LIBRARY OF CONGRESS

Copyright Royalty Board

37 CFR Part 385

[Docket No. 2006-3 CRB DPRA]

Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding

AGENCY: Copyright Royalty Board, Library of Congress.

ACTION: Final rule.

SUMMARY: The Copyright Royalty Judges are announcing their final determination of the rates and terms for the use of musical works in physical phonorecords, permanent downloads, and ringtones and are adopting as final regulations the rates and terms for the use of musical works in limited downloads, interactive streaming, and incidental digital phonorecord deliveries.

DATE: [INSERT DATE THAT IS FIRST DAY OF THE SECOND MONTH FROM DATE OF PUBLICATION IN THE **FEDERAL REGISTER**].

ADDRESSES: The final determination also is posted on the Copyright Royalty Board Web site at *http://www.loc.gov/crb/proceedings/2006-3/dpra-public-final-rates-terms.pdf*.

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SUPPLEMENTARY INFORMATION:

I. Introduction

This is a rate determination proceeding convened under 17 U.S.C. 803(b) and 37 CFR 351. A Notice announcing commencement of the proceeding with a request for Petitions to Participate to determine the rates and terms of royalty payments[1] for the making and distribution

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[1] Section 115 divides the responsibility of setting terms governing royalty payments between the Copyright

of phonorecords, including digital phonorecord deliveries ("DPDs"), under the statutory license set forth in Section 115 of the Copyright Act was published in the **Federal Register** on January 9, 2006. 71 FR 1454. The rate to be paid to songwriters and music publishers for the reproduction and distribution of their musical works in physical phonorecords and permanent digital downloads is the larger of 9.1¢ or 1.75¢ per minute of playing time (or fraction thereof) for the entire license period; the rate to be paid under Section 115 for ringtones is 24¢. Consistent with our adoption of the same term for late payments in the *Webcaster II* and *SDARS* determinations, 72 FR 24084, 24107 (May 1, 2007)(*Webcaster II*), 73 FR 4080, 4099 (January 24, 2008)(*SDARS*), we are establishing a late payment fee of 1.5% per month measured from the date the payment was due as provided in the regulations of the Register. *See* 37 CFR 201.19(e)(7)(i). Section 803(d)(2)(B) of the Copyright Act governs the effective date of the rates and terms established in this proceeding. 17 U.S.C. 803(d)(2)(B). The parties submitted a settlement regarding the rates to be paid to songwriters and music publishers for the reproduction of their musical works in limited downloads, interactive streaming and incidental DPDs and that settlement was published for comment pursuant to 17 U.S.C. 801(b)(7)(A)(i). Having received no objection to the settlement from any participant, we are adopting the settled rates and terms as final regulations. The effective date of these rates and terms also is governed by 17 U.S.C. 803(d)(2)(B).

II. This Proceeding

A. Procedural History

Royalty Judges and the Register of Copyrights. *See* 17 U.S.C. 115(c)(3)(C) & (D) (setting forth Judges' authority) and (b)(1) & (c)(4)-(5) (setting forth Register's authority); *see also*, *Final Order, Division of Authority Between the Copyright Royalty Judges and the Register of Copyrights under the Section 115 Statutory License*, Docket No. RF 2008-1, 73 FR 48396 (August 19, 2008); *see also infra* at Section V.

The following entities filed Petitions to Participate in response to the January 9, 2006, request: Royalty Logic, Inc. ("RLI"); the Songwriters Guild of America ("SGA"); the National Music Publishers' Association, Inc. ("NMPA"), the Songwriters Guild of America, and the Nashville Songwriters Association International, jointly (collectively, "Copyright Owners"); Apple Computer, Inc.; America Online, Inc.; RealNetworks, Inc.; Napster, LLC; Sony Connect, Inc.; Digital Media Association ("DiMA"); Yahoo! Inc.; MusicNet, Inc.; MTV Networks, Inc.; and Recording Industry Association of America ("RIAA").

Following an unsuccessful negotiation period, the following parties filed written direct statements by the November 30, 2006 deadline: RIAA; Copyright Owners; and DiMA, joined by its member companies America Online, Inc., Apple Computer, Inc., MusicNet, Inc., Napster, LLC, RealNetworks, Inc. and Yahoo! Inc.[2] RLI filed its written direct statement on March 2, 2007.[3]

Discovery was followed by live testimony. Testimony in the direct phase was taken from January 28, 2008, to February 26, 2008. Copyright Owners presented the testimony of the following witnesses: Mr. Rick Carnes, songwriter, and President, Songwriters Guild of America; Mr. Steve Bogard, professional songwriter and President, Nashville Songwriters Association International; Mr. Roger Faxon, Chairman and Chief Executive Officer ("CEO"),

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[2] Yahoo! Inc. and Napster LLC each subsequently withdrew from the proceeding. *See* Yahoo! Inc. Notice of Withdrawal of Petition to Participate (filed August 24, 2007) and Napster, LLC Notice of Withdrawal (filed October 19, 2007).

[3] The Judges never officially accepted RLI's written direct statement. That aside, RLI's direct statement made clear that its participation was solely "on the issue of competition among agents for the licensing of musical works and/or the collection and distribution of royalties, on behalf of copyright owners and/or their agents." RLI Written Direct Statement at 1. Subsequently, RLI and the Copyright Owners stipulated that RLI would not participate in the direct or rebuttal phases of the proceeding or the closing arguments unless the issue identified in RLI's direct statement was raised at any point in the proceeding. *See Joint Stipulation Regarding Participation by Royalty Logic, Inc. in the Above-Captioned Proceeding* (filed February 1, 2008). The issue was not raised.

EMI Music Publishing; Mr. Philip Galston, songwriter, music publisher and record producer; Ms. Victoria Shaw, songwriter; Ms. Maia Sharp, singer, songwriter and musician; Mr. Steven Paulus, composer; Mr. Irwin Z. Robinson, Chairman, Paramount Arabella Music; Ms. Claire Enders, CEO, Enders Analysis; Mr. David Israelite, President and CEO, NMPA; Mr. Ralph Peer, Chairman and CEO, Peermusic, Inc.; Ms. Helen Murphy, President, International Media Services, Inc.; Dr. William Landes, Clifton R. Musser Professor of Law and Economics, University of Chicago Law School; and Mr. Nicholas Firth, former Chairman and CEO, BMG Music Publishing Worldwide.

RIAA presented testimony from the following witnesses: Mr. Geoffrey Taylor, CEO, British Phonographic Industry; Mr. Richard Boulton, Global Managing Director, Finance and Accounting Services; Ms. Linda McLaughlin, Senior Vice President, National Economic Research Associates; Mr. Colin Finkelstein, Chief Financial Officer, EMI Music North America; Ms. Andrea Finkelstein, Senior Vice President of Business Affairs Operations and Administration, SONY BMG Music Entertainment; Mr. Michael Kushner, Senior Vice President, Business and Legal Affairs, Atlantic Music Group; Mr. Jerold Rosen, Executive Vice President of the Commercial Music Group, SONY BMG Music Entertainment; Dr. David J. Teece, the Thomas Tusher Chair, Haas School of Business, and Director, Institute of Management, Innovation and Organization, University of California at Berkeley; Ms. Victoria Bassetti, Senior Vice President of Industry and Government Affairs Worldwide and Vice President, Anti-Piracy, North America, for EMI Music; Mr. Ronald Wilcox, former Executive Vice President and Chief Business and Legal Affairs Officer, SONY BMG Music Entertainment; Mr. David Hughes, Senior Vice President of Technology, RIAA; Mr. Glen Barros, President and

CEO, Concord Music Group; and Mr. David Munns, independent music consultant in the United Kingdom, former Vice Chairman of EMI Music and CEO of EMI Music North America.

DiMA presented testimony from the following witnesses: Mr. Eduardo ("Eddy") Cue, Vice President, iTunes; Mr. Alan McGlade, President and CEO, MediaNet Digital; Ms. Margaret Guerin-Calvert, Vice Chairman, Compass Lexecon and Senior Managing Director, FTI; and Mr. Timothy Quirk, Vice President of Music Programming, Rhapsody America.

The parties filed written rebuttal statements on April 10, 2008. Rebuttal testimony was taken from May 6, 2008, through May 21, 2008. On May 15, 2008, the parties informed the Copyright Royalty Judges ("Judges") that they had reached a settlement regarding the rates and terms for "limited downloads and interactive streaming, including all known incidental digital phonorecord deliveries." *See Joint Motion to Adopt Procedures for Submission of Partial Settlement* at 1 (filed May 15, 2008).[4] The parties filed the partial settlement on September 22, 2008, and it was published in the **Federal Register** on October 1, 2008, 73 FR 57033. Public comments were due on October 31, 2008. A single comment, filed jointly by CTIA-The Wireless Association and the National Association of Broadcasters, was received. *See infra* at Section III.C.

DiMA presented the rebuttal testimony of: Ms. Guerin-Calvert; Mr. Dan Sheeran, Senior Vice President of Business Development, RealNetworks; and Mr. Alexander Kirk, General

[4] In the motion, the parties requested that the Judges permit the parties to submit the settlement on September 15, 2008, or a later date set by the Judges, and relieve the parties of their obligation to file proposed findings of fact and conclusions of law on the settled issues. *See Joint Motion to Adopt Procedures for Submission of Partial Settlement* at 2-3 (filed May 15, 2008). On May 27, 2008, the Judges denied the parties' request to set a deadline for submission of the partial settlement and granted their request regarding their obligation to address the settled issues in their proposed findings of fact and conclusions of law. *See Order Re Joint Motion to Adopt Procedures for Submission of Partial Settlement*, Docket No. 2006-3 CRB DPRA (May 27, 2008). Subsequently, the Judges amended their order to provide for a September 22, 2008 deadline for the parties to submit their settlement. *See Order Setting Deadline to File Settlement*, Docket No. 2006-3 CRB DPRA (September 17, 2008).

Manager of Product Management, Rhapsody America, LLC.

RIAA presented the rebuttal testimony of: Mr. David Alfaro, Managing Director, FTI Technology Practice; Ms. Terri Santisi, President, T. Media Services, International; Mr. Scott Pascucci, President, Rhino Entertainment Company, an affiliate of Warner Music Group; Dr. Daniel Slottje, Professor of Economics, Southern Methodist University and Senior Managing Director, FTI Consulting, Inc.; Mr. Bruce Benson, Senior Managing Director, FTI Consulting, Inc.; Ms. Finkelstein; Dr. Steven Wildman, James H. Quello Professor of Telecommunication Studies and Co-Director of the Quello Center for Telecommunications Management and Law, Michigan State University; Mr. Mark Eisenberg, Executive Vice President, Business and Legal Affairs, in the Global Digital Business Group, SONY BMG Music Entertainment; and Mr. Robert Emmer, Chief Operating Officer and co-founder, Shout! Factory.

Copyright Owners presented the rebuttal testimony of: Mr. Faxon; Mr. Jeremy Fabinyi, Managing Director of Mechanicals, MCPS-PRS Alliance; Dr. Kevin Murphy, George J. Stigler Distinguished Service Professor of Economics in the Graduate School of Business and the Department of Economics, University of Chicago; Mr. Alfred Pedecine, Senior Vice President and Chief Financial Officer, The Harry Fox Agency; Dr. Landes; Dr. Ketan Mayer-Patel, Associate Professor, Department of Computer Science, University of North Carolina at Chapel Hill; and Ms. Judith Finell, President, Judith Finell MusicServices, Inc.

In addition to the written direct statements and written rebuttal statements, the Judges heard 28 days of testimony, which filled over 8,000 pages of transcript. Over 140 exhibits were admitted. The docket contains over 340 pleadings, motions and orders.

On July 2, 2008, after the evidentiary phase of the proceeding, the Participants filed their respective Proposed Findings of Fact and Conclusions of Law. The Participants filed replies on July 18, 2008. Closing arguments occurred on July 24, 2008, after which time the record was closed.

