use of sound recordings depends on the year, the technology used to deliver music, and whether their digital music service was in existence in 1998.

Viewed in historical context, sound recording copyrights are new. While the first Copyright Act in the United States was enacted in 1790,[15] sound recordings did not become technologically and commercially feasible until the late 1800's. For most of the 20th century, sound recordings were not granted any federal copyright protection at all.

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In 1971, to address concerns regarding increased piracy in vinyl records and cassette tapes, Congress enacted the Sound Recording Act[16] granting sound recording copyright owners a reproduction right, but, notably, not a public performance right.[17] This gave sound recording copyright owners increased legal authority to prevent unauthorized reproduction and sales of their records, but still left them without a royalty when their songs were broadcast. The Copyright Act of 1976,[18] which was the most significant overhaul of U.S. copyright law since 1909,[19] continued to exclude a public performance right for sound recordings.[20]

The Digital Performance Right in Sound Recordings Act of 1995

Beginning in the mid-1990s, the growth of the Internet, continued declines in digital storage costs, and advances in communications technologies made it practical to deliver digital music without requiring listeners to take physical possession of a storage medium such as a CD. This led to the creation of new business models for providing music, including both non-interactive streaming services delivered via satellite, digital cable, and the Internet, as well as interactive services allowing consumers to choose and then download specific songs.

In 1995, spurred in large part by concerns among traditional broadcasters and the recording industry regarding the threat posed by digital music technologies, Congress enacted the Digital Performance Right in Sound Recordings Act of 1995 (DPRA).[21] The DPRA provided, for the first time in the United States, a performance right for sound recording copyright holders, but limited that right to subscription-based digital services.[22]

This limitation served several crucial purposes. First, it ensured that traditional over-the-air AM and FM "terrestrial" broadcasters, whose support was essential to the DPRA's passage, would not be forced to start paying performance royalties.[23] Second, it provided the recording industry, whose support was also politically essential, with an opportunity to extract new revenue not from traditional radio broadcasters, but from the much less powerful new companies providing digital audio services. Finally, the United States has long been one of the only major countries in the world without a broadly applicable sound recording performance royalty right. While the performance royalty right provided by the DPRA was very narrow, it allowed the United States to claim some progress with respect to international harmonization efforts.[24]

The Digital Millennium Copyright Act of 1998

Almost immediately after the ink was dry on the DPRA, it became evident that it was insufficient. By limiting the new sound recording royalty right to subscription services, the DPRA failed to anticipate the potential growth of non-subscription services, particularly advertiser-supported webcasting. With the number of webcasting companies and listeners growing rapidly, the recording industry, represented by the Recording Industry Association of America (RIAA), began lobbying Congress to address non-subscription services.[25]

In June 1998 the RIAA began asserting the view, despite the language in then-existing copyright law to the contrary, that non-subscription Internet radio stations needed to obtain sound recording performance licenses.[26] This led webcasters to advocate through their own trade group, the Digital Media Association (DiMA) to counter the RIAA's claims.

In October 1998, after a frenzied several months of lobbying, meetings, and hearings involving trade groups including the RIAA, DiMA, the National Association of Broadcasters, and the Songwriter's Guild of America, the Digital Millennium Copyright Act (DMCA)[27] was signed into law. The DMCA addressed issues well beyond sound recording copyrights. For example, it provided harmonization with two international copyright treaties that had recently been adopted by the World Intellectual Property Organization[28] and also addressed limitations on copyright infringement liability for online content.

With respect to digital music royalties, the DMCA's impact has been profound. The DMCA modified copyright law to partition non-interactive digital audio services into two categories, each with its own standard for statutory royalty rate determinations. For companies such as Sirius XM providing a "preexisting satellite digital audio radio service"[29] or companies such as Music Choice and Muzak providing a "preexisting subscription service,"[30] statutory sound recording copyright royalties are calculated under the "801(b)"[31] standard.[32] By contrast, for "new subscription services"[33] and "eligible non-subscription transmissions"[34] such as Internet radio, the "willing buyer/willing seller" standard is used.[35]

The 801(b) and willing buyer/willing seller standards have very different policy objectives, and, unsurprisingly, lead to very different royalty rates. This partition, which limits access to the more favorable 801(b) standard to certain digital broadcasters that were "preexisting" on July 31, 1998, is the single biggest factor in explaining the wide variations in rates paid today.

"Statutory" Royalty Rates

Both the 801(b) and willing buyer/willing seller standards pertain to the setting of royalty rates for "statutory" (also known as "compulsory") licenses by the Copyright Royalty Board (CRB),[36] which is a panel of three Copyright Royalty Judges appointed by the Librarian of Congress.[37] In the absence of an agreement negotiated directly with a copyright user, a copyright holder must abide by the statutory rates, which are thus "compulsory."

From 1909 to 1976 there was only one statutory license under U.S. copyright law, which applied to the making and distribution of vinyl records, cassette tapes, and other "phonorecords."[38] The Copyright Act of 1976 added three new statutory licenses for "cable, jukebox, and noncommercial broadcasting."[39] The DPRA and DMCA amended the Copyright Act to add statutory sound recording performance licenses for almost[40] all forms of non-interactive digital audio broadcasting. By contrast, companies that provide interactive[41] digital music services do not have access to statutory rates and must obtain licenses from sound recording copyright owners.

The CRB sets statutory rates through rate determination proceedings[42] that typically include participation from copyright users, copyright holders, and trade or other groups representing their respective interests. The proceedings include an initial three-month period during which the parties are asked to engage in voluntary negotiations. In the absence of a settlement, participants then submit written statements, conduct discovery, and then again attempt to arrive at a negotiated settlement.

At any time during the proceeding, some or all of the participants are free to reach an agreement regarding what they believe to be the appropriate statutory rates. The proposed rates are then submitted to the CRB and published to allow potentially impacted parties to comment. The CRB can adopt the proposed rates but also has the option to "decline to adopt the agreement as a basis for statutory terms and rates for participants that are not parties to the agreement."[43]

If, on the other hand, there is no agreement reached among the parties, the CRB generally hears live testimony at an evidentiary hearing, and then issues a determination that is published in the Federal Register.[44] Participants unsatisfied with the outcome can request a rehearing, which the CRB can choose to grant or deny. CRB determinations can also be challenged through an appeal filed with the United States Court of Appeals for the District of Columbia Circuit.

Statutory sound recording performance royalties are paid to and distributed by SoundExchange, a non-profit performance rights organization created as a division of the Recording Industry Association of America in 2000 and spun off in 2003.[45] The royalty amounts distributed by SoundExchange have become quite large, exceeding $100 million per quarter this year.[46] In June 2012, SoundExchange announced that it "reached a major milestone of $1 billion in digital royalty payments to recording artists and record labels since its inception."[47]

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As an alternative to paying the CRB rates under statutory licenses created by Congress, digital music service providers can, in theory, negotiate rates directly with record companies and pay the royalties directly to the record companies, bypassing SoundExchange. Whether they can do so in practice is the subject of a March 2012 federal antitrust complaint[48] filed by Sirius XM against SoundExchange and A2IM, a record industry trade association for independent record labels.

Sound recording performance royalties, either when set by the CRB or through separate agreements, typically require payments based on one or more of the following:

- A flat annual rate. This is most commonly used for smaller broadcasters.
- A rate based on the number of "aggregate tuning hours" (ATH). "ATH refers to the total hours of programming transmitted to all listeners during the relevant time period. Thus, one hour of programming transmitted to 20 simultaneous listeners would produce 20 aggregate tuning hours or 20 ATH."[49]
- A "per play" rate. This is an amount paid each time a song is broadcast to one listener. For example, if the per play rate is $.0008, and a webcaster broadcasts a song to one million people, the corresponding royalty would be 800 dollars.
- A percentage of revenues.