On October 2, 2008, the Judges issued the Initial Determination of Rates and Terms. Pursuant to 17 U.S.C. 803(c)(2) and 37 CFR Part 353, RIAA filed a motion on October 17, 2008, for rehearing to reconsider the timing of the late payment fee of 1.5% per month. At the same time, all the parties jointly requested that the Judges "hold this motion for 20 days to allow negotiation by the parties" because they were of the view that they "may be able to resolve the issues related to the timing of the late fee through negotiation, which may obviate this motion." As part of the joint request, Copyright Owners indicated they opposed the rehearing, while DiMA took no position on rehearing. The parties' negotiations failed to resolve the issues related to the timing of the late fee within the requested 20 days, and nothing further was filed on the motion. Having reviewed the motion, the Judges denied the motion for rehearing, by Order dated November 12, 2008. As reviewed in said Order, none of the grounds in the motion presented the type of exceptional case where the Initial Determination is not supported by the evidence. 17 U.S.C. 803(c)(2)(A); 37 CFR 353.1 and 353.2. The motion did not meet the required standards set by statute, by regulation and by case law. The motion amounted to no more than a rehash of the same arguments the Judges considered and rejected in the Initial Determination.

B. Referrals to the Register

During the course of the proceeding, RIAA and DiMA each sought from the Judges referral of a novel question of law to the Register of Copyrights ("Register"). RIAA filed its motion prior to the filing of written direct statements; DiMA filed its motion prior to the presentation of oral testimony in the direct phase of the proceeding. In addition, the Judges, *sua sponte*, referred a material question of substantive law to the Register after the close of the record.

1. Ringtones

In its motion, RIAA sought referral to the Register of a novel question of law regarding the eligibility of ringtones for licensing under Section 115. *See Motion of [RIAA] Requesting Referral of a Novel Question of Substantive Law* (filed August 1, 2006). After considering the views of all of the participants, the Judges granted RIAA's motion in part and referred to the Register two novel questions of law regarding (1) whether ringtones--regardless of whether the ringtone is monophonic, polyphonic or a mastertone--constitute delivery of a digital phonorecord subject to statutory licensing under Section 115 and (2) if so, what legal conditions and/or limitations would apply. *See Order Granting in Part the Request for Referral of a Novel Question of Law*, Docket No. 2006-3 CRB DPRA (August 18, 2006). On October 16, 2006, the Register transmitted a Memorandum Opinion to the Judges that addressed the novel questions of law, concluding:

> [R]ingtones (including monophonic and polyphonic ringtones, as well as mastertones) qualify as digital phonorecord deliveries ("DPDs") as defined in 17 U.S.C. 115. . . .[W]hether a particular ringtone falls within the scope of the statutory license will depend primarily upon whether what is performed is simply the original musical work (or a portion thereof), or a derivative work (*i.e.*, a musical work based on the original musical work but which is recast, transformed, or adapted in such a way that it becomes an original work of authorship and would be entitled to copyright protection as a derivative work).

The Register's Memorandum Opinion was published in the **Federal Register** on November 1, 2006. 71 FR 64303.

2. Interactive Streaming

DiMA requested referral to the Register of what it described as a novel question of law as to whether "interactive streaming" constituted a DPD under Section 115. *See Motion of [DiMA] Requesting Referral of a Novel Material Question of Substantive Law* ("DiMA Motion") (filed January 7, 2008).[5] Copyright Owners opposed DiMA's motion and RIAA took no position on it. The Judges heard oral arguments on the motion on January 28, 2008.

On February 4, 2008, the Judges denied DiMA's motion, finding that the definition of "interactive streaming" presented a question of fact and not a question of law as required by Section 802(f)(1)(B). *See Order Denying Motion of [DiMA] for a Referral of a Novel Material Question of Substantive Law*, Docket No. 2006-3 CRB DPRA (February 4, 2008). We stated:

> During oral argument, there was much discussion regarding the term "interactive streaming." The term is neither defined nor mentioned in the Copyright Act, and it is apparent that there is not agreement among the parties as to the meaning of the term. Given these two factors, the Judges determine that there is not a "novel question of substantive law concerning an interpretation of those provisions" of the Copyright Act. 17 U.S.C. 802(f)(1)(B). Rather, the matter of what is "interactive streaming" is a factual question. The Register could not render a determination as to whether "interactive streaming" is a digital phonorecord delivery without inquiring into the factual circumstances and types of activities that could be considered "interactive streaming," and the extent to which these factual circumstances and types of activities result in reproductions of musical works. That is not a matter of substantive law as required by the statute.

[5] DiMA defined "interactive streaming" for purposes of its requested referral as "the playing of a specific sound recording in response to a listener's request without the creation of an audio file that remains accessible on the client computer beyond the playing of such sound recording." *See* DiMA Motion at 1 (footnote omitted).

Order Denying Motion of DiMA at 2. The correctness of our conclusion that streaming is not a defined term or behavior was confirmed subsequently by the witness testimony. 5/14/08 Tr. at 6594-95 (Kirk) ("I mean, one of the wonderful things about computers on the internet is they offer you a number of different ways to do things. And streaming can encompass a whole range of behaviors."); *see also* 5/15/08 Tr. at 6664-65; 5/21/08 Tr. at 7598 (Mayer-Patel) ("Yes, streaming is–is a reasonably broad word and, for the most part, it's generally understood to mean making use of data as it arrives as opposed to waiting for the entire data to arrive and then making use of it."). The Register also concluded that this matter has many uncertainties.[6]

3. Authority Over Terms

After closing arguments, the Judges, on their own motion, referred to the Register a material question of substantive law concerning the division of authority between the Judges and the Register to establish terms under the Section 115 statutory license. *See Order Referring Material Question of Substantive Law*, Docket No. 2006-3 CRB DPRA (July 25, 2008). On August 8, 2008, the Register transmitted a Memorandum Opinion to the Judges that addressed the material question of substantive law.[7] *See infra* at Section V.

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[6] In announcing her interim rule clarifying the scope and application of Section 115 as it relates to DPDs, the Register stated:

> It is sufficient to note that the record in this rulemaking and the *Cartoon Network* opinion create sufficient uncertainty to make it inadvisable to engage in rulemaking activity based on the Office's analysis in the *DMCA Section 104 Report*. Consequently, the interim rule does not address whether streaming of music that involves the making of buffer copies, but which makes no further copies, falls within the Section 115 compulsory license, or whether such buffer copies qualify as DPDs.

Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries: Interim Rule and request for comments. 73 FR 66173, 66177 (November 7, 2008).

[7] The Memorandum Opinion was published in the **Federal Register** on August 19, 2008. 73 FR 48396.

III. The Section 115 License

A. Overview of the License

Created shortly after the turn of the twentieth century, the Section 115 compulsory license represents Congress' first effort to balance the exclusive rights of copyright owners with the concern of public access to protected works. Despite the almost 100-year history of the license, our proceeding marks only the second time that a governmental body other than the Congress is establishing the royalty rates to be paid for reproductions of musical works by copyright users.

At the time of Congress' major revision of the copyright laws in 1909, protection for musical works was a long-recognized concept. The protection extended to performances of musical works and to copies of sheet music made by songwriters and music publishers. However, the year before, the United States Supreme Court decided in *White-Smith Music Publishing Co. v. Apollo Co.*, 209 U.S. 1 (1908), that piano rolls did not embody a system of notation that could be read and therefore were not "copies" of musical works within the meaning of the existing copyright laws, but rather were merely parts of devices for mechanically performing the music. Reacting to this decision, Congress extended the protection of musical works to include the right to make mechanical devices embodying musical works but without extending the protection to the mechanical devices themselves. H.R. Rep. No. 60-2222, at 9 (1909). The extension of protection was tempered, however, by a concern about monopolistic control of music for recording purposes by the makers of piano rolls and phonorecords. The right of a copyright owner to mechanical control of his or her musical work was limited by a compulsory license once the owner made or authorized the recording of his or her musical composition; hence the now common term "mechanical license." 17 U.S.C. 1 (1909). Upon payment of a royalty rate of 2¢ per "mechanical," any person was free to manufacture and distribute a reproduction of a musical work.

Congress revisited the mechanical license in the 1976 copyright law revision, now found in Section 115 of title 17 of the United States Code, clarifying that the license cannot be invoked unless and until a nondramatic musical work embodied in a phonorecord has been distributed to the public under authority of the copyright owner (clarifying that a demonstration record or tape is not subject to the license); that the license is not available for duplicating, without authorization, another's sound recording of a musical work; that the license for phonorecords is not transferable; and that compulsory licensees are granted some latitude in the arrangement of their version of the recorded musical work. The Copyright Office was directed to establish requirements (terms) for the notice of intention to obtain the Section 115 license, as well as the payment of royalties. These regulations are currently found at 37 CFR 201.18 and 201.19. The 2¢ per phonorecord royalty fee adopted under the 1909 Act was retained, but the Copyright Royalty Tribunal was instructed to conduct a proceeding to adjust the rate. That proceeding is discussed *infra* at Section III.B.

Change came to the Section 115 license almost 20 years later[8] with the passage of the Digital Performance Right in Sound Recordings Act, Public Law No. 104-39, 109 Stat. 336. Of the amendments made by this Act, the most important is extension of the license to "digital phonorecord deliveries," which the statute defines as

[8] Congress did make a slight adjustment to Section 115 when it abolished the Copyright Royalty Tribunal in 1993 by authorizing copyright arbitration royalty panels ("CARPs") to adopt terms–and in particular notice and recordkeeping terms–in rate adjustment proceedings. Copyright Royalty Tribunal Reform Act of 1993, Public Law No. 103-198, 107 Stat. 2304. This authorization was carried forward to the Judges upon abolition of the CARP system. Copyright Royalty and Distribution Reform Act of 2004, Public Law No. 108-419, 118 Stat. 2341.

> each individual delivery of a phonorecord by digital transmission of a sound recording which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording, regardless of whether the digital transmission is also a public performance of the sound recording or any nondramatic musical work embodied therein. A digital phonorecord delivery does not result from a real-time, non-interactive subscription transmission of a sound recording where no reproduction of the sound recording or the musical work embodied there is made from the inception of the transmission through to its receipt by the transmission recipient in order to make the sound recording audible.

17 U.S.C. 115(d). The license now covers digital transmissions of phonorecords, in addition to the physical copies, such as compact discs (CDs), vinyl and cassette tapes, and, unlike the license for physical phonorecords, the license for DPDs is transferable. Congress also created a subset of the DPD, the "incidental digital phonorecord delivery" ("IDPD"), and although it did not define what constitutes an IDPD, instructed the Judges to adopt royalty terms and rates that distinguish between DPDs and IDPDs.

In describing this history and structure of the Section 115 license, the Judges note how extensive and detailed is its operation, particularly with respect to the regulations adopted by the Copyright Office. The complexity of compliance, and the associated transactions costs, create a curious anomaly: virtually no one uses Section 115 to license reproductions of musical works, yet the parties in this proceeding are willing to expend considerable time and expense to litigate its royalty rates and terms. The Judges are, therefore, seemingly tasked with setting rates and terms for a useless license. The testimony in this proceeding makes clear, however, that despite its disuse, the Section 115 license exerts a ghost-in-the-attic like effect on all those who live below it. *See* 5/12/08 Tr. at 5757:10-17 (A. Finkelstein). Thus, the rates and terms that we set today will have considerable impact on the private agreements that enable copyright users to clear the rights for reproduction and distribution of musical works.

B. History of the Section 115 Rates

When Congress created the Section 115 license as part of the 1909 Copyright Act, it set the statutory rate for the making and distributing of physical phonorecords at 2¢ for each musical work embodied in the phonorecord. 17 U.S.C. 1(e) (1909). This rate remained in effect until Congress revised the copyright laws in 1978, with the passage of the 1976 Copyright Act, Public Law No. 94-553, 90 Stat. 2541. In the 1976 Copyright Act, Congress codified the mechanical compulsory license as Section 115 and raised the statutory rate to 2.75¢ per phonorecord or .6¢ per minute of playing time or fraction thereof, whichever amount was larger. 17 U.S.C. 115(c)(2) (1978). Congress also determined that future adjustments of the Section 115 rates would not be set by statute but rather would be made by the Copyright Royalty Tribunal ("CRT"), an administrative body created by Congress in the 1976 Act to administer all of the compulsory licenses.[9] *See* H.R. Rep. No. 94-1476, at 111 (1976) ("This rate will be subject to review by the [CRT], as provided in Section 801, in 1980 and at 10-year intervals thereafter."); *see also* 17 U.S.C. chapter 8 (1978). With regard to the Section 115 license, the CRT was tasked with the job of setting "reasonable" royalty rates informed by a set of four delineated factors. 17 U.S.C. 801(b)(1) (1978). The CRT had no authority to set terms for the license; rather, Congress delegated that authority to the Register of Copyrights.[10]

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[9] At the time the 1976 Copyright Act was enacted, the other compulsory licenses were set forth in 17 U.S.C. 111, 116 and 118.