The 801(b) Standard

As noted above, the 801(b) standard is used for determining statutory sound recording copyright royalty rates for digital audio broadcasts by "preexisting satellite digital audio radio services" and "preexisting subscription services."[50] Today, only a very small number of digital music broadcasting companies qualify under these designations (e.g., Sirius XM, Music Choice, and Muzak).

The standard has its origins in the Copyright Act of 1976, and the belief expressed by the Register of Copyrights in a 1975 report that it would be "wise to establish, in the statute, certain criteria beyond 'reasonableness' " to apply when determining royalty rates.[51] This led to language in the newly created section 801(b)(1) identifying the following four policy 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.[52]

The first two objectives are direct reflections of the goals of the copyright system, which aims to provide an incentive for the production of creative works. This is recognized in Article I of the Constitution, which gives Congress the power to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[53] In 1975, the Supreme Court articulated this concept in somewhat more modern language, explaining with respect to copyright that

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 artistic creativity for the general public good.[54]

The third objective is more nuanced, as it requires consideration of "the relative roles of the copyright owner and the copyright user" with respect to factors including "capital investment, cost, risk, and contribution to the opening of new markets." In the context of digital music broadcasting, this can exert downward pressure on rates, as it is the copyright users (i.e. the digital broadcasters) that will generally be making the larger investments. The fourth policy objective aims to minimize disruption and, as a result, has the most potential to move rates

An important and illustrative example of the respective roles of the four 801(b) policy objectives was furnished by the CRB proceeding during 2006 and 2007 that set the royalty rates for XM and Sirius satellite radio (the merger between the two companies was not completed until July 2008)[55] through 2012. In 2007, XM and Sirius were classified as "preexisting" satellite digital audio radio services (SDARS), thus giving them access to the 801(b) standard. The post-merger company, Sirius XM, retains that classification.

The CRB began by first identifying benchmark "marketplace" royalty rates. The CRB determined 13% of subscriber revenues to be "a reasonable estimate of a marketplace derived benchmark."[56] The CRB then declared the 13% estimate to be "the upper boundary for a zone of reasonableness,"[57] and proceeded to consider what influence, if any, each of the four 801(b) policy objectives should have on altering that percentage.

For the first two objectives, the CRB concluded that no adjustment of the benchmark was necessary. The CRB concluded that the third objective "may weigh in favor of a discount from the market rate"[58] due to the cost of continuing satellite technology objectives, but also found that this issue was "intimately intertwined"[59] with the fourth objective.

The CRB determined 13% of subscriber revenues to be "a reasonable estimate of a marketplace derived benchmark."

With respect to the fourth objective, the CRB made several key statements:

First, given that the current rates paid by the SDARS for these inputs are in the range of 2.0% to 2.5% of revenues, an immediate increase to the upper boundary of the zone of reasonableness (i.e., 13%) would be disruptive.[60]

In order not to significantly delay the attainment and amounts of EBITDA profitability and positive free cash flow, some rate within the zone of reasonableness that is less than 13% is warranted.[61]

[A]nother factor that requires attention is any undue constraint on the SDARS' ability to successfully undertake satellite investments planned for the license period. A failure to complete these investments as scheduled clearly raises the potential for disruption of the current consumer service.[62]

Based in large part on these considerations, the CRB concluded in a December 2007 ruling[63] that the satellite radio royalty rates should start at 6% of gross revenue for 2006, rising gradually to 8% in 2012.[64] In this case the fourth 801(b) objective played a key role in leading to lower rates.

Under different circumstances, however, the impact of the 801(b) objectives could be different. For example, in a 2009 ruling related to statutory royalty rates for ringtones, CDs, and permanent downloads, the CRB concluded that none of the 801(b) objectives justified any adjustment to rates.[65] And, a 2010 Government Accountability Office (GAO) communication noted that while "the section 801(b)(1) standards may have contributed to a lower royalty rate in proceedings to date, the Chief [Copyright Royalty] Judge said that application of standards could act to lower or raise the rate."[66]

The fourth 801(b) objective, in particular, was the subject of discussion in 2010 in connection with the proposed Performance Rights Act,[67] which passed both the House and Senate Judiciary Committees in 2009 but never received a vote by either the full House or Senate. Under the Performance Rights Act, webcasters and terrestrial AM/FM stations would have been subject to a modified form of 801(b) in which the fourth factor was removed. As the GAO observed in August 2010, it "is unclear how the proposed removal of the fourth standard from the section 801(b)(1) standards would impact future rate-setting proceedings."[68]

The "Willing Buyer/Willing Seller" Standard

The willing buyer/willing seller standard is used by the CRB to set statutory rates for "new subscription services"[69] and "eligible non-subscription transmissions."[70] Notably, this includes Internet radio.

The willing buyer/willing seller standard applied by the CRB is as follows:

In determining such rates and terms, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms 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 its decision on economic, competitive and programming information presented by the parties, including –

> *(i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and*
>
> *(ii) the relative roles of the copyright owner and the transmitting entity 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.*[71]

This is a starkly different standard than 801(b). As discussed above, in applying the 801(b) standard during the satellite radio rate determination proceeding in 2006-7, the CRB first identified a "marketplace" rate and then proceeded to adjust that rate downwards after considering the four 801(b) policy objectives. By contrast, the two factors in the willing buyer/willing seller standard are explicitly not to be used as a basis for adjusting rates. This was clarified in a 2002 report from the Copyright Arbitration Royalty Panel, which was the predecessor to the CRB:

Accordingly, the willing buyer/willing seller standard is the only standard to be applied. The two factors enumerated in the statute do not constitute additional standards or policy considerations. Nor are these factors to be used after determining the willing buyer/willing seller rate as bases to adjust that determination upward or downward. The statutory factors are merely factors to be considered, along with any other relevant factors, in determining rates under the willing buyer/willing seller standard.[72]

The 2002 report went on to state that the appropriate rates under the willing buyer/willing seller standard are simply "the rates to which, absent special circumstances, most willing buyers and willing sellers would agree."[73]

... [A] fundamental flaw in this approach is that it assumes the presence of a competitive market for sound recording performance royalties that simply does not exist today, and has never existed in the past.

On its face, the term "willing buyer/willing seller" might appear to be an eminently reasonable, free-market approach. What could be wrong with setting "marketplace" rates that would be acceptable to both buyers and sellers? However, a fundamental flaw in this approach is that it assumes the presence of a competitive market for sound recording performance royalties that simply does not exist today, and has never existed in the past. As the Digital Media Association (DiMA) wrote in a statement filed for a July 2008 Senate Judiciary Committee hearing, "[t]he 'market' itself is a fiction, and its characteristics display none of the competitive factors that one would expect in a 'fair' market."[74] The DiMA statement also observed:

The fundamental flaw with the fair market value standard is that the "market" the standard seeks to measure does not exist. First, there is no market for licensing these rights other than under the statutory license itself. The sound recording performance right came into existence at the same time as the statutory license. Today, the statutory license is essentially the sole means for licensing non-interactive services. The only "market" for these rights is the compulsory license market.

Second, there is no history of "fair market" licensing for the rights. To the contrary, all licensing negotiations are conducted under an antitrust exemption, by a single seller (SoundExchange), and are carefully calculated by the seller to set precedent for future arbitration, rather than to reflect a fair market price.[75]

The lack of a genuine market to provide legitimate benchmarks when applying the willing buyer/willing seller standard has been highly problematic. Most notably, in a proceeding known in the industry as "Webcaster II," in March 2007 the CRB issued a ruling[76] based on the willing buyer/willing seller standard providing statutory sound recording royalty rates for commercial webcasters for the period 2006 to 2010. The CRB rates started at $.0008 per play in 2006[77] and rose to $.0019 for 2010. The rates were quickly denounced as punitive, as they had the potential to exceed a webcaster's total revenue.