[10] Specifically, Congress charged the Register with the authority to promulgate regulations governing the notice of intention to obtain the Section 115 license as well as the monthly and annual statements of account. *See* 17 U.S.C. 115(b)(1) and (c)(3) (1978); *see also* 37 CFR 201.18 (notice of intent to obtain license) and 201.19

Pursuant to its statutory directive, the CRT conducted the first, and only other, contested proceeding to set rates for the Section 115 compulsory license, which it began in 1980. 45 FR 63 (January 2, 1980). The copyright owners were represented by, among others, NMPA and the Nashville Songwriters Association International, while the copyright users were represented primarily by RIAA. *See* 46 FR 10466 (February 3, 1981).

After taking 46 days of testimony from 35 witnesses which comprised over 6,000 pages of transcripts, the CRT issued a lengthy decision in which it substantially increased the existing 2.75¢ rate per phonorecord made and distributed to 4¢ per phonorecord and established a complex system for future interim adjustments during the 7-year license period to reflect increases in the average list price of record albums. *Id.* at 10467, 10485-86. Specifically, the CRT concluded "that the application of the statutory criteria [in Section 801(b)(1)] to the evidence in this proceeding demonstrates that the mechanical royalty rate must be adjusted to either four cents, or three-quarters of one cent per minute of playing time or fraction thereof, whichever amount is larger." *Id.* at 10485. With respect to future interim adjustments, the CRT found "that any adjustment to the rate should and must be directly related to the retail list price of records, now and in the future." *Id.*

The United States Court of Appeals for the District of Columbia Circuit upheld the CRT's determination of the rates but set aside the CRT's mechanism for adjusting the rates within the licensing period as being beyond the CRT's statutory authority. *Recording Industry Ass'n. of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981). The court remanded the case to the CRT "for the limited purpose of allowing the Tribunal to consider whether it wishes

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(statements of account).

to adopt an alternative scheme for interim adjustments." 46 FR 55276 (November 9, 1981). Upon remand, the CRT adopted automatic adjustments to occur in 1983, 1984 and 1986. By 1986, the rate had been increased to the larger of 5¢ per musical work or .95¢ per minute of playing time or fraction thereof. 46 FR 66267 (December 23, 1981); *see also* 37 CFR 255.3(a)-(c).

The next adjustment of the Section 115 rates was scheduled to begin in 1987. On March 18, 1987, the CRT received a joint proposal from NMPA and SGA, on behalf of the copyright owners, and RIAA, on behalf of copyright users, seeking adoption of rates voluntarily negotiated by the parties. The settlement, which was ultimately adopted by the CRT, set the rate at 5.25¢ per track beginning on January 1, 1988, and established a schedule of rate increases based on the percentage change in the CPI every two years over the next 10 years, except that the rates would remain the same when the CPI declined and could not be increased in any single adjustment by more than 25%. *See* 52 FR 22637 (June 15, 1987). Over the ensuing decade, the rate increased until 1996, when the rate was 6.95¢ per track or 1.3¢ per minute of playing time or fraction thereof. *See* 37 CFR 255.3(d)-(h).

Congress abolished the CRT in 1993 and replaced it with the Copyright Arbitration Royalty Panel ("CARP") system. *See* Copyright Royalty Tribunal Reform Act of 1993, Public Law No. 103-198, 107 Stat. 2304. The CARPs were to set reasonable rates and, for the first time, terms for the Section 115 license, subject to review by the Librarian of Congress ("Librarian").[11]

Because the rates set by the CRT pursuant to the 1987 settlement were set to expire on

[11] The Register still retained her authority over the notice of intention to obtain the license and the monthly

December 31, 1997, the year 1997 was a window year for adjusting the Section 115 rates. The first step in the process of adjusting rates under the CARP system was for the Librarian to initiate a voluntary negotiation period to allow copyright owners and users to negotiate terms and rates of the license. The Librarian set the negotiation period to run from July 17, 1996, through December 31, 1996. 61 FR 37213 (July 17, 1996). The second step of the process was to convene a CARP to determine reasonable terms and rates for parties not subject to a negotiated agreement. The convening of a CARP was not necessary because NMPA, SGA and RIAA were able, after lengthy negotiations, to reach an agreement regarding the adjustment of the physical phonorecord and digital phonorecord delivery royalty rates. Under the settlement, which was ultimately adopted by the Librarian, the rate for physical phonorecords was set at 7.1¢ per track beginning on January 1, 1998, and a schedule was established for fixed rate increases every two years over the next 10-year period with the rate beginning on January 1, 2006, being the larger of 9.1¢ per track or 1.75¢ per minute of playing time or fraction thereof. *See* 37 CFR 255.3(i)-(m); *see also*, 63 FR 7288 (February 13, 1998). The rates adopted for digital phonorecord deliveries for the 10-year period were the same as those set for physical phonorecords, and the rates for incidental DPDs were deferred until the next scheduled rate proceeding. *See* 37 CFR 255.5, 255.6; *see also*, 64 FR 6221 (February 9, 1999). These rates for physical and digital phonorecords are still in effect.

C. The Parties' Settlement of Rates and Terms for Conditional Downloads, Interactive Streaming and Incidental Digital Phonorecord Deliveries

During the latter stages of the rebuttal hearings, counsel for Copyright Owners, RIAA and

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and annual statements of account.

DiMA advised the Judges that they had reached a global settlement with respect to limited downloads, interactive streaming, and "all known incidental DPDs." Copyright Owners PFF at ¶ 199. The parties announced their intention to file their settlement just a short period of time before the October 2 deadline for the Judges' initial determination, expressing concern that it might influence our decision with respect to physical phonorecords, downloads and ringtones, and finally did so after we issued an Order compelling them to submit the settlement no later than noon on September 22, 2008. *Order Setting Deadline to File Settlement*, Docket No. 2006-3 CRB DPRA (September 17, 2008). Upon receipt of the agreement and pursuant to 17 U.S.C. 801(b)(7)(A), we published it in the **Federal Register**. *See*, 73 FR 57033 (October 1, 2008).[12] No objections were filed by any of the participants to the proceeding. A joint comment was received from CTIA-The Wireless Association and the National Association of Broadcasters arguing that adoption of the settlement is beyond the Judges' authority, contrary to law and bad policy.

Our jurisdiction with respect to the settlement is clear. Section 801(b), entitled "FUNCTIONS" of the Copyright Royalty Judges, sets forth our responsibilities in eight specific subsections. Subsection (7)(A) directs us:

> To adopt as a basis for statutory terms and rates or as a basis for the distribution of statutory royalty payments, an agreement concerning such matters reached among some or all of the participants in a proceeding at any time during the proceeding, except that –
>
> > (i) the Copyright Royalty Judges shall provide to those that would be bound by the terms, rates, or other determination set by any

[12] We are making two technical amendments in the regulatory text of this final rule to correct two errors that appeared in the proposed regulatory text. Both corrections are in § 385.13 of title 37 of the Code of Federal Regulations. In the second sentence of § 385.13(a)(1), the reference to § 385.12(b)(1) is changed to § 385.12(b)(3); and in the first sentence of § 385.13(a)(2), the reference to § 385.12(b)(3) is changed to § 385.12(b)(1).

> agreement in a proceeding to determine royalty rates an opportunity to comment on the agreement and shall provide to participants in the proceeding under section 803(b)(2) that would be bound by the terms, rates, or other determination set by the agreement an opportunity to comment on the agreement and object to its adoption as a basis for statutory terms and rates; and
>
> (ii) the Copyright Royalty Judges may decline to adopt the agreement as a basis for statutory terms and rates for participants that are not parties to the agreement, if any participant described in clause (i) objects to the agreement and the Copyright Royalty Judges conclude, based on the record before them if one exists, that the agreement does not provide a reasonable basis for setting statutory terms or rates.

17 U.S.C. 801(b)(7)(A). Thus, we are mandated to adopt the determination of the settling parties to a distribution and rate proceeding. If it is a rate proceeding (but not a distribution proceeding), we must afford those who would be bound by the settled rates and terms, but are not parties to the proceeding, an opportunity to comment and we must afford the parties to the proceeding an opportunity to object to the settlement. The comments received from non-parties have no bearing on the outcome since the statute does not grant us authority to reject or amend the settlement on that basis. Only if an objection is received by one or more of the parties are we given any discretion over the settlement, and then we are limited to rejecting it if we determine that the settlement "does not provide a reasonable basis for setting statutory rates and terms." *Id.*[13] Chapter 8 of the Copyright Act encourages settlements among the parties. The procedure in Section 803 incorporates mandated settlement negotiations.

In the present case and as noted above, we have published the settlement in the **Federal**

[13] The requirement that a rate settlement must be offered for public comment without consequence is curious but apparently intentional. Only parties to a proceeding have a voice in whether the settlement is adopted, an apparent effort to encourage those who will be bound by the rates and terms of a proceeding to actively engage in the proceeding rather than sit on the sidelines and attempt to later seek to influence the outcome. There is no legislative history on this point.

Register. Unsurprisingly, none of the parties have objected. Therefore, we have no choice but to adopt it as the basis for the necessary statutory rates and terms applicable to the corresponding licensed activities.[14] In doing so, we observe that the provisions of the settlement do not constitute a finding of fact or a resolution of law by us. The statute provides that the settlement is an adjustment of rates and terms by the parties that we *must* adopt. We emphasize this statutory distinction to clarify the procedure applicable to the settlement. The provisions of 17 U.S.C. 802(f)(1)(D) permit the Register of Copyrights to review material questions of substantive law that are resolutions that are part of our final determination; however, inasmuch as the settlement does not represent a resolution of the Judges, the Register's review is not part of the procedure applicable to the relevant rates and terms established by this settlement.[15]

IV. Determination of Royalty Rates

A. Application of Section 115

Based on the applicable law and relevant evidence received in this proceeding, the Copyright Royalty Judges must determine rates for the Section 115 musical works reproduction

[14] The Joint Comment of CTIA-The Wireless Association and the National Association of Broadcasters argues that the Judges "may not adopt a rule that is contrary to law, regardless of whether or not the parties to the proceeding may agree." Joint Comment at 6. As discussed above, the statute provides that the Judges adopt settlements, except when specific conditions occur. By adopting a settlement when these conditions are absent, the Judges are adopting a regulation that follows the law. Further review of settlements as proposed in the Joint Comment will require amendments to 17 U.S.C. 801(b)(7)(A). As the Joint Comment suggests, it may be good public policy for the Judges to have discretion to decide if the terms of a settlement should be adopted. Had CTIA-The Wireless Association and the National Association of Broadcasters participated in this proceeding, their objections to the settlement and proposed revisions may have been the basis for considering the merits of the settlement.

[15] In her review of substantive questions of material law in Docket Nos. 2005-5 CRB DTNSRA and 2006-1 CRB DSTRA, the Register concluded that it was legal error for the Judges not to set forth a standalone rate for the section 112 license for preexisting subscription services and new subscription services. 73 FR 9143 (February 19, 2008). The rates and terms for these services, however, were adopted pursuant to settlements of the parties under Section 801(b)(7)(A) and were not a final determination of the Judges. *See*, 73 FR at 9145 (Register does not address the statutory limitations imposed on the Judges with regard to settlements in merely stating, without more, that: "The

licenses utilized by record companies and other music distributors in the distribution of phonorecords of such works.

The Copyright Act requires that the Copyright Royalty Judges establish rates for the Section 115 license that are reasonable and calculated to achieve the following four specific policy objectives: (A) to maximize the availability of creative works to the public; (B) to afford the copyright owner a fair return for his 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; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. 17 U.S.C. 115(c) and 17 U.S.C. 801(b)(1).

Having carefully considered the relevant law and the evidence received in this proceeding, the Copyright Royalty Judges determine that the appropriate Section 115 license rate is the greater of 9.1¢ per song or 1.75¢ per minute of playing time (or fraction thereof) for physical phonorecord deliveries and for permanent digital downloads; and, further, that the appropriate Section 115 license rate is 24¢ for ringtones. Section 803(d)(2)(B) governs the effective date of the rates established in this proceeding.

The applicable rate structure for the Section 115 license is the starting point for the Copyright Royalty Judges' determination.

B. The Rate Proposals of the Parties and

Copyright Royalty Judges have authority to accept or reject the settlement and it is the resulting Final Order which is then subject to review by the Register").

The Appropriate Royalty Structure for Section 115 Licenses

1. Rate Proposals

The contending parties propose several different rate structures. In its second amended rate proposal, RIAA offers a percentage of wholesale revenues approach as its preferred alternative, with a rate of 9% of all-in wholesale revenues applicable to physical product and permanent downloads and a rate of 15% of all-in wholesale revenues applicable to ringtones. As its less preferred alternative, RIAA proposes a "penny-rate" ranging from 3.6¢ per track to 9.45¢ per track depending on the corresponding level of wholesale price associated with the track for tracks reproduced on physical product or as permanent downloads. As part of this alternative approach, RIAA proposes a separate rate of 18¢ per ringtone. RIAA Second Amended Rate Proposal (July 2, 2008) at 1-6.

DiMA offers a second amended rate proposal applicable only to permanent downloads that is formulated as a "greater of" comparison between 6% of applicable receipts and 4.8¢ per track for singles or 3.3¢ per track for tracks sold as part of bundles. DiMA Second Amended Rate Proposal (July 2, 2008) at 3.

By contrast, the Copyright Owners' second amended rate proposal presents only a "penny-rate" choice for physical product and permanent downloads, equal to the greater of 12.5¢ per song or 2.4¢ per minute of playing time for physical product and the greater of 15¢ per track or 2.9¢ per minute of playing time for permanent downloads. These penny rates would be additionally subject to a "periodic" adjustment ostensibly to reflect the change in the consumer price index (CPI-U) over such period. However, in the case of ringtones, Copyright Owners propose a tri-partite "greater of" comparison between (1) 15% of all revenue received in conjunction with the licensed product or service; (2) 33.3% of the total content costs paid for mechanical rights to musical compositions and rights to sound recordings; and (3) 15¢ per ringtone subject to periodic adjustments for inflation as measured by the consumer price index (CPI-U) over such period. Copyright Owners Second Amended Rate Proposal (July 2, 2008) at 1-2.

2. Rate Structure

From the evidence of record, the Copyright Royalty Judges conclude that several factors tip the scales in favor of a usage fee structure for those licenses for which contested proposals have been submitted by the parties. First, unlike our recent determination in the *SDARS* proceeding, here we are not faced with difficult or intractable problems in measuring usage nor do we find that a percentage of revenue approach provides the most efficient mechanism for capturing the value of the reproduction and distribution rights at issue here. *See* 73 FR at 4085-4087. Second, although not presenting as many of the same problems as the proposed revenue-based metrics in *Webcaster II* (*see* 72 FR at 24088-24090), we conclude that the evidence in the record here is that enough difficulties remain with the revenue-based proposals submitted by the parties to determine that it is more reasonable to adopt a usage-based fee structure for the licenses still at issue in this proceeding.

In the instant proceeding, measuring usage is straightforward. Each reproduction of the musical work on a physical CD (or some other older physical format such as cassette tapes or vinyl LPs), a permanent digital download or a digital ringtone counts as a use of the musical work. No proxies need be formulated to establish the number of such reproductions. They are readily calculable as the number of units in transactions between the parties. *See* 2/7/08 Tr. at 2173-4 (Landes). Such ease of calculation with respect to usage was not observed by the Judges in the *SDARS* proceeding.[16] Indeed, in the *SDARS* proceeding, the best the parties could offer were "per play" and "per broadcast" alternatives that were problematic proxies for a usage metric. Adjustments aimed at improving the "per play" and "per broadcast" proposals in that proceeding resulted in additional ambiguities rather than more precision. *See* 73 FR at 4085-4087. In the instant case, measuring the quantity of reproductions presents no such problems. This ease of application offers an efficiency in valuing the rights at issue not available under the percentage of revenue alternatives offered by the parties in this proceeding.

In contrast to the ease of applying a usage metric in this proceeding, some of the difficulties associated with a percentage of revenue approach cited in *Webcaster II* are also discernible in the instant matter. In *Webcaster II*, we concluded that the evidence in the record of that proceeding weighed in favor of a per performance usage fee structure for both commercial and noncommercial webcasters, but we further suggested that, in the absence of some of the more egregious problems noted therein, the use of a revenue-based metric as a proxy for a usage-based metric might be reasonable. *Webcaster II*, 72 FR at 24090. Unfortunately, at least some of the same salient difficulties associated with a percentage of revenue approach in *Webcaster II* appear in this proceeding as well.

[16] In the *SDARS* proceeding, the Judges concluded that: "Indeed, in stark contrast to the record in *Webcaster II*, neither the SDARS nor SoundExchange provided substantial evidence to indicate that a true per performance rate was susceptible of being calculated by the parties to this proceeding. Therefore, we find that a revenue-based measure is currently the most effective proxy for capturing the value of the performance rights at issue here, particularly in the absence of any substantial evidence of how some readily calculable true per performance metric could be applied to the SDARS." 73 FR 4087.

In particular, one of the more intractable problems associated with the revenue-based metrics proposed by the parties in *Webcaster II*, 72 FR at 24090, was the parties' strong disagreement concerning the definition of revenue for certain services. This was further complicated by questions related to applying the same revenue-based metric to noncommercial as well as commercial services. *See Webcaster II*, 72 FR 24094 at n.15. Although the same degree of difficulty is not presented by the applicable facts in this proceeding,[17] yet some similar difficulties remain. For example, even in those cases where opposing parties to this proceeding proposed a revenue-based metric, there were important differences and disagreements related to the definition of revenues in their proposals. *Compare* Copyright Owners PFF at ¶¶ 610, 614-22, Copyright Owners RFF at ¶¶ 667 *and* DiMA PFF at ¶¶ 219-220, 237-9, DiMA RFF at ¶¶ 105, 113-4, DiMA RCL ¶ 39 *and* RIAA PFF at ¶¶ 1603-4, 1620-2, 1628-9, 1632-47, 1650, 1653, 1655, 1663-4, RIAA PCL at ¶¶ 182-3, RIAA RFF at ¶¶ 457, 462-5.

Moreover, while such differences may be surmountable for some formats, in the case of the physical formats and permanent digital downloads that account for the overwhelming bulk of mechanical license use at issue in this proceeding, the parties have until now lived under a penny-rate standard not a revenue-based regime. Therefore, the parties are less familiar with the operation of a revenue-based metric. The value of such familiarity lies in its contribution towards minimizing disputes and, concomitantly, constraining transactions costs.[18] Therefore,

[17] For example, accounting differences between for-profit entities and not-for-profit entities are not an issue in the instant proceeding. Similarly, in contrast to commercial webcasting, identifying relevant user revenues here does not appear to be as complex across the spectrum of potential mechanical license users as doing so for a number of commercial webcasters (such as some simulcasters) who offer features and formats either unrelated to music or who only partially employ music as part of their programming. *See Webcaster II*, 72 FR at 24089.

[18] In addition, auditing and enforcement costs are likely to be lower. Fewer data elements are required to be collected and reviewed under the existing penny-rate system as compared to a revenue-based metric. Copyright Owners PFF at ¶¶ 595-596 and 648.

the absence of such familiarity with respect to the large majority of transactions at issue in this proceeding may well give rise to higher transactions costs, stemming from the greater likelihood of disputes over component definitions of revenue. Continuing the familiar penny-rate system will avoid such disputes.

In addition, some higher costs to Copyright Owners will be avoided by leaving publisher-songwriter contracts structured on a penny-rate system, and not having to modify them to accommodate a revenue-based structure. 5/14/08 Tr. at 6427-37 (Faxon).

RIAA's shrill contention that a penny-rate structure "would be disruptive as consumer prices continue to decline" and should, therefore, be replaced by a percentage rate system in order to satisfy 801(b) policy considerations related to the minimization of disruption (*see*, for example, the RIAA contention summarized in RIAA PFF at ¶ 1478) is not supported by the record of evidence in this proceeding. As the Judges indicated in the *SDARS* proceeding, "disruption" typically refers to an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for the industry participants to adequately adapt to the changed circumstances and, as a consequence, such adverse impacts threaten the viability of the music delivery currently offered under the license in question. *See* 73 FR at 4097. In the instant proceeding RIAA offers no persuasive evidence of a *causal* relationship between any specified past level of record industry revenue shortfalls and the *structure* (as distinguished from the amount) of this one component of industry expenses (as distinguished from several other major cost components) over the same period. Nor does the RIAA offer any persuasive evidence that would in any way quantify any claimed adverse impact on projected future revenues stemming from the continued application of a penny-rate structure over the course of the license period in question.

Then too, RIAA's and DiMA's asserted claims of the relative advantage of their proposed revenue-based structures fail to adequately consider negative impacts on copyright owners. For example, RIAA's claim that a pure percentage rate allows more pricing flexibility than a penny rate appears exaggerated and unfairly ignores the disadvantages of the pure percentage rate for copyright owners. RIAA contends that "With a fixed cents rate, record companies cannot lower their prices below a certain threshold without losing the margin needed to cover their very significant costs." (See this RIAA contention in RIAA PFF at ¶ 1503). Yet the record of evidence in this proceeding does not identify such a threshold, but rather indicates that even under the current penny rate the record companies have been able to reduce prices. *See*, for example, 5/14/08 Tr. at 6425-26 (Faxon); 2/12/08 Tr. at 2683 (Firth); 2/5/08 Tr. at 1666-7 (Peer); 2/14/08 Tr. at 3376, 3379-80 (A. Finkelstein). Record companies may have other costs such as overhead that also could serve as the source for further potential price reductions.[19] Copyright Owners PFF at ¶¶ 422-23. Moreover, this purported business flexibility "advantage" raises serious questions of fairness precisely because the percentage of revenue metric may be a less than fully satisfactory proxy for measuring more usage or the actual intensity of the usage of the rights in question.[20] Copyright Owners RCL at ¶ 132. It is not fair to fail to properly value the

[19] It is also not clear from the record of evidence how much of record company costs savings have been translated into consumer price reductions and how much have been retained by the companies in order to preserve profit margins.

[20] DiMA's offer of a dual minimum penny rate (*i.e.*, with two different minima for stand-alone tracks and bundled tracks) as part of its percentage-based proposal ostensibly aims to mitigate this adverse effect in exchange for less than full flexibility. Thus, the DiMA proposal adds the complexity and costs of multiple measurements, but does not offer persuasive evidence that such costs are reasonably incurred relative to the more modest potential benefits to users (*i.e.*, some price flexibility although less than full flexibility) and owners (*i.e.*, no zero payments for

reproduction rights at issue in this proceeding. Such a result is at odds with the stated policy objective of the statute to afford the copyright owner a fair return for his creative work. 17 U.S.C. 801(b)(1).

At the same time, DiMA contends that the adoption of a percentage rate structure would increase their incentives to invest more in the quality and breadth of their offerings and therefore expand the availability of works to the public consistent with the first of the four policy objectives of 801(b). *See*, for example, DiMA PFF at ¶¶ 216, 219. However, these contentions are related to the amount of revenue (net of the payment of a specific amount of mechanical license fees) that would remain to DiMA members *irrespective* of the structure of the rate. ("But this advantage will be realized *only if the percentage rate is not set so high* (or accompanied by unreasonably high "minima") that it discourages technological experimentation." DiMA PFF at ¶ 216, emphasis added. "A percentage rate can promote technological investment and innovation, and thereby expand the availability of works to the public, *only if the revenue base is not overly broad*." DiMA PFF at ¶ 219, emphasis added.) Therefore, so far as the *structure* of the rate is concerned, there is nothing novel in these additional DiMA contentions that set them apart from the business flexibility arguments previously discussed above and found wanting.

For all of the above reasons, we are persuaded that the penny-rate structure provides a better measure of actual usage than the alternatives proposed by parties in this proceeding and that the application of the penny-rate structure to all the licenses in contention in this proceeding will result in fewer overall transaction cost issues over the course of the license period compared

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use of additional musical work although differential payments for use of same work still possible) flowing from its proposed rate structure.

to the proffered alternatives.[21] While the problems identified above for a revenue-based proxy for usage may be remedied in the future by the parties in light of evolving circumstances, the parties' proposals in this proceeding do not offer a sufficient basis upon which to determine that a revenue-based alternative is a reasonable alternative to the penny rate for the licenses at issue in this proceeding.