Congress Steps In: The Webcaster Settlement Acts of 2008 and 2009

Faced with the prospect of webcasters closing their doors, in fall 2008 Congress passed the Webcaster Settlement Act of 2008[78] giving webcasters until February 15, 2009 to negotiate[79] directly with SoundExchange for lower alternatives to the CRB rates.

The National Association of Broadcasters,[80] the Corporation for Public Broadcasting,[81] and a group[82] of small webcasters[83] reached agreements with SoundExchange before the deadline, but other groups, including the larger pureplay (broadcasting exclusively over the Internet) commercial webcasters did not. Congress then enacted the Webcaster Settlement Act of 2009 giving the parties until July 30, 2009 to reach an agreement.[84]

In early July, an agreement[85] was announced calling for pureplay webcasters with annual revenues of $1.25 million or more to pay SoundExchange the greater of 25% of revenue or a per play rate starting at $.0008 per play in 2006 and rising to $.0015 per play in 2015 for nonsubscription services.

Even the "lower" rates in the pureplay webcaster/SoundExchange agreement have resulted in extremely high royalty burdens. For example, for the first fiscal quarter of 2013, which ended April 30, 2012, Internet radio company Pandora reported[86] revenues of $80.78 million and total content acquisition costs of $55.8 million, corresponding to 69% of revenue. Sound recording performance royalty payments to SoundExchange were by far the largest component of those costs.[87]

What would Pandora have paid under the statutory rates calculated in accordance with the willing buyer/willing seller standard as opposed to those established in the 2009 SoundExchange agreement? An indication can be found in the rates set by the CRB for the period 2011 to 2015 for commercial webcasters that (unlike Pandora) are not participants (through the timely filing of initial and subsequent annual election notices) in the 2009 agreement. Those rates, which reflect application of the willing buyer/willing seller standard, start at $.0019 per play in 2011 and increase to $.0023 in 2015.[88] For 2012, the rate is $.0021. By contrast, the nonsubscription 2012 rate for large pureplay commercial webcasters under the Webcaster Settlement Act of 2009 is $.0011.

If Pandora had been paying a nonsubscription per play rate of $.0021 instead of $.0011 during the fiscal quarter ending April 30, 2012, its payments to SoundExchange for sound recording performance licenses would likely have increased by tens of millions of dollars. This would have caused Pandora's total content acquisition costs for that quarter to approach or exceed its revenue of $80.1 million. Clearly, in a free market transaction, that is not an arrangement Pandora would have been "willing" to accept.[89]

Subscription Services: A Comparison

Another measure of the difference between the 801(b) and willing buyer/willing seller standard can be found in the statutory royalty rates for subscription services. For "preexisting" services the relevant rate standard is 801(b). For "new" subscription services, the relevant standard is willing buyer/willing seller.

In 2005[90] and 2006,[91] the CRB began two separate proceedings to determine the respective statutory royalty rates for preexisting and new subscription services. In both cases, the parties reached agreements with SoundExchange during the proceedings, and the terms were proposed to and then adopted by the CRB. A comparison between the corresponding settlements is instructive, as they were motivated by the parties' expectations regarding the potential outcome of a CRB evidentiary hearing and associated rate decision.

> ... [N]early 15 years after the enactment of the DMCA, it is increasingly difficult to justify using a 1998 snapshot of the digital music broadcasting industry as a basis for deciding which companies get access to the more reasonable 801(b) standard.

In the settlement between Music Choice and SoundExchange announced in late 2007, the royalty rate was 7.25% of gross revenues for 2008-2011, and 7.5% for 2012.[92] By contrast, the settlement between MTV, Sirius, XM,[93] and SoundExchange announced at almost exactly the same time called for paying the greater of 15% of revenue and a per subscriber fee.[94]

Commenting on these settlements on Broadcast Law Blog in November 2007, David Oxenford discussed some of the concerns arising from the use of two different rate standards:

The fact that two settlements, one providing rates that are double the amount of the other when the only effective difference between the services was whether they were in existence at the time the governing statute was written fuels complaints about the arbitrary nature of the Copyright Royalty process . . . And, to the extent that all services are deemed to be part of a single broad market for audio services, as some have argued, is there really justification for different treatment between subscription, non-subscription, Internet and non-Internet based services?[95]

Moving Forward: A Legislative Solution

The current system is problematic in multiple ways. First, the use of two different standards for setting statutory royalty rates for non-interactive digital music services is unfair. Second, nearly 15 years after the enactment of the DMCA, it is increasingly difficult to justify using a 1998 snapshot of the digital music broadcasting industry as a basis for deciding which companies get access to the more reasonable 801(b) standard. Third, most broadcasters, including all new companies that might contemplate offering these services, can only obtain statutory rates under the willing buyer/willing seller standard. The prospect of punitive rates provides a strong disincentive for investment and innovation.

Congress should enact legislation providing for the use of the 801(b) standard in statutory royalty rate determinations for essentially[96] *all* non-interactive digital audio broadcasting, not just the subset of "preexisting" services that were protected under the DMCA. The willing buyer/willing seller standard should no longer be used for CRB proceedings, as it has proven to lead to onerous rates that, absent congressional intervention, have risked driving innovative companies out of business.

The proposal to move to a broadly applicable 801(b) standard is not new. It has been repeatedly articulated, including in law review articles by Andrew Stockment[97] and Cassondra Anderson,[98] in testimony[99] and statements[100] at congressional hearings, and other venues. More generally, the inequities among royalty rates among different digital broadcasters are widely recognized, and are often cited in congressional testimony, articles in the popular press, statements from companies and industry trade groups, and academic papers.

In contrast with the Performance Rights Act proposed in 2009, any new legislation should not include a provision to end the AM and FM over-the-air "terrestrial" broadcasters' longstanding sound recording performance royalty exemption. While this exemption has become increasingly unfair in light of recent technology advances, every one of the dozens of legislative attempts to end it since 1926[101] has run up against extremely strong opposition from terrestrial broadcasters and has failed. New legislation including a provision ending the terrestrial broadcasters' exemption would be likely to fail as well.

By contrast, legislation that leaves the exemption in place while leveling the playing field for digital royalties may even garner the support of the National Association of Broadcasters (NAB). Terrestrial radio stations are seeing small but increasing numbers of their listeners migrate to their online streams. The current NAB agreement with SoundExchange under the Webcaster Settlement Act of 2008 expires at the end of 2015,[102] meaning that terrestrial broadcasters, like pureplay webcasters, would benefit from a more reasonable digital broadcast statutory royalty framework.

As this paper is going to press, there are reports[103] that Rep. Jason Chaffetz (R-Utah) plans to introduce a bill later in 2012 called the Internet Radio Fairness Act of 2012. The new legislation would reportedly replace the willing buyer/willing seller standard with 801(b) for Internet radio. As the full text of the bill has not yet been made public, the precise manner in which it might alter the CRB rate determination framework (other than the move to 801(b)) is not clear.

The Impact of a Broadly Applicable 801(b) Rate Standard

One obvious consequence of broadly applying 801(b) would be lower royalty rates for webcasters. Given all the moving parts, the precise impact on other players in the ecosystem is less clear. Currently, revenues from Pandora and Sirius XM constitute a large fraction of SoundExchange's total revenue. (The exact proportion is a matter of some dispute. According to an analysis by Live365 attorney Angus MacDonald, Pandora and Sirius XM accounted for about 90% of SoundExchange's 2011 revenue.[104] SoundExchange however, called that figure incorrect and stated that "the real number is substantially below that."[105]) Regardless of the exact figures, payments from Pandora and Sirius XM are certainly the two biggest levers driving SoundExchange's revenue, and thus its distributions to artists and record labels.

Under 801(b), webcasters would pay lower rates and SoundExchange's revenue from Pandora would drop correspondingly. However, regardless of whether copyright law is changed, SoundExchange's revenue from Sirius XM is very likely to increase. As discussed above, in the 2007 ruling that set the statutory satellite radio rates for 2006-2012, the CRB explicitly noted that (pre-merger) Sirius and XM had previously been paying rates of 2 to 2.5% of revenue, and that "an immediate increase" to 13% "would be disruptive."[106] The resulting rates, which started at 6% of revenue in 2006 and have now risen to 8% in 2012, reflected the CRB's view on how to implement a rate increase in a manner that would minimize disruption while also achieving the other 801(b) objectives.

This suggests that the currently ongoing CRB proceeding[107] to set satellite radio royalty rates for 2013 to 2017 may result in a continued upward rate trajectory. The record labels and SoundExchange know this, and have little incentive to agree to settlements enabling Sirius XM to continue paying its current 8% rate. Thus, the negative revenue impact to SoundExchange of computing webcasting rates under 801(b) would likely be mitigated, perhaps completely, by the coincidental and unrelated increase in payments from Sirius XM.

It is also important to recognize that while 801(b) has proven far better than willing buyer/willing seller in CRB rate proceedings, it is not without concerns. As an initial matter, any attempts to judge its efficacy run up against the small sample size problem. Prior to proceeding initiated in 2006 for preexisting satellite radio services and preexisting subscription services, there had only been three prior statutory license proceedings involving 801(b): the first involving jukeboxes in 1980,[108] the second in 1981 relating to sales of phonorecords,[109] and the third in 1997 involving subscription-based digital music delivery.[110] Only the last of these involved digital broadcasting performance rights. Thus, the record with respect to 801(b) is very limited, in particular in the context of digital broadcasting.

Additionally, when applying the fourth 801(b) policy objective to "minimize any disruptive impact on the structure of the industries involved" in the 2006-2007 satellite radio rate proceeding, the CRB did not face the challenge of distinguishing between an industry generally, and the different companies within it. Sirius and XM, which had announced their intent to merge during the CRB proceeding, essentially defined the satellite radio industry.

If, for example, smaller, newer, unprofitable companies were competing against more established, highly profitable companies, would rates that could be borne by the established companies but not the newcomers be deemed disruptive?

In a diverse industry with more market participants, considering factors such as EBITDA profitability and future investment commitments, as the CRB did in that proceeding, would raise the obvious question: whose profitability and whose investment commitments should have the most influence on rates? If, for example, smaller, newer, unprofitable companies were competing against more established, highly profitable companies, would rates that could be borne by the established companies but not the newcomers be deemed disruptive? Or, if due to technological obsolescence, poor management, or other factors, a legacy company had poorer EBITDA prospects than a new market entrant, would the fourth 801(b) factor be employed as a protectionist measure to prop up the legacy company, to the detriment of artists and record labels who would see reduced performance revenues as a result? After all, while rates that are too high can be punitive, so can rates that are too low, as they shortchange the content creators on which the entire music broadcasting industry depends.

Under current copyright law, the questions related to applying 801(b) in a diverse digital broadcasting industry are largely moot. The number of broadcasters eligible for rate determinations under the 801(b) standard is extremely small, and the "preexisting" clause in current copyright law prevents new entrants into this category. However, if copyright law is modified so that the 801(b) standard is used for all statutory sound recording performance royalty rates, these issues will become important.

Another potential concern is that the CRB's application of 801(b) can run up against the same lack of a real market that has plagued willing buyer/willing seller. As described above, in the 2006-7 satellite radio rate proceeding, the CRB first identified a "marketplace" benchmark and then adjusted the rate downward after considering the four 801(b) policy objectives. Thus, as implemented by the CRB, both 801(b) and willing buyer/willing seller involve the challenge of identifying market rates. Given the existence of statutory licenses, determination of those rates is an inherently problematic exercise.

In practice, a difference – and perhaps the key difference – is that 801(b) has a safety valve in the form of the four policy objectives, and willing buyer/willing seller does not. Since "market" analysis performed in the absence of a real market often produces unreasonable rates, those rates will tend to be disruptive, and the CRB can then invoke the fourth policy objective to adjust the rates to more balanced levels. In 2007, that adjustment was downward, though in future proceedings it might be upward. Willing buyer/willing seller does not provide that flexibility to the CRB.

It is also important to address a potential defense of willing buyer/willing seller that might be offered. Outside the context of the CRB, efforts to set performance royalty rates for musical compositions (as opposed to sound recordings) based on a framework that resembles the CRB's willing buyer/willing seller standard have been more successful.

Digital music is not a zero sum game, and leveling the playing field with respect to statutory royalties can play an important role in increasing the size of the overall pie.

Under separate consent decrees related to antitrust issues, both ASCAP and BMI are subject to the jurisdiction of a "rate court" (the United States District Court for the Southern District of New York).[111] A party seeking a license from ASCAP or BMI can, if direct negotiations fail to produce an agreement, ask the rate court to determine reasonable fees. As the rate court explained in a 2008 ruling involving ASCAP fees, this task "necessitates an appraisal of 'fair market value' – an appraisal based essentially on an estimation of the 'price that a willing buyer and a willing seller would agree to in an arms-length transaction.'"[112] The court also recognized that in a market lacking "broad-based competition," "there exists minimal evidence as to what that market would look like, much less the prices it would yield."[113]

The 2008 rate court ruling followed a hearing to determine rates for blanket licenses sought by AOL, Real Networks, and Yahoo! for the use of the music in ASCAP's catalog. The court noted that ASCAP requested a rate of 3% of revenue.[114] AOL, Real Networks, and Yahoo! of course sought lower rates, and in the ruling the court set the rate at 2.5% of revenue.[115]

This is a reasonable result. However, the possible outcomes in the ASCAP case were bounded in a range that, at least when compared with what is encountered in CRB rate proceedings, was very narrow. Almost any standard aiming to balance the interests of copyright holders and users would have produced a reasonable result.

The real test of a rate standard occurs when there are highly divergent views among the parties regarding the appropriate rates, just as occurs in CRB proceedings regarding statutory sound recording performance royalty rates. And, as the 14-year experiment launched with the enactment of the DMCA has shown, while 801(b) is far from perfect, it provides a much better rate determination framework than willing buyer/willing seller.

Conclusion

The future of music distribution is clearly digital. As Arbitron and Edison Research reported[116] in a study released in early 2012, an estimated 39% of Americans had listened to Internet radio in the month preceding the study, up from 20% in 2007. Sirius XM has over 22 million subscribers.[117] Traditional AM and FM stations are extending their reach by streaming content online. And interactive music services, while not subject to the statutory licenses discussed in this paper, are also an important and quickly growing part of the ecosystem.

Like any industry, digital music will be more likely to thrive if it is governed by fair rules. Digital music is not a zero sum game, and leveling the playing field with respect to statutory royalties can play an important role in increasing the size of the overall pie. If digital audio broadcasters can afford to make more investments to improve and broaden their offerings, and if new companies can enter the market without fear of encountering punitive royalty rates, more customers will choose listen to digital music broadcasts. This would lead to more revenue for broadcasters, songwriters, recording artists, and record labels.

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Endnotes

[1] For the first fiscal quarter of 2013, which ended April 30, 2012, Internet radio company Pandora reported total revenues of $80.78 million and content acquisition costs of $55.8 million, corresponding to 69% of revenue. See Pandora Media, Inc., Quarterly Report (Form 10-Q), at 4 (June 4, 2012), *available at* http://investor.pandora.com/phoenix.zhtml?c=227956&p=irol-sec. The report does not specify what subset of that amount was paid to SoundExchange to license sound recording copyrights. However, Pandora's annual 10-K annual report filed with the SEC for the fiscal year ending January 31, 2012 states "For our fiscal year ended January 31, 2012 we incurred SoundExchange related content acquisition costs representing 49.7% of our total revenue for that period." See Pandora Media, Inc., Annual Report (Form 10-K), at 20 (Mar. 19, 2012), *available at* http://investor.pandora.com/phoenix.zhtml?c=227956&p=irol-sec. When combined with Pandora's reported FY2012 annual revenue and content acquisition costs, that implies that applies that other (non-SoundExchange) content acquisition costs amounted to 4.5% of revenues. Most of this 4.5% was paid to the three Performing Rights Organizations (PROs) for the performance rights to broadcast musical compositions. (The Annual Report at page 21 states that "For our fiscal year ended January 31, 2012, we incurred BMI, SESAC and ASCAP related content acquisition costs representing 4.1% of our total revenue for that period."). It seems reasonable to assume that the non-SoundExchange component of Pandora's content acquisition costs remained at approximately 4.5% of revenue during the first fiscal quarter of 2013. This in turn implies that of the $55.8 million in total content acquisition costs paid during the quarter, approximately $52.2 million was paid to SoundExchange. $52.2 million corresponds to over 64% of the $80.8 million revenue reported for the same period.