C. The Section 115 Royalty Rates

Chapter 8 and Section 115 of the Copyright Act require the Judges to determine reasonable rates and terms of royalty payments for the activities specified by Section 115 of the Copyright Act. 17 U.S.C. 115(c)(3)(C). The rates the Judges establish under Section 115 of the Copyright Act must be calculated to achieve the objectives set forth in Section 801(b)(1)(A) through (D) of that Act. Moreover, in establishing rates and terms under Section 115, the Judges may consider voluntary license agreements described in subparagraphs (B) and (C) of Section 115(c)(3). *See* 17 U.S.C. 115(c)(3)(D).

The parties in the proceeding agree that in determining reasonable rates, market benchmarks can be a useful starting point. RIAA PCL at ¶ 26 (although "royalty rates set in this proceeding need not be market rates...market benchmarks can be a very useful starting point"); Copyright Owners PCL at ¶ 26, quoting SDARS Determination ("determination of a reasonable mechanical rate should 'begin with a consideration and analysis of [marketplace] benchmarks

[21] While both Copyright Owners and RIAA have proposed a revenue-based alternative for compensating ringtones and while some ringtone agreements in the record offer revenue-based compensation as one alternative in a "greater of" formulation, Copyright Owners and RIAA have not shown whether or how those agreements have overcome the hereinabove described problems with the parties' revenue-based proposals. Therefore, in light of the efficiency of administration gained from a single structure when spread over the much larger number of musical works reproduced as physical phonorecords or digital permanent downloads as compared to ringtones and the fact that both Copyright Owners and RIAA have also proposed a penny-rate alternative for ringtones, the Judges determine that a single penny-rate structure is best applied to ringtones as well as physical phonorecords and digital permanent downloads.

and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives' of Section 801(b). [M]arketplace benchmarks are critical to the identification of 'the parameters of a reasonable range of rates within which a particular rate most reflective of the four 801(b) factors can be located.'"); DiMA PCL at ¶ 73 ("[t]he statutory objectives help to determine a 'range of reasonable royalty rates' along with various potential benchmarks from which the Court is free to make a judgment about how best to proceed," *quoting Recording Industry Assoc. of America v. Copyright Royalty Tribunal*, 662 F.2d 1, 9 (D.C. Cir. 1981).

As discussed below, however, the parties disagree about what constitutes the most appropriate benchmark to guide the Judges in determining a reasonable rate. Moreover, the parties do not limit their offer to benchmarks for similar products drawn from a marketplace in which buyers and sellers are similarly situated, but rather offer a variety of negotiated rates, legislated rates, and previously determined rates as proposed benchmarks. These various proffered benchmarks are described and discussed below.

1. Copyright Owners' Proposed Benchmarks

Copyright Owners argue that the most appropriate benchmarks, as proffered by their expert economist, Dr. Landes, are: (1) licenses for mastertones;[22] (2) licenses for synchronization rights; and (3) the royalty structure of the Audio Home Recording Act ("AHRA"). 17 U.S.C.

[22] A ringtone is a digital audio file that is downloaded to a mobile phone or similar portable device to personalize the ring that alerts the consumer to an incoming call or message. Monophonic ringtones contain only a musical work's melody (or a portion of the melody). Polyphonic ringtones contain a musical work's melody and harmony (or a portion thereof). Mastertones are ringtones that are extracted from digital sound recordings. Mastertone sellers must acquire rights to both the musical work and the sound recording. Copyright Owners PFF at ¶ 492. Although the Register has determined that certain ringtones qualify as DPDs as defined in Section 115, "[t]he vast majority of the ringtone and mastertone licenses reviewed by Dr. Landes predated the [Register's] Ringtone Opinion." Copyright Owners PFF at ¶ 492.

1001-1010. These benchmarks are proffered to support royalty rates applicable to several types of uses of the Section 115 compulsory license.

a. Proposed Mastertone Benchmark

With respect to mastertones, economic expert Dr. Landes found that Copyright Owners entered into agreements with two different groups consisting of: (1) third-party sellers of ringtones (*i.e.*, aggregators or cellular telephone companies) and (2) record companies. The agreements with the third-party sellers typically provided for royalty payments for the musical works reproduction at the greater of (1) a per-mastertone penny-rate minimum; (2) a percentage of retail price of the mastertones; or (3) a percentage of gross revenue. Copyright Owners PFF at ¶ 494. The penny rate minimums for such agreements ranged from 10 cents to 25 cents, with an average of 12.5 cents. *Id.* at ¶ 495. Retail price percentages ranged from 10% to 15%, with an average of 10.5%. *Id.* at ¶ 496. Stated gross revenue percentages ranged from 9% to 20%. *Id.* at ¶ 497.[23]

Ringtone agreements between Copyright Owners and record companies have taken the form of either a (1) "New Digital Media Agreement" ("NDMA"), covering, among other rights, the licensing of musical compositions for use in mastertones; or (2) standalone licenses for mastertones only. *Id.* at ¶ 498. The NDMAs specified a tiered royalty rate for mastertones under which record companies agreed to pay a fee equal to the greater of 10 cents, 10% [of the retail price of the mastertone sold], or 20% of the wholesale price of each mastertone sold. Copyright Owners PFF at ¶ 500.

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[23] Dr. Landes reviewed and relied upon nearly 200 third-party agreements from six different music publishers spanning the years 2004, 2005, and 2006. Copyright Owners PFF at ¶ 494. The Copyright Owners proposed no factual findings with respect to the sophistication or lack thereof of the publishers or the third-party sellers.

According to Copyright Owners, mastertones have typically been sold at retail prices of $1.99 or more, and music publishers have therefore been paid on a percentage of revenue rather than the minimum penny rate. Actual payments have ranged from 16 cents to 25 cents per mastertone.[24] Copyright Owners PFF at ¶ 503. Dr. Landes concludes that Copyright Owners typically acquire 20% of the total amount paid for compositions and sound recordings in the mastertone market. Copyright Owners PFF at ¶ 491.

RIAA expert economist Dr. Wildman maintains that the NDMAs provide a blanket license, "which is a significant benefit to record companies because it avoids the complexities and administrative burden of individual license negotiations. In contrast, the compulsory license is a burdensome, song-by-song licensing process with the burdens falling primarily on the record companies." Wildman WRT at ¶ 46. Nevertheless, Copyright Owners represent that standalone mastertone licenses, presumably with record companies rather than third-party sellers, that postdate the NDMAs have identical rates as those contained in the NDMAs. Copyright Owners PFF at ¶ 502.

In addition, prior to the November 2004 execution date for the NDMAs, certain non-record company mastertone sellers obtained mastertone licenses under which the sellers of the mastertones agreed to pay music publishers the greater of 15 cents or 10% of retail revenue per mastertone. Copyright Owners PFF at ¶ 501. However, Copyright Owners contend that the rates in the NDMAs "were consistent" with these earlier agreements. *Id.* They refrain from offering an explanation for the 33% drop in the minimum penny rate from the earlier agreements to the

[24] Dr. Landes stated that one company commonly licenses its recordings for a flat rate, ranging in its agreements from $1.00 to $1.35. Twenty percent of those wholesale rates yields a range of 20 cents to 27 cents per mastertone sold.

NDMAs that could well be due to increased bargaining power of the major record companies compared to the earlier mastertone sellers (*e.g.*, Opera Telecom), the maturing of the mastertone market, or a combination of these and other factors. Without some credible explanation for the differences between the two sets of agreements, we cannot agree with the Copyright Owners' assessment that these rate structures are fully consistent.

Copyright Owners concede that a "relatively small number of songs account for the bulk of mastertone revenue," but contend that the mastertone market mirrors the music industry as a whole, which, according to Copyright Owners, is "hit-driven." Copyright Owners PFF at ¶ 513. Perhaps as a result of these contentions, Copyright Owners offer no adjustment to the proposed mastertone benchmark to align it to the market for CDs or downloads.[25]

While the proposed mastertone benchmark certainly offers valuable rate evidence from the marketplace[26] for one of the types of products covered by the Section 115 license that is the subject of this proceeding (*i.e.*, ringtones), it is much less persuasive when that benchmark is applied to the other products at issue in this proceeding (*i.e.*, CDs and permanent downloads) that are, at best, only in small part similar in nature and ultimate consumer use. For example, although CDs and permanent downloads may be easily perceived as substitutes by consumers, it is unlikely that consumers would regard a CD as a very good substitute for a mastertone or vice-versa. In short, we find that although substantial empirical evidence shows that sound recording

[25] RIAA's expert economist Dr. Wildman contends that not only would an adjustment of the mastertone benchmark be required to align it with the market for CDs and downloads but one would also be required to align the mastertone benchmark with the market for mastertones. *See* Wildman WRT at 44-52 (citing the fact that NDMAs include interdependent rights in addition to mastertone use). Dr. Wildman concludes, however, that the adjustment of the mastertone rate to derive a rate for CDs and downloads "is all but impossible to make...with any real level of confidence." Wildman WRT at 46.

rights are paid similar multiple times the amounts paid for musical works rights in most ringtone markets, that proposed benchmark evidence is far from dispositive of what the *size* of that multiple might be for other types of products such as CDs and permanent downloads.[27] While similar sellers and sometimes even similar buyers might be participants in both the proposed benchmark ringtone market and the target CD and permanent download markets, the benchmark and target markets differ significantly in terms of the ultimate product consumed.

b. Proposed Synch License Benchmark

With respect to synch licenses, Copyright Owners represent that they typically receive one-half of the total licensing fees paid by licensees who wish to use a sound recording in an audiovisual work. Copyright Owners PFF at ¶ 531. To use a sound recording in an audiovisual work, such as a film, television show or commercial, a licensee must obtain a "synchronization" (or "synch") license for the underlying musical composition as well as a "master use" license for the sound recording, neither of which is subject to a compulsory license. Copyright Owners PFF at ¶ 532. Synch licenses and master use licenses typically contain "most favored nation" provisions, which state that if a licensee acquires one of the two necessary rights and subsequently agrees to pay the licensor of the other necessary right more than it paid the first, the

[26] The record of evidence is that mastertones have substantially displaced monophonic and polyphonic ringtones in the current marketplace. Rosen WDT at 5; RIAA Ex. 102-RR at Figure 2.

[27] It is clear from their offer of a range of relative values, bounded on the low end by their ringtone benchmark and on the high end by their synch market benchmark, that even Copyright Owners must recognize that their relative value of music content benchmark evidence varies with the particular benchmark markets they have selected. This is not surprising, given the different use to which the ultimate consumer product in these markets is put and, therefore, given the relative difference in importance that each respective input plays in shaping the nature of the differing output in each of the respective markets in question. In some markets, a specific sound recording by a particular artist is simply more important to the consumers of the ultimate product than in others, so that its relative value compared to that of the underlying musical work is higher than it might be in other markets. This is further underlined by the Copyright Owners' proposals for different shares of content costs varying by product market (*e.g.*, 33% of content costs for ringtones compared to equivalent of 20% for permanent downloads).

licensee will be obligated to increase retroactively the fee paid to the first party. Copyright Owners PFF at ¶ 534. The presence of most favored nation provisions in typical synch license agreements may effectively dictate that the fees paid to music publishers for synch rights walk in lockstep with those paid to record companies for master use rights. *See* Copyright Owners PFF at ¶ 535. Even assuming that the differences in the market for synch rights and that for CDs, downloads, and ringtones could be reconciled, it is difficult to see what useful information could be gleaned about the value of a compulsory license to make and distribute a phonorecord from the relative value of two licenses that a prospective licensee must obtain to use a particular recording in an audio-visual work where obtaining those licenses is predicated on the licensee paying each of the licensors an equal share of royalties.

Copyright Owners represent that there are tens of thousands of synchronization transactions completed each year. *Id.* at ¶ 533. They do not, however, proffer proposed factual findings relating to the percentage of songs recorded in a particular year that might be the subject of a synch license. Moreover, Copyright Owners do not proffer evidence that would allow the Judges to generalize about the relative bargaining power of licensees and licensors in the benchmark market as compared to the target market.