[2] The 8% rate for Sirius XM is applicable for 2012. See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4083 (Jan. 24, 2008) (to be codified at 37 C.F.R. pt. 382), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf.

[3] Copyright law is contained in Title 17 of the United States Code (U.S.C.). Chapter 8 of 17 USC is titled "Proceedings by Copyright Royalty Judges," and contains a total of five sections, denoted § 801 through § 805. See 17 U.S.C. § 801 through § 805, *available at* http://www.copyright.gov/title17/92chap8.html (last visited July 22, 2012). "801(b)" refers to the four policy objectives identified in 17 U.S.C. § 801(b)(1).

[4] U.S. copyright law identifies eight categories of "works of authorship", including "musical works, including any accompanying words" and "sound recordings." 17 U.S.C. § 102(a)(2) & (7), Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/102 (last visited July 22, 2012).

[5] 17 U.S.C. § 101 states: "
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) to transmit or otherwise communicate a performance 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. See 17 U.S.C. § 101, Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/101 (last visited July 22, 2012).

[6] Recently, it has become feasible for record labels and publishers to track public performances on their own, without relying on the infrastructure of a PRO. This ability was undoubtedly a key factor in record

label and music publisher EMI's 2011 decision to withdraw from ASCAP for "new media" licensing. See David Oxenford, *Another Royalty Payment for Webcasters? EMI Withdraws From ASCAP For New Media Licensing*, BROADCAST LAW BLOG, May 8, 2011, http://www.broadcastlawblog.com/2011/05/articles/internet-radio/another-royalty-payment-for-webcasters-emi-withdraws-from-ascap-for-new-media-licensing/. For the moment, at least, EMI remains an exception, and the combined catalogs of the three PROs still contain the vast majority of the non-public-domain compositions of interest to digital broadcasters.

[7] American Society of Composers, Authors, and Publishers. See About ASCAP, http://www.ascap.com/about/ (last visited July 22, 2012).

[8] Broadcast Music, Incorporated . See About BMI, http://www.bmi.com/about/ (last visited July 22, 2012).

[9] Society of European Stage Authors and Composers. See About SESAC, http://www.sesac.com/About/About.aspx (last visited July 22, 2012).

[10] Adam Deutsch, *A Historical Perspective of Music Distribution and Copyright Law: How Internet Radio is the Next Frontier*, SCRIBD, June 14, 2010, http://www.scribd.com/doc/37780490/A-Historical-Perspective-of-Music-Distribution-and-Copyright-Law-How-Internet-Radio-is-the-Next-Frontier.

[11] David D. Oxenford & Robert J. Driscoll, *The Basics of Music Licensing in Digital Media: 2011 Update*, DAVIS WRIGHT TREMAINE LLP, Feb. 22, 2011, http://www.dwt.com/advisories/The_Basics_of_Music_Licensing_in_Digital_Media_2011_Update_02_22_2011/.

[12] News and talk radio stations, and other broadcasters with programming that is not predominantly music, would pay less.

[13] See Jonathan Cardi, *Über-Middleman: Reshaping the Broken Landscape of Music Copyright*, 92 IOWA L. REV., 835, 845-6 (2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=991553. See also Cassondra Anderson, *We Can Work It Out: A Chance to Level the Playing Field for Radio Broadcasters*, 11 N.C. J.L. & TECH. 72, 93 (2009), http://www.ncjolt.org/system/files/Anderson.pdf. Cardi cites a figure of "approximately two percent of a station's adjusted gross receipts" for ASCAP and BMI for radio and television. Anderson notes "the rate of 3% to 5% of revenue that all radio broadcasters pay to music publishers and songwriters through their licenses with ASCAP, BMI, and SESAC."

[14] Source: ASCAP. "Of the $5-billion generated worldwide each year, the three U.S. organizations account for close to $2 billion in collections." ASCAP, http://www.ascap.com/music-career/articles-advice/music-money/money-payments.aspx (last visted July 22, 2012).

[15] Copyright Act of 1790, 1 Stat. 124 (1790), *available at* http://www.copyright.gov/history/1790act.pdf

[16] Sound Recording Act of 1971, Pub. L. 92-140, 85 Stat. 391 (1971)

[17] Mathew S. DelNero, *Music: Long Overdue?: An Exploration of the Status and Merit of a General Public Performance Right in Sound Recordings*, 6 VAND. J. ENTM'T & TECH. LAW, , 181, 185-186 (2004), http://www.jetlaw.org/wp-content/journal-pdfs/MatthewDelNero-LongOverdue.pdf.

[18] Copyright Act of 1976, Pub. L. 94-553, 90 Stat. 2541 (1976)

[19] Copyright Act of 1909, Pub. L. 60-349, 35 Stat. 1075 (1909)

[20] The Copyright Act of 1976 enumerated, in § 106, a bundle of five "exclusive rights in copyrighted works" held by a copyright owner, including, in § 106(4), a right of public performance. However, § 114(a) then carved out a critical exception, providing that "[t]he exclusive rights of the owner of copyright in a sound recording" "do not include any right of performance under section 106(4)."

[21] The Digital Performance Right in Sound Recordings Act of 1995 (DPRA), Pub. L. No. 104-39, 109 Stat. 336 (1995), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-104publ39/pdf/PLAW-104publ39.pdf. 17 U.S.C. § 106 pertains to "Exclusive rights in copyrighted works." The DPRA amended § 106, providing "the owner of copyright under this title" with "the exclusive rights to do and to authorize" . . . ""in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission." See 17 U.S.C. § 106, *available at* http://www.copyright.gov/title17/92chap1.html#106 (last visited July 22, 2012).

[22] Brian Day, *The Super Brawl: The History and Future of the Sound Recording Performance Right*, 16 MICH. TELECOMM. & TECH. L. REV. 179 (2009), http://www.mttlr.org/volsixteen/day.pdf .

[23] Kimberly L. Craft, *The Webcasting Music Revolution is Ready to Begin, as Soon as We Figure Out the Copyright Law: The Story of the Music Industry at War With Itself*, 24 HASTINGS COMM. & ENT. L.J. 1, 10–13 (2001), http://socrates.berkeley.edu/~scotch/innovation/Craft.htm.

[24] *Id.*

[25] *Id*.

[26] Al Kohn & Bob Kohn, Kohn On Music Licensing, pg. 1471 (4th ed., Aspen Law & Business 2009).

[27] The Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860, 2896, *available at* http://www.gpo.gov/fdsys/pkg/PLAW-105publ304/pdf/PLAW-105publ304.pdf.

[28] The WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty had both been concluded in Switzerland in December 1996, just under two years prior to the enactment of the DMCA. WIPO (the World Intellectual Property Organization) is an agency of the United Nations. See Frequently Asked Questions about WIPO, http://www.wipo.int/about-wipo/en/faq.html (last visited on July 22, 2012).

[29] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(10)) a "preexisting satellite digital audio radio service" as follows: "a subscription satellite digital audio radio service provided pursuant to a satellite digital audio radio service license issued by the Federal Communications Commission on or before July 31, 1998, and any renewal of such license to the extent of the scope of the original license, and may include a limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service." 17 U.S.C. § 114(j)(10), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[30] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(11)) a "preexisting subscription service" as follows: "a service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998, and may include a limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service. See 17 U.S.C. § 114(j)(10), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[31] While the standard is often referred to as "801(b)," strictly speaking, 17 U.S.C. § 801(b) is a relatively lengthy section of copyright law that lays out the functions of the Copyright Royalty Judges. Within that section is a subsection, 801(b)(1), that identifies the four policy objectives to be used when calculating statutory sound recording copyright royalties for "preexisting" digital audio services under section 114(f)(1)(B). Those policy objectives are also used for calculating statutory royalty rates for §§ 115 and 116. See 17 U.S.C. § 801, Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/801 (last visited July 22, 2012).

[32] Andrew Stockment, *Internet Radio: The Case for a Technology Neutral Royalty Standard*, 95 VA. L. REV. 2129, 2163 (2009), http://virginialawreview.org/content/pdfs/95/2129.pdf.

[33] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(8)) a "new subscription service" as follows: "a service that performs sound recordings by means of noninteractive subscription digital audio transmissions and that is not a preexisting subscription service or a preexisting satellite digital audio radio service." See 17 U.S.C. § 114(j)(8), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[34] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(6)) an "eligible nonsubscription transmission" as follows: "a noninteractive nonsubscription digital audio transmission not exempt under subsection (d)(1) that is made as part of a service that provides audio programming consisting, in whole or in part, of performances of sound recordings, including retransmissions of broadcast transmissions, if the primary purpose of the service is to provide to the public such audio or other entertainment programming, and the primary purpose of the service is not to sell, advertise, or promote particular products or services other than sound recordings, live concerts, or other music-related events." See 17 U.S.C. § 114(j)(6), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[35] Stockment, *supra* note 32, at 2163.

[36] United States Copyright Royalty Board, http://www.loc.gov/crb/background/ (last visited July 22, 2012).

[37] Statutory rate determinations have been performed by the CRB since its creation in the mid-2000s; prior to that they were the responsibility of the Copyright Arbitration Royalty Panel. The Copyright Royalty and Distribution Reform Act of 2004 (Pub. L. No. 108-419, 118 Stat. 2341) replaced the Copyright Arbitration Royalty Panel with the Copyright Royalty Board. See Copyright Act of 2004, Pub. L. 108-419, 118 Stat. 2341 (2004), *available at* http://www.loc.gov/crb/laws/pl108-419.pdf. The constitutionality of the CRB has been repeatedly challenged in recent years, and was argued before the U.S. Court of Appeals in the District of Columbia in February 2012. In June 2012, the Court issued a ruling stating that the appointment of the Copyright Royalty Judges did indeed violate the Appointments Clause of the Constitution. The Court then resolved the issue by granting the Librarian of Congress the power to remove CRB judges.

[38] 73 Fed. Reg. 16, 4080, 4082 n.12 (Jan. 28, 2008), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf. "Phonorecords" are defined in 17 U.S.C § 101 as "material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device." Vinyl records, cassette tapes, and CDs containing music are examples of phonorecords.

[39] *Id*. at 4082.

[40] An exception is hybrid digital (HD) radio. 17 U.S.C. § 114(j)(3) defines a "broadcast" transmission as "a transmission made by a terrestrial broadcast station licensed as such by the Federal Communications Commission." All nonsubscription broadcasts from such stations, including not only AM and FM broadcasts, but also HD radio broadcasts, are exempt from the performance royalty. See Deutsch, *supra* note 10, at 26.

[41] 17 U.S.C. § 114(j)(7), Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/114 (last visited July 22, 2012), provides a definition of an "interactive service" that states, in part: "An 'interactive service' is one that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient."

[42] Proceedings of Copyright Royalty Judges, 17 U.S.C. § 803, Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/803 (last visited July 22, 2012).

[43] See 17 U.S.C. § 801(b)(7)(A), Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/801 (last visited July 22, 2012).

[44] Links to CRB notices in the Federal Register are found at http://www.loc.gov/crb/fedreg/

[45] SoundExchange General Questions, http://www.soundexchange.com/faq/ (last visited July 22, 2012).

[46] Ben Sisario, *Royalties From Digital Radio Start to Add Up*, N. Y. TIMES, June 17, 2012., http://www.nytimes.com/2012/06/18/business/media/digital-radio-royalties-start-to-add-up.html.

[47] Press Release, SoundExchange, SoundExchange Announces $1 Billion Paid to Artists and Labels, June 18, 2012, http://www.soundexchange.com/2012/06/18/soundexchange-announces-1-billion-paid-to-artists-and-labels/.

[48] *Sirius XM Radio Inc. v. SoundExchange, Inc. and Am. Ass'n. of Indep. Music*, No. 12 CV 2259 (SDNY 2012). The Plaintiff Sirius XM Radio Inc.'s Complaint is *available at* http://www.scribd.com/doc/87049319/Sirius-XM-v-SoundExchange-Antitrust-Complaint; and Defendant SoundExchange, Inc.'s Motion to Dismiss All Counts of the Complaint is *available at* http://www.scribd.com/doc/92797569/Soun-Exchange-Response.

[49] 72 Fed. Reg. 83, 24099 n.47 (May 1, 2007), *available at* http://www.loc.gov/crb/fedreg/2007/72fr24084.pdf.

[50] 17 U.S.C. § 801(b)(1), Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/801 (last visited July 22, 2012), which provides that the four policy objectives are applies when calculating "rates applicable under sections 114(f)(1)(B), 115, and 116." Section 114(f)(1)(B) identifies "preexisting subscription services and preexisting satellite digital audio radio services." Sections 115 pertains to mechanical licenses for "making and distributing phonorecords." Section 116 pertains to "licenses for public performances by means of coin-operated phonorecord players," i.e., jukeboxes.

[51] Second Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, Chapter XV, p. 31 (1975) , as cited in 73 Fed. Reg. 16, 4080, 4082 (Jan. 24, 2008), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf .

[52] 17 U.S.C. § 801(b)(1) , Cornell Legal Info. Inst., *available at* http://www.law.cornell.edu/uscode/text/17/801 (last visited July 22, 2012).

[53] U.S. CONST. art. I, § 8, *available at* http://www.archives.gov/exhibits/charters/constitution_transcript.html.

[54] *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151 (1975), a*vailable at* Justia.com, http://supreme.justia.com/cases/federal/us/422/151/case.html (last visited July 22, 2012).

[55] *Sirius completes acquisition of XM Satellite*, REUTERS, July 29, 2008, *available at* http://www.reuters.com/article/2008/07/30/industry-satellite-dc-idUSN2926292520080730.

[56] See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf. Commenting on this ruling at Broadcast Law Blog, David Oxenford wrote that the rate "would be higher - probably over 20% - if it was based on just music programming." However, "a significant part of the satellite radio programming is not music oriented . . ." See David Oxenford, *Satellite Radio Music Royalty Reconsideration Denied by Copyright Royalty Board—What a Difference a Standard Makes*, BROADCAST LAW BLOG, Jan. 12, 2008, http://www.broadcastlawblog.com/2008/01/articles/internet-radio/satellite-radio-music-royalty-reconsideration-denied-by-copyright-royalty-board-what-a-difference-a-standard-makes/.

[57] *Id.* at 4094.

[58] *Id.* at 4096

[59] *Id*.

[60] *Id.* at 4097

[61] *Id*.

[62] *Id*.

[63] *See generally* 73 Fed. Reg. 16, 4080 (Jan. 24, 2008), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf.