At bottom, the consumer products from which demand is derived for music inputs are clearly not comparable in the proposed benchmark market and the target market.[28] No

[28] *See* Pascucci WRT at 3-4 ("[t]he purpose that music serves when it is licensed for use in movies, television shows and advertisements is fundamentally different from the purpose it serves when used in CDs, downloads and other audio formats . . . While music can serve important purposes in terms of dramatizing a story, setting a mood, creating positive associations with a product, or drawing people's attention, the purpose of the music [in the synch market context] is secondary to that of the larger audio-visual work into which the music is incorporated–and it is that larger work that consumers pay to watch (in the case of a movie) or for which producers and advertisers pay with the hope that consumers will watch (in the case of a television show or advertisement).").

benchmark adjustments are proffered to remedy this shortcoming. Therefore, we do not find the proposed synch license benchmark to be of any meaningful value.

Potential benchmarks are confined to a zone of reasonableness that excludes clearly noncomparable marketplace situations. The musical works inputs in the synch market are used in very different ultimate consumer products by different input buyers as compared to the target market and the input sellers may have different degrees of market power in the benchmark market as compared to the target market. The mere fact a musical work is used as an input in both the proposed benchmark market and the target market is not sufficient to overcome all the aforementioned fundamental differences between the proposed benchmark market and the target market even in a purely relative value analysis. Because of the large degree of its incomparability, the synch market "benchmark" clearly lies outside the "zone of reasonableness" for consideration in this proceeding. Therefore, we find this particular benchmark cannot serve as a starting point for the 801(b) analysis that must be undertaken in this proceeding.

c. The Audio Home Recording Act

Dr. Landes also offered a third benchmark—the royalty structure from the Audio Home Recording Act ("AHRA"). 17 U.S.C. 1001-1010. Under the AHRA, royalties payable by manufacturers of digital recording devices are divided as follows: one-third for the "Musical Works Funds" and two-thirds for the "Sound Recording Fund." Copyright Owners contend that this royalty allocation "provides corroboration of the relative value of the rights to musical compositions and sound recordings through the statute's division of royalties from the sale of digital audio recorders." Copyright Owners PFF at ¶ 490. According to Copyright Owners, the AHRA was "spurred by concerns within the music industry that new digital recording devices would permit consumers to easily make high-quality digital copies of music, adversely affecting the market for audio recordings." Copyright Owners PFF at ¶ 541.

Dr. Landes concedes that the AHRA "is not strictly the result of a voluntary exchange in a competitive market," rather, "it reflects the outcome of a compromise among competing interest groups in the legislative context." Copyright Owners PFF at ¶ 542. Nevertheless, Dr. Landes contends that the AHRA rate structure "provides evidence of the relative value of copyrighted songs and sound recordings." *Id.*

Although the AHRA refers to the payments required under the act as "royalties," they are, we conclude, in no material respect comparable to the payments prospective licensees of copyrighted musical works agree to pay to obtain a license to make and distribute those works. Rather, the AHRA payments are legislative assessments imposed on the manufacturers of digital audio recording devices and media to partially offset potential lost revenues that the copyright owners and record companies may suffer as a result of unlicensed copies of sound recordings facilitated by those recording devices and media. Congress determined that a certain percentage of those assessments should be allocated to musical works and a certain percentage to sound recordings. We cannot conclude on the record before us that Congress intended its allocation of AHRA assessments to reflect in any respect its view of the relative value of musical works *vis-à-vis* sound recordings. Nor can we conclude that such an assessment would reasonably reflect market conditions today for comparable products, which is the essence of a benchmark analysis. In the absence of such evidence, we do not find this proffered "benchmark" particularly relevant to the task at hand.

2. RIAA and DiMA Proposed Benchmarks

RIAA contends that a number of "benchmarks" are most relevant to our determination, including: (1) several types of "average effective mechanical royalty rates" as calculated by their economics expert Dr. Wildman; (2) certain mechanical rates applicable in other countries; and (3) an analysis of historical norms by their economic expert Dr. Teece. DiMA also argues, together with RIAA, that certain mechanical rates applicable in other countries provide a useful benchmark for the licenses at issue in this proceeding.

a. Effective Mechanical Rate Data

RIAA argues that the most appropriate "benchmark",[29] as proffered by their economics expert, Dr. Wildman, is derived by analyzing the overall average effective mechanical rate, compared to what would be paid if all mechanicals were paid at the statutory rate. Dr. Wildman further supplements this analysis by examining (1) what is paid for first uses of songs (as opposed to a subsequent use of a song that has previously been released), which are not subject to the compulsory license; and (2) the mechanical royalty rates paid for first uses to certain non-singer songwriters who agree to rates that are not part of some broader agreement like those containing controlled composition clauses for singer-songwriters.[30] Wildman WRT at 5-6; 42-

[29] Although RIAA indicated in their final oral argument that their primary "benchmark" was the average effective royalty rate in the free market (*see* 7/24/08 Tr. at 7864 (Smith, Closing Oral Argument for RIAA)), it is not clear that Dr. Wildman was affirmatively offering such a "benchmark." First, Dr. Wildman testified only as a rebuttal witness and, in the context of criticizing Dr. Landes' choice of benchmarks, presented evidence that he indicated cast doubt on the accuracy of Dr. Landes' benchmarks. *See* Wildman WRT at 30. Second, in his rebuttal testimony, Dr. Wildman opined that for benchmarks to be useful, they must satisfy three specific criteria. Wildman WRT at 3. Dr. Wildman then not only found Dr. Landes' benchmarks wanting with respect to these three criteria (*see*, for example, Wildman WRT at 3-4), but also appeared to indicate that his own evidence failed to meet these three criteria (*see* 5/12/08 Tr. at 5881). Nevertheless, irrespective of whether they meet Dr. Wildman's criteria for a benchmark, we find that Dr. Wildman's various summaries of mechanical license data do provide some limited information relevant to our inquiry. Inasmuch as both RIAA as well as Copyright Owners refer to these data as "benchmarks" in their arguments, we adopt their label as a convention in this determination.

[30] Controlled composition clauses reduce the royalty rate that a copyright user is willing to pay a songwriter who is also a performer. A typical controlled composition clause would place a percentage cap on the amount of mechanical royalties that a record company would be willing to pay to a songwriter/performer (*i.e.*, a cap of 75% of

43. According to Dr. Wildman, an examination of all three data sets lead to the conclusion that the market rate for mechanicals on CDs and digital downloads is between 5.25 cents and 7.8 cents per track, or about 7.25% to10.08% of wholesale revenues. *Id.* at 6.

Dr. Wildman based his analysis of potential benchmarks on mechanical royalty data he received from three major record companies: SONY BMG ("SONY"), Warner Music Group ("WMG"), and Universal Music Group ("UMG"). *Id.* at 35. As a preliminary matter, the data from the record companies was limited to mechanical royalties negotiated and paid on one quarter of one fiscal year's releases, including data on which releases involved agreements by singer-songwriters to receive reduced royalties, which releases involved co-writers who had agreed to write songs for reduced rates, and which individual tracks were first uses (and thus not subject to the compulsory license). *Id.* In short, the analysis was based on data from only three record companies and only for a single quarter. Indeed, the data from one of the record companies, UMG, was not even from the same quarter as that from the others.[31] Moreover, Dr. Wildman conceded that the data he received from UMG had limited usefulness since UMG does not separately break out situations in which co-writers agreed to write songs at reduced rates because of similar restrictions that apply to their companion songwriter. *Id.* at 36. Dr. Wildman also limited his analysis to rates for physical rather than digital products. In sum, Dr. Wildman himself conceded that his data set was less than ideal. 5/12/08 Tr. at 5850-51 (Wildman).

Based on this limited data set, Dr. Wildman concluded that the average effective per track

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the statutory rate). A typical controlled composition clause might also reduce the amount of mechanical royalties that a record company would be willing to pay a songwriter/performer by limiting the number of album tracks upon which the company would be willing to pay mechanicals (e.g., a 10-track limit on mechanical royalties).

[31] For SONY and WMG, the data was from the third quarter of 2006. For UMG, it was from the fourth quarter of 2007. 5/12/08 Tr. at 5844.

rates for mechanical royalties for physical products paid by the three record companies ranged from [REDACTED] for WMG to [REDACTED] for UMG. Wildman WRT at 37-38. However, there are substantial unexplained differences in the average effective rates he obtains from his analysis of the data both as between different companies (UMG mean [REDACTED] than WMG mean) and also as between results obtained from different data sources for the same companies (e.g. 7.42 cents mean for SONY from publisher data as compared to [REDACTED] for SONY from record company data). Even the direction of the latter difference is not consistent for the two companies for which Dr. Wildman presents publisher data. Wildman WRT at 37-39; 5/12/2006 Tr. at 5850-1 (Wildman). Dr. Wildman acknowledges that the agreements he analyzed were negotiated in an environment where the statutory rate is 9.1 cents, which, Copyright Owners contend is a ceiling above which the record companies will not pay.[32] Dr. Wildman also acknowledged the presence in the agreements of so-called "controlled composition clauses."

Dr. Wildman analyzed just that portion of the agreements that involved the first use of sound recordings, which are not subject to the compulsory mechanical royalty rate, but which may include controlled composition clauses. The average effective per track rates were [REDACTED] for SONY, [REDACTED] for WMG, and [REDACTED] for UMG. Wildman

[32] Under this argument, made by Dr. Landes and others, recording companies have no incentive to pay above the compulsory royalty rate in a voluntary agreement because they can always pay the compulsory rate if they are willing to comply with the compulsory licensing process. *See*, for example, Landes WRT at 39. The evidence in the record suggests that most are not. *See*, for example, Tr. 2/14/08 at 3325-6 (A. Finkelstein). RIAA's expert economist supplies another view of the compulsory license process compared to that offered by Dr. Landes. *See* Wildman WDT at 31 and n.39 ("[a]s witnesses for both record companies and music publishers have explained, essentially no one uses the compulsory license process—licenses for mechanical royalties for sales of sound recordings are negotiated in the market on a voluntary basis….The fact that they enter into voluntary agreements is not itself evidence that transaction costs [in such agreements] are low. It simply means that the transaction costs of voluntary agreements are lower than those associated with using the compulsory license….").

WRT at 42. In addition, Dr. Wildman further analyzed first use agreements involving ostensibly only "pure" songwriters (*i.e.*, not singer-songwriters) or "co-writers who had agreed to controlled rates and all individuals not subject to a controlled composition clause at all." Wildman WRT at 43. The per track average effective rate for this latter group was [REDACTED] for SONY and [REDACTED] for WMG. (UMG data did not permit such an analysis). Wildman WDT at 43-44. Yet, these two more limited (in scope of coverage) supplemental analyses do not serve to provide substantial corroboration for Dr. Wildman's initial broader effective rate analysis. Looked at on a company-by-company basis, each data base cut produces a substantially different result for the same company and a different rank order for the companies analyzed. These differences are not explained. Moreover, Dr. Wildman admits that his regression analysis of the first use data provides very little explanatory power for the variation in the effective rate obtained for WMG and UMG and, even in the best case, leaves over half the variation in the effective rate obtained for SONY unexplained. 5/12/2008 Tr. 5853-4 (Wildman).

Even viewed in the best light, Dr. Wildman's overall effective rate analysis is simply no more than a "starting point" as he himself cautions. 5/12/08 Tr. 5881 (Wildman). It makes no adjustment for the impact of controlled composition clauses that reflect trade-offs between the various elements of an artist contract that may cover rights and forms of compensation well beyond the mechanical rights addressed by the clause. Copyright Owners PFF at ¶¶ 686-7. As briefly noted hereinbefore, the effective rates derived by Dr. Wildman also suffer from empirical shortcomings. Therefore, we decline to assign the weight necessary to Dr. Wildman's effective rate analysis to view it as a useful specific benchmark. However, given the absence of any more substantial or better evidence in the record of a lower rate, the Wildman overall effective rate data can help to identify the low-end limits for reasonable rates in this proceeding. Therefore, we conclude that the effective rate data submitted by Dr. Wildman show only that a reasonable rate for the mechanical license for CDs and permanent downloads could not be lower than the range indicated by his broadest effective rate data set (*i.e.*, 5.88 cents to 7.68 cents per song).

Dr. Wildman does not offer an independent benchmark that would apply specifically to ringtones. Rather, he proffers an adjustment to Dr. Landes' mastertone benchmark that Dr. Wildman contends would yield a reasonable rate for ringtones of between 14.5% to 20% of the wholesale price of ringtones. *See* Wildman WRT at 53. Although he does not elaborate, the upper end of the 14.5% to 20% of wholesale range would yield a penny rate of 25 cents based on his assumed wholesale price of $1.25. The lower boundary of his estimate is based on a "surplus" analysis that assumes a sharing of "surplus" revenues in the same proportion as would occur in the CD and permanent download market--assuming that the results of his previously discussed effective rate analysis were deemed to be accurate. However, given the shortcomings of his effective rate analysis and his own strong cautions against assuming that the mastertone market is comparable to the CD and permanent download market absent numerous other quantifiable adjustments (*see* Wildman WRT at 46), this attempt at bootstrapping falls flat. In addition, there are serious questions concerning the adequacy of Dr. Wildman's assumptions concerning his treatment of costs. Copyright Owners RFF at ¶¶ 422-5. In short, questionable assumptions coupled with concerns over the reliability of the data used in the Wildman effective rate analysis cause us to regard the findings of Dr. Wildman's "surplus" analysis as carrying little, if any, weight.

b. 1981 CRT Decision and Historical Norms

RIAA also invites the Judges to consider in setting a rate the approach taken by the Copyright Royalty Tribunal ("CRT") in the 1981 Section 115 determination, as characterized by RIAA's expert economist, Dr. David Teece.[33] According to Dr. Teece, the best place to begin the rate analysis should be to use the 1981 CRT decision "as a starting point and [adjust it] for changes in the industry over the interim period." Teece WDT at 76. In other words, Dr. Teece recommends that the 1981 rate, adjusted to reflect its relative value in terms of today's average retail CD prices, should be adopted by the Judges as a benchmark and then further adjusted downward by an unspecified amount in order to reflect a consideration of changed circumstances[34] over the past 25 years in the 801(b) factors. In the alternative, Dr. Teece suggests adjusting the 1997 industry settlement rate by the percent change in the wholesale CD price since 1998.

Dr. Teece contends that following the 1981 CRT decision would produce a rate today of 7.8% of wholesale, which should then be adjusted downward to bring it into accordance with the Section 801(b) factors. Teece WDT at 81. In the alternative, adjusting forward from the initial 1997 industry settlement rate would produce a rate today of 7.6% of wholesale. Teece WDT at

[33] *See Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, Copyright Royalty Tribunal Docket No. 80-2, 46 FR 10466 (Feb. 3, 1981).

[34] For example, Dr. Teece explained that the record industry now confronts significant and sustained business challenges, such as the spread of piracy and the advent of new digital distribution challenges that were not present when the CRT raised the mechanical royalty rates in the 1981 proceeding. Dr. Teece contends that almost every financial indicator of the record companies' financial position has worsened from that described by the CRT in its 1981 decision. Teece WDT at 79-80. However, Dr. Teece failed to adequately consider whether financial measures such as revenue generation were of greater or lesser significance than company profitability as the industry's structure has changed. Similarly, Dr. Teece fails to adequately inquire as to whether any impact of changed industry circumstances or changed profitability has greater or lesser significance for that substantial portion of the industry where record companies and publishers are units of the same parent company as compared to standalone record companies and publishers.

113.

We do not find that either the 1981 CRT rate or the basis of the 1997 industry settlement is useful as a benchmark. Both the 1981 CRT decision and the 1997 settlement reflect a view of the product market that has changed substantially relative to the types of products and the modes of product distribution modes available today. Moreover, both the 1981 CRT rate as well as the 1997 industry settlement explicitly or implicitly incorporated the equivalent of some or all the 801(b) factor analysis. Although the Judges acknowledge that the financial condition of the industry, including the potential impact of piracy, can properly play a role in considering whether an adjustment is necessary to a particular benchmark, such considerations, in and of themselves, do not form the basis of a useful benchmark. Therefore, we find that neither of Dr. Teece's proffered "benchmarks" provide sufficient comparability to offer a useful yardstick by which to gauge prices in today's markets, and we defer further discussion of the condition of the industry until our consideration of the Section 801(b) factors below.

c. Foreign Mechanical Rates

DiMA contends that the most useful benchmark in the record is the license agreement reached in the United Kingdom for 8% of retail revenue plus applicable minima, which includes the reproduction, distribution and public performance of musical works by digital music services. This benchmark, according to DiMA, represents an "upper bound estimate for a reasonable rate in this proceeding." DiMA PCL ¶ 77. This benchmark was proffered by DiMA economics expert Ms. Guerin-Calvert. In addition to also proffering the U.K. mechanical rates as a benchmark, RIAA suggests that both Japanese and Canadian rates are also relevant, although the bulk of the evidence presented by RIAA also related to the U.K. mechanical rates. RIAA, while agreeing with the 8% of retail price cited by DiMA, notes that the rate is set at 8% of retail price less 17.5% Value Added Tax ("VAT"). RIAA PFF at ¶¶ 729, 731. The RIAA presents further adjustments to arrive at a wholesale price equivalent of 7.7% (*see* RIAA PFF at ¶ 740), which may rise to as much as 11.1% of wholesale (or approximately 8.0 cents) depending on the amount of discounting from the Published Price to Dealer ("PPD") assumed for the U.K. in order to translate the U.K. rate to an actual wholesale price received by record companies in the U.S. (*see* RIAA RFF at ¶ 123).

DiMA and RIAA contend that the rates adopted in the U.K. settlements should serve as a useful benchmark because they claim those rates involve comparable markets,[35] comparable parties[36] and a comparable basket of rights (*i.e.*, mechanical rights for permanent downloads). *See,* for example, DiMA PFF at ¶¶ 316-320 and RIAA PFF at ¶¶ 316-320.

In reply, Copyright Owners object to the comparability of the foreign rates on, among other grounds, that: (1) the percentages presented are not applied consistently to the same revenue base (Copyright Owners RFF at ¶¶ 597-601); and (2) the various foreign percentage rates may translate into higher actual revenue for copyright owners than they currently receive in the U.S. because of exchange rate differences (Copyright Owners RFF at ¶¶ 601-3). The Copyright Owners' objections related to revenue base calculation may not fully capture the range of problems surrounding this issue. For example, the revenue base for the foreign rates is also

[35] DiMA and RIAA contend that there are a number of similarities between the recorded music industries and markets in the two countries (e.g., both have "extremely significant record markets;" invest heavily in A&R (artist and repertoire), marketing and promotion, and in developing an online music market while battling piracy; and are international in focus). DiMA PFF at ¶¶ 316-318, RIAA PFF at ¶¶ 705-715.

[36] For example, DiMA states that the U.K. settlements resolved licensing rate disputes among the British Phonographic Industry Limited (a record company trade association whose members include the major record

subject to differing tax structures in the U.S. as compared to the U.K., adding to the difficulties of translating the U.K. benchmark into a U.S. equivalent benchmark.[37]

While the Copyright Owners' objections to the foreign rate benchmark noted hereinabove have merit, they serve to underline the greater concern that comparability is a much more complex undertaking in an international setting than in a domestic one. There are a myriad of potential structural and regulatory differences whose impact has to be addressed in order to produce a meaningful comparison. For example, the fact that the record industry in the U.K. does not employ controlled composition clauses needs to be carefully weighed in seeking to extend the proposed benchmark to physical product subject to such clauses in this country. Copyright Owners PFF at ¶ 713. Similarly, even if the foreign benchmark were purely a product of a negotiated settlement between similar types of parties, it is hard to imagine that such parties would structure their settlement to encompass not only the U.K. copyright regime and U.K. industry considerations but to simultaneously encompass the U.S. copyright regime and U.S.

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labels), the Mechanical-Copyright Protection Society Limited (which distributes royalties to the owners of mechanical rights), and digital distributors such as iTunes, Napster and MusicNet. *Id.* at ¶ 319.

[37] To underscore this difficulty in making a comparison of rates across countries, one only need examine the difficulty RIAA's witness has in explaining the tax structure in the U.K. 2/12/08 Tr. 2771-2 (Taylor):

CHIEF JUDGE SLEDGE: I hate to interrupt. On page 12, before you leave that chart, the rates exclude the value added tax. What is the amount of that?

THE WITNESS: That is 17-1/2 percent, Your Honor, in the U.K.

BY MR. SMITH: Q. Now, on--

CHIEF JUDGE SLEDGE: And--17-1/2 percent of what?

THE WITNESS: It's charged--I'm not a tax expert, Your Honor, but it's actually more complicated than being charged on the retail price. I think you have to do some complicated calculation of 117.5 percent of something. I'm sorry. I can't explain it very well, but essentially it's 17-1/2 percent of the retail price, but it's calculated not by taking 17-1/2 percent of the retail price and adding it. It's slightly more complicated than that.

industry considerations. To the extent such parties fail to do so and differences exist, a comparison between such foreign rates becomes less probative for benchmark purposes. We find, that on the record before us, the full range of comparability issues has not been sufficiently analyzed and presented to permit us to use the foreign rates presented as a benchmark for the target U.S. markets in question in this proceeding.

3. Conclusions With Respect To Benchmarks

Based on the evidence before us, we conclude that no single benchmark offered in evidence is wholly satisfactory with respect to all of the products for which we must set rates.

As previously noted, the proposed mastertone benchmark certainly offers valuable rate evidence from the marketplace for one of the types of products covered by the Section 115 license that is the subject of this proceeding (*i.e.*, ringtones). The mastertone benchmark yields a rate of 20% of wholesale which if applied to the $1.20 wholesale price of a ringtone suggested by RIAA in their penny rate proposal (*see* RIAA Second Amended Rate Proposal, July 2, 2008, at 1-6),[38] produces a penny-rate equivalent of 24 cents. However, the mastertone benchmark carries little weight when it is applied to the other products at issue in this proceeding (*i.e.*, CDs and permanent downloads) that are, at best, only in small part similar in nature and ultimate consumer use.

Also as noted hereinbefore, because the effective rates derived by Dr. Wildman suffer from analytical and empirical shortcomings, we decline to employ the results of his analysis as a specific benchmark for CDs and permanent downloads. Rather, we conclude that the effective rate data submitted by Dr. Wildman show only that a reasonable rate for the mechanical license for CDs and permanent downloads could not be lower than the range indicated by his overall effective rate data set, or 5.88 cents to 7.68 cents per song or track. Moreover, since this proffered benchmark was based only on physical product data and was offered only as a benchmark for CDs and permanent downloads, we decline to assign little, if any, weight to the Wildman effective rate data set in determining the rate for such a different product as ringtones.

In sum, the usable evidence with respect to rate comparables offered by the parties supports the determination of the parameters of a zone of reasonableness. Based on the record of evidence in this proceeding, we have determined that the 20% rate (or 24 cent penny-rate equivalent) identified hereinabove marks the upper boundary for a zone of reasonableness for potential marketplace benchmarks. We have also determined that potential marketplace benchmarks cannot be less than somewhere between 5.88 cents and 7.68 cents. However, neither of these two pieces of evidence offers a specific benchmark for all the products at issue in this proceeding in terms of comparability. Rather we find that the upper boundary serves as a good benchmark for ringtones, but only carries small weight as a benchmark for CDs and permanent downloads. On the other hand, with respect to CDs and permanent downloads, some rate closer to the lower boundary carries more weight than one closer to the upper boundary in terms of comparability, but, given the previously noted analytical and empirical shortcomings of Dr. Wildman's effective rate analysis, we are not persuaded that the existing 9.1 cent rate for such products, now in effect for nearly three years, is too high or inappropriate. We now turn to the 801(b) policy considerations to determine the extent to which those policy considerations weigh in the same direction or a different direction as the benchmark evidence hereinbefore reviewed.

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[38] This wholesale price is consistent with Mr. Benson's testimony concerning a wholesale price for

4. The Section 801(b) Factors

Section 801(b)(1) of the Copyright Act states, among other things, that the rates that the Judges establish under Section 115 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 markets for creative expression and media for their communication; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practice. 17 U.S.C. 801(b)(1). In the *SDARS* proceeding, we stated that "the issue at hand [in analyzing the Section 801(b) factors] is whether these policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence." *See* 73 FR at 4094. In the current proceeding, we have found that only one applicable benchmark, the mastertone benchmark proffered by Dr. Landes, serves as a relevant reference point for determining a mechanical royalty rate, but only for ringtones. For CDs and permanent downloads, we find that the proffered benchmarks lead only to the conclusion that the existing statutory rate[39] is neither too high nor too low or otherwise inappropriate. Our analysis of the Section 801(b) objectives, discussed below, leads us to further conclude that the available evidence submitted by the parties

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ringtones in 2006 of $1.21. Benson WRT at 22.