[64] "In short, the Judges find that the percentage of gross revenues rate applicable to each year of the license for the SDARS is as follows: 6.0% for 2007, 6.0% for 2008, 6.5% for 2009, 7.0% for 2010, 7.5% for 2011, and 8.0% for 2012. We find no basis for making further adjustments to this revenue rate to reflect inflation." *Id*. at 4098. The percentages are with respect to "monthly Gross Revenues resulting from Residential services in the United States." *Id.* at 4102. "Gross Revenues" are defined on page 4102. These § 114 rates also include within them § 112 rates. The CRB declined "to ascribe any particular percentage of the Section 114 royalty as representative of the value of the Section 112 license." *Id.* at 4098. However, that percentage is no doubt small. As the CRB noted, "Of the thousands of pages of testimony and exhibits submitted by the parties in this proceeding, virtually none of them are devoted to any discussion of the Section 112 license and ephemeral copies. It is therefore evident that the parties consider the Section 112 license to be of little value at this point in time." *Id.*

[65] Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding; Review of Copyright Royalty Judges Determination; Final Rule and Notice, 74 Fed. Reg. 15, 4510, 4523-4525 (Jan. 26, 2009) (to be codified at 37 C.F.R. pt. 385), *available at* http://www.loc.gov/crb/fedreg/2009/74fr4510.pdf.

[66] Mark L. Goldstein, U.S. Gov't Accountability Office, GAO-10-828R, *In a Previous Rate-Setting Proceeding for Some Sound Recording, the Standard Addressing the Disruptive Impact of the Industries Contributed to a Lower Copyright Royalty Rate, but the Effect of Its Proposed Removal Is Unclear*, 5 (August 4, 2010), *available at* http://www.gao.gov/new.items/d10828r.pdf.

[67] 2010 GAO report on the proposed Performance Rights Act: Letter from William T. Lake,, Chief, Media Bureau, to the Honorable John Conyers, Jr., Chairman, *et al*, re *Preliminary Observations on Potential Effects of the Proposed Performance Rights Act on the Recording and Broadcast Radio Industries*, Feb. 26, 2010, *available at* http://www.gao.gov/new.items/d10428r.pdf. See also Performance Rights Act, H.R. 848, 111th Cong. (2009), *available at* http://www.govtrack.us/congress/bills/111/hr848 for the House version of the bill and for the Senate version, Performance Rights Act, S. 379, 111th Cong. (2009), *available at* http://www.govtrack.us/congress/bills/111/s379.

[68] Goldstein, *supra* note 66.

[69] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(8)) a "new subscription service" as follows: "a service that performs sound recordings by means of noninteractive subscription digital audio transmissions and that is not a preexisting subscription service or a preexisting satellite digital audio radio service." See 17 U.S.C. § 114(j)(8), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[70] The DMCA amended 17 U.S.C. § 114(j) by defining (in the new § 114(j)(6)) an "eligible nonsubscription transmission" as follows: "a noninteractive nonsubscription digital audio transmission not exempt under subsection (d)(1) that is made as part of a service that provides audio programming consisting, in whole or in part, of performances of sound recordings, including retransmissions of broadcast transmissions, if the primary purpose of the service is to provide to the public such audio or other entertainment programming, and the primary purpose of the service is not to sell, advertise, or promote particular products or services other than sound recordings, live concerts, or other music-related events." See 17 U.S.C. § 114(j)(6), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012).

[71] From 17 U.S.C § 114(f)(2)(B), *available at* http://codes.lp.findlaw.com/uscode/17/1/114 (last visited July 22, 2012). Section 114 addresses the "scope of exclusive rights in sound recordings." The "willing buyer, willing seller" language is also contained in 17 U.S.C. § 112(e)(4), which pertains to statutory licenses for ephemeral recordings.

[72] Report of the Copyright Arbitration Royalty Panel, *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Feb. 20, 2002, at 21, *available at* http://www.copyright.gov/carp/webcasting_rates.pdf.

[73] *Id*, at 25.

[74] Supplemental Statement of the Digital Media Association Senate Judiciary Committee Hearing,*Music and Radio in the 21st Century: Assuring Fair Rates and Rules across Platforms*, July 29, 2008, at 6, *available at* http://www.digmedia.org/component/docman/doc_download/89-dima-supplemental-testimony.

[75] *Id*. at 5.

[76] Digital Performance Right in Sound Recordings and Ephemeral Recordings (Final Rule and Order*)* 72 Fed. Reg. 83, 24084, 24096 (May 1, 2007) (to be codified at 37 C.F.R. pt. 380), *available at* http://www.loc.gov/crb/fedreg/2007/72fr24084.pdf. The ruling was issued by the Copyright Royalty

Board on March 2, 2007 and published in the Federal Register on May 1. The CRB rates covered both the digital transmissions of sound recordings (17 U.S.C. § 114) as well as the associated ephemeral recordings (17 U.S.C. § 112).

[77] For 2006 and 2007, the CRB provided a transition period allowing rate calculation based on Aggregate Tuning Hours (ATH). *Id*. at 24096.

[78] Webcaster Settlement Act of 2008, H. R. 7084, 110th Cong., 2d Sess. (2008), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-110hr7084rds/pdf/BILLS-110hr7084rds.pdf.

[79] Greg Sandoval, *Pandora, Webcasting see victory in Senate*, CNET, Sep. 30, 2008, http://news.cnet.com/8301-1023_3-10055055-93.html.

[80] 74 Fed. Reg. 40, 9293, 9299 at Appendix B (Mar. 3, 2009), available at http://www.gpo.gov/fdsys/pkg/FR-2009-03-03/pdf/E9-4439.pdf. '

[81] *Id*. at Appendix A.
See also David Oxenford, *SoundExchange and Corporation for Public Broadcasting Settlement on Internet Radio Royalties for 2011-2015*, BROADCAST LAW BLOG, Aug. 9, 2009, http://www.broadcastlawblog.com/2009/08/articles/internet-radio/soundexchange-and-corporation-for-public-broadcasting-settlement-on-internet-radio-royalties-for-20112015/.

[82] List of "Small Webcasters" party to the 2009 agreement with SoundExchange. 74 Fed. Reg. 40, 9293, 9294 n.1 (Mar. 3, 2009), *available at* http://www.gpo.gov/fdsys/pkg/FR-2009-03-03/pdf/E9-4439.pdf.

[83] *Id*. at 9302 at Appendix C.

[84] Michael Schmitt, *Rain 7/1: Obama approves Webcaster Settlement Act of 2009*, RADIO AND INTERNET NEWSLETTER, July 1, 2009, http://textpattern.kurthanson.com/articles/716/rain-71-obama-approves-webcaster-settlement-act-of-2009.

[85] David Oxenford, *Pureplay Webcasters and SoundExchange Enter Into Deal Under Webcaster Settlement Act to Offer Internet Radio Royalty Rate Alternative for 2006-2015*, BROADCAST LAW BLOG, July 9, 2009, http://www.broadcastlawblog.com/2009/07/articles/internet-radio/pureplay-webcasters-and-soundexchange-enter-into-deal-under-webcaster-settlement-act-to-offer-internet-radio-royalty-rate-alternative-for-20062015/. See publication of the agreement. 74 Fed. Reg. 136, 34796 (July 17, 2009) *available at* http://www.gpo.gov/fdsys/pkg/FR-2009-07-17/pdf/E9-17092.pdf.

[86] Press Release, Pandora Media, Inc., Pandora Reports 1Q13 Financial Results, May 23, 2012, http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTQxNDIxfENoaWxkSUQ9LTF8VHlwZT0z&t=1.

[87] *Supra* note 1.

[88] 76 Fed. Reg. 16, 13026 (Mar. 9, 2011), *available at* http://www.loc.gov/crb/fedreg/2011/76fr13026.pdf.

[89] As described in note 1, an analysis of Pandora financial statements and SEC filings from 2012 suggests that Pandora made non-SoundExchange content acquisition payments of about 4.5% of revenue during the first fiscal quarter of 2013. That in turn implies of the $55.8 million in total content acquisition costs paid during the quarter, approximately $52.2 million went to SoundExchange for sound recording performance licenses. The Pandora Media, Inc. Annual Report (Form 10-K) at 4 (Mar.

19, 2012) cited in note 1 states that subscription services comprised 13% of revenue in FY2011 and FY2012. However, the Annual Report does not identify the percentage of the payments to SoundExchange that are due to nonsubscription versus subscription services. For 2012, Pandora pays a per play rate of $.0011 for nonsubscription services and $.0020 for subscription services (see the Pandora Annual Report at 9). Even if only half of the Q1 FY2013 payment to SoundExchange was due to nonsubscription services (and in fact, the fraction was very likely more than that), using the CRB rate of $.0021 would have increased Pandora's payments to SoundExchange from an estimated $52.2 million to approximately $77 million. If three quarters of the Q1 FY2013 payment to SoundExchange was due to nonsubscription services, using the CRB rate of $.0021 would have increased Pandora's payments to SoundExchange from an estimated $52.2 million to approximately $88 million.

[90] 70 Fed. Reg. 232, 72471 (Dec. 5, 2005), *available at* http://www.loc.gov/crb/fedreg/2005/70fr72471.pdf.

[91] 71 Fed. Reg. 5, 1455 (Jan. 9, 2006), *available at* http://www.loc.gov/crb/fedreg/2006/71fr1455.pdf.

[92] 72 Fed. Reg. 243, 71795 (Dec. 19, 2007), available at http://www.loc.gov/crb/fedreg/2007/72fr71795.pdf.

[93] With respect to this proceeding, Sirius and XM were providing new subscription services, as David Oxenford explained in a post at Broadcast Law Blog, "as an add-on to a subscription to multichannel video providers." See David Oxenford, *Another Proposed Settlement of Another Copyright Royalty Board Procedding – New Subscription Services*, BROADCAST LAW BLOG, Nov. 9, 2007, http://www.broadcastlawblog.com/2007/11/articles/intellectual-property/another-proposed-settlement-of-another-copyright-royalty-board-proceeding-new-subscription-services/. Thus, while Sirius and XM were satellite radio companies that were both in existence prior to the key 1998 date under the DMCA, for these particular services the relevant classification was "new subscription services."

[94] 72 Fed. Reg. 244, 72253 (Dec. 20, 2007), *available at* http://www.loc.gov/crb/fedreg/2007/72fr72253.pdf.

[95] Oxenford, *supra* note 93.

[96] The one exception should be nonsubscription digital broadcasts from a "terrestrial broadcast station licensed as such by the Federal Communications Commission," such as hybrid digital (HD) radio. Any legislation that leaves the performance royalty exemption in place for terrestrial AM and FM broadcasts, should also leave that exemption in place for nonsubscription digital transmissions from terrestrial broadcast stations.

[97] Stockment, *supra* note 32, at 2172. In particular, Mr. Stockment wrote: "These amendments would ensure that the public performance and ephemeral license royalties for all types of digital audio transmissions would be determined using a single standard: Section 801(b)(1). The result would be copyright royalties that are determined in a manner that (A) balances the interests of copyright owners, copyright users, and the public; (B) is technology neutral; and (C) conforms to the purposes of United States copyright policy in promoting ―progress of science and useful arts." [footnote omitted]

[98] Anderson, *supra* note 13, abstract, writing with respect to 801(b) factors in the Performance Rights Act of 2009: "Including this standard in the legislation is vital in addressing the current disparity in royalty payments. However, as it currently stands, the legislation fails to include one important factor of the "801(b)" standard, and Congress should amend the legislation to include this factor before passing the bill. "

[99] *Music and Radio in the 21st Century: Assuring Fair Rates and Rules Across Platforms, Hearing Before U.S. S. Judiciary Comm.*, 110th Cong. 2d Sess. (July 29, 2008) (Testimony of Joe Kennedy, President and Chief Executive Officer, Pandora Media, Inc.), *available at* http://www.digmedia.org/component/docman/doc_download/91-joe-kennedy-pandora-testimony-.

[100] Supplemental Statement of the Digital Media Ass'n S. Judiciary Comm. Hearing on *Music and Radio in the 21st Century: Assuring Fair Rates and Rules across Platforms*, July 29, 2008, *available at* http://www.digmedia.org/component/docman/doc_download/89-dima-supplemental-testimony.

[101] DelNero, *supra* note 17, page 181.

[102] 74 Fed. Reg. 40, 9299, *supra* note 80.

[103] Jennifer Martinez, *Bill stirs up fight over online music royalties*, THE HILL, July 18, 2012, http://thehill.com/business-a-lobbying/238845-bill-stirs-up-fight-over-online-music-royalties.

[104] Paul Resnikoff, *Pandora + Sirius XM = 90% of SoundExchange Revenues…*, DIGITAL MUSIC NEWS, Apr. 14, 2012, http://www.digitalmusicnews.com/permalink/2012/120413soundexchange.

[105] Glenn Peoples, *Business Matters: Why Sirius XM and Pandora Don't Account For 90% of Soundexchange's Collections*,BILLBOARD.BIZ, Apr. 17, 2012, http://www.billboard.biz/bbbiz/industry/digital-and-mobile/business-matters-why-sirius-xm-and-pandora-1006791952.story.

[106] 73 Fed. Reg. 16, 4080, 4097 (Jan. 24, 2008).

[107] 76 Fed. Reg. 591 (Jan. 5, 2011), *available at* http://www.loc.gov/crb/fedreg/2011/76fr591.pdf.

[108] 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, 46 Fed. Reg. 884, 1981 WL 110161, at *1 (Jan. 5, 1981) (to be codified at 37 C.F.R. pt. 306).

[109] "Adjustment of the Royalty Payable Under Compulsory License for Making and Distributing Phonorecords, 46 Fed. Reg. 10466, 1981 WL 115839, at *1 (Feb. 3, 1981) (to be codified at 37 C.F.R. pt. 307).

[110] In re: Determination of Statutory License Terms and Rates for Certain Digital Subscription Transmissions of Sound Recordings, Report of the Copyright Arbitration Royalty Panel, Docket No. 96-5 CARP DSTRA (November 28, 1997). This document is referenced in 73 Fed. Reg. 16, 4080, 4083 (Jan. 24, 2008) (to be codified at 37 C.F.R. pt. 382), *available at* http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf.

[111] *U.S. v. Am. Society of Composers, Authors and Publishers*, 559 F.Supp.2d 332 (S.D.N.Y. 2008), *available at* http://www.ascap.com/~/media/Files/Pdf/members/ratecourtdecision.pdf. On pages 1 and 18 of the court ruling in this link.

[112] *Id.* at 117. Quoting from *United States v. Am. Soc'y of Composers, Authors, and Publishers (Applications of Capital Cities/ABC, Inc. and CBS, Inc.)*, 831 F. Supp. 137, 140 (S.D.N.Y. 1993), which in turn is quoting from *Am. Soc'y of Composers, Authors, and Publishers v. Showtime/The Movie Channel, Inc.*, 912 F.2d 563, 569 (2d. Cir. 1990)

[113] *Id.* at 118. Quoting from *United States v. Am. Soc'y of Composers, Authors, and Publishers (Applications of Capital Cities/ABC, Inc. and CBS, Inc.)*, 831 F. Supp. 137, 144 (S.D.N.Y. 1993)

[114] *Id.* at 81.

[115] *Id*. at 153. The 2.5% rate is applied to "music-use-adjusted" revenue.

[116] Arbitron Inc. and Edison Research, *The Infinite Dial 2012: Navigating Digital Platforms*, April 10, 2012, *available at* http://www.edisonresearch.com/wp-content/uploads/2012/04/Edison_Research_Arbitron_Infinite_Dial_2012.pdf.

[117] *SiriusXM, Corporate Overview*, http://www.siriusxm.com/corporate (last visited on July 19, 2012) stating "SiriusXM broadcasts more than 135 channels of commercial-free music, premier sports, live news, talk, comedy, entertainment, traffic and weather to more than 22 million subscribers."