[39] The current rate for physical products and permanent downloads is 9.1 cents per track or 1.75 cents per minute of playing time or fraction thereof. This rate, reached in a settlement between RIAA, NMPA and SGA, and adopted by the Librarian, has been in effect since January 1, 2006.

related to these policy objectives does not reasonably weigh in favor of any further adjustments beyond establishing a 24 cent statutory rate for ringtones and the maintenance of the existing previously negotiated 9.1 cent rate for CDs and permanent downloads without any add-on to account for general inflation during the license period.

a. Maximize Availability of Creative Works

The various arguments of the parties ultimately reduce to a question of whether their respective incentives with respect to this policy objective will be adversely impacted by the rates adopted in this proceeding.

Copyright Owners' argument with respect to this objective is that songwriters and music publishers rely on mechanical royalties and both have suffered from the decline in mechanical income. *See* Copyright Owners PFF at ¶ 343. Under the current rate, they contend, songwriters have difficulty supporting themselves and their families. As one songwriter witness explained, "the vast majority of professional songwriters live a perilous existence." Carnes WDT at 3. We acknowledge that the songwriting occupation is financially tenuous for many songwriters. However, the reasons for this are many and include the ability of a songwriter to continue to generate revenue-producing songs, competing obligations both professional and personal, the current structure of the music industry, and piracy. The mechanical rates alone neither can nor should seek to address all of these issues. We find no persuasive evidence in the record to support the notion that the current mechanical royalty rates are leading to a shortage of musical compositions. Furthermore, while we acknowledge that the mechanical royalty rate is an important source of income for songwriters, we find no persuasive evidence in the record that an undiminished nominal[40] mechanical rate will fail to ensure adequate incentives for songwriters and publishers over the course of the license period in question.

RIAA for its part contends that this policy objective is only satisfied to the extent that the mechanical rate levels provide sufficient incentives for record companies to make sound recordings out of the musical works provided by the songwriters because, they contend, it is only through these sound recordings that the musical works reach the consuming public. *See*, for example, RIAA PCL at ¶ 69. RIAA argues that in light of declining industry revenues from the sale of physical products, the mechanical royalty rate must be lowered so as to provide record companies with sufficient cost reductions and, thereby, sufficient incentives to continue to make sound recordings available to the same degree. *See*, for example, RIAA RFF at ¶ 349. However, Copyright Owners respond that: (1) record company declining album sales in recent years have not been shown to be the result of the current mechanical rate and, indeed, Dr. Teece, RIAA's own economic expert, attributes the decline to a "whole set of demand-related phenomena" rather than only the size of mechanical royalties; and (2) notwithstanding this recent decline in physical product revenues, other product lines have grown and the record companies continue to enjoy profitability. *See* Copyright Owners RFF at ¶¶ 85-86 and 147. While the recording industry's physical product revenues have declined in recent years, the reasons for this decline are many and include, but are not limited to, various management and business planning decisions made by individual record companies, shifts in the modes of music distribution, and piracy. We find no persuasive evidence in the record to support the notion that the current mechanical royalty rates are substantially responsible for, let alone are the direct and sole reason

[40] We employ the term "nominal" only to connote that the rate in question is stated in current dollars.

for, any espoused contraction in the overall number of sound recordings reaching the public. Similarly, there is no persuasive case made in the record that reducing the nominal mechanical rate will positively impact sound recording production and distribution. Nor does the record before us even persuasively indicate that a reduction in this one specific nominal royalty rate is the only cost cutting solution available.[41] In other words, we find that the record of evidence does not support the notion that an undiminished nominal mechanical rate will reduce record company incentives over the course of the license period in question.

At the same time, in an environment where overall industry revenues are declining, any increase in the nominal mechanical rates to reflect general inflation should be reasonably justified. Because the Copyright Owners' general inflation adjustment is neither specific as to timing or frequency (*see* 7/24/08 Tr. at 7791-2, Cohen Closing Argument for Copyright Owners) nor supported by any persuasive rationale justifying such an adjustment (RIAA RFF at ¶¶ 479-81; *see also* DiMA PFF at ¶¶ 259-60), we find no reason to increase these nominal rates to reflect changes in the general level of inflation.

DiMA contends that this policy objective is best satisfied by lowering mechanical royalty rates to encourage companies, such as DiMA members, that make musical works available to the public through digital distribution. DiMA PCL at ¶ 34. But DiMA's focus is a narrow one which excludes consideration of the impact of its proposals on the overall supply of sound recordings through both physical and electronic distribution modes. It fails to adequately consider and measure the substitution effects of changes in the price of only one mode of distribution. Therefore, we are not persuaded that lowering the nominal cost for a single input

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[41] For example, the record companies may well be able to make reductions in overhead costs which remain substantial despite restructuring efforts. *See* Copyright Owners RFF at ¶¶ 131-3.

used in a single mode of distribution will call forth even greater *overall* growth in the production and distribution of sound recordings.[42] Moreover, even with respect to the limited scope of its concerns, DiMA offers no specific empirical evidence such as demand elasticities or persuasive consumer surveys to support the cause-and-effect results which it postulates. While we agree that digital distribution of musical recordings, such as that provided through DiMA members like Apple's iTunes, provides an important avenue for enhancing the public's access to creative works, we find no persuasive evidence in the record that simply lowering the mechanical rates, as DiMA has proposed, will necessarily increase the public's access to those creative works. Indeed, as noted hereinbefore, digital distribution has grown considerably while the current mechanical rates have been in place.

We find that the current nominal statutory mechanical rates for physical products and permanent downloads as well as the current market nominal rates for ringtones as reflected by the Landes benchmark, on balance, will address each of the issues stressed by the parties and should help to maximize the availability of creative works to the public. In other words, the policy goal of maximizing the availability of creative works to the public is reasonably reflected in these current nominal rates and, therefore, no further adjustment is warranted.

b. Afford Fair Return/Fair Income Under Existing Market Conditions

With respect to this policy objective, Copyright Owners contend that "[w]hereas the record companies can ensure themselves a fair return through their pricing policies, a songwriter has no such option, because the right of songwriters and music publishers to earn a fair return depends upon the availability of a sufficient statutory rate of return." Copyright Owners PCL at ¶

[42] Dr. Landes also points out that setting a low rate simply to favor one mode of distribution may lead to market distortions of a type that may not be justifiable economically. Landes WRT at 18.

81, citation omitted.

Copyright Owners further contend that:

> [S]ubstantial evidence adduced at trial shows that record company profitability has been increasing due to streamlining of the physical business and improved margins on digital sales, which have relieved the record companies of substantial manufacturing, distribution and returns expense. Record companies have also identified, and have begun to exploit, other new revenue streams through "360 contracts," synchronization deals and performing rights royalty collections. The economics of digital distribution should lead to even greater profitability as the share of digital sales continues to grow.

Copyright Owners PCL at ¶ 89.

Copyright Owners also contend that "[t]he record shows that iTunes, the dominant seller of permanent downloads, is profitable and would continue to be profitable if the 15 cent permanent download rate [proposed by the Copyright Owners] were adopted, whether or not Apple absorbs the cost." *Id.* Copyright Owners further assert that "[t]he evidence also shows that there has been substantial new entry into the permanent download business and DiMA has not established that new entrants would be precluded from entering the business, and thriving in it, by the Copyright Owners' proposed rate." *Id.*

For its part, RIAA contends that, in analyzing this policy objective, the Judges must consider existing economic conditions, which, RIAA asserts "means a period in which record companies have faced and continue to face enormous challenges, in which consumers are willing to pay less and less for CDs, the prices of digital downloads are stagnant or softening and the prices of ringtones are falling, and in which publishers are making healthy profits far beyond a reasonable risk-adjusted return on capital." RIAA PCL at ¶ 80. On this latter point, RIAA further contends that "The result of the current system is that music publishers generate bloated profit margins and record companies and songwriters each bear the brunt." RIAA PCL at ¶ 96.

DiMA proposes that, in analyzing this policy objective, we also consider the impact of piracy on the music industry and the role that digital music services play as "the most important bulwark against piracy." DiMA PCL at ¶ 41.

In addressing this policy objective, we have analyzed the myriad of forces that are currently at play in the music industry. These include, as discussed above, falling sales of CDs and the commensurate impact that such decreases have had on record companies as well as on the copyright owners. We have also considered the rising importance to record companies and copyright owners of revenues from downloads and from mastertones. Then too, we have examined the record evidence regarding the role that piracy has played in the industry. In this latter context, we have analyzed the available evidence on the costs that record labels and publishers have incurred in battling piracy, whether through legal action or through changes in business models. We have also examined the role that new services, such as iTunes, may have played in channeling consumers toward legal sources of sound recordings. In addition, in determining reasonable mechanical rates, we considered evidence that there is little if any actual current use of the Section 115 statutory license even when an identical rate is agreed upon by users and owners.[43] Then too, we have considered that a significant portion of the mechanical royalties that songwriters earn, in those instances where the songwriter is not also the publisher, ultimately is paid to music publishers, including some that are affiliated with the record companies themselves. We also considered the relative contribution that music publishers make to the process.

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[43] *See*, for example, 2/14/2008 Tr. 3325-6 (A. Finkelstein).

Viewing the totality of the evidence on this policy objective, we find that Copyright Owners have not provided sufficient evidence to establish that songwriters or publishers, under existing market conditions, will fail to receive a fair return for the artists' creative works as a result of the adoption of a 24 cent statutory rate for ringtones based on marketplace evidence and the maintenance of the existing statutory 9.1 cent rate for CDs and permanent downloads. Nor do we find that RIAA or DiMA have provided sufficient evidence that would establish that their income, under existing economic conditions, would be unfairly constrained by adopting these rates. In short, we do not find that the evidence in the record supports any further adjustment to these in order to achieve this policy objective.

c. Reflect Relative Roles of Copyright Owner and Copyright Users

This policy objective requires that the rates we adopt 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 markets for creative expression and media for their communication. In this connection, the Copyright Owners emphasize the songwriters' efforts in writing the creative work, the publishers' efforts in supporting the songwriters, both financially through advances, and professionally by introducing them to co-writers.[44] Not surprisingly, RIAA emphasized the record companies' efforts in identifying promising artists, financing sound

[44] Copyright Owners maintain that "the songwriter is the provider of an essential input to the phonorecord: The song itself." Copyright Owners PCL at ¶ 91, *quoting* the 1981 CRT decision, 46 FR at 10480. Copyright Owners further contend that "the overwhelming weight of the evidence established that music publishers—both majors and independents—are responsible for discovering and developing songwriters and then assisting them in sharing their creativity with the public. This requires significant financial investments and involves substantial risk. Publishers provide advances to songwriters, which typically constitute a large percentage of the publishers' yearly expenses. In addition, the success rate of songwriters is very low. Thus, the recoupment rates of publishers are low, and yearly write-offs are high." Copyright Owners PCL at ¶ 94.

recordings, promoting and distributing the songwriters' creative works.[45] Finally, DiMA emphasized the contribution digital distribution companies make, both through technological innovation, and through capital expenditure in developing and nurturing new avenues for the commercial exploitation of the artists' works.[46]

Upon a careful weighing of the evidence submitted by the parties, we find that the current market indicated rate for ringtones and the current statutory rate for physical product and permanent downloads require no further adjustment arising from a consideration of this policy factor. Stripped of the considerable hyperbole attached to the evidentiary interpretations offered by the parties' advocates, no persuasive evidence of substantial change in the balance of the contributions made by the parties appears to necessitate against the unadjusted continuation of these previously negotiated nominal rates over the course of the license period.

d. Minimize Disruptive Impact

In the *SDARS* proceeding, we noted that a new mechanical royalty rate may be considered

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[45] RIAA also asks that we consider that "[t]he record companies' business model is changing radically and they are facing declining sales and revenues, while at the same time the music publishers are facing much less difficult economic times." *Id.* at ¶ 101. RIAA also asserts that "the impact of investment by record companies on other revenue streams of the music publishers is highly relevant to the risks that each party faces. Where, as here, expenditures of the record companies on the creation, marketing, and distribution of sound recordings actually facilitate and promote other revenue streams of the music publishers (such as synchronization and performance revenues), that promotion reduces the risk faced by songwriters and music publishers." *Id.* at ¶ 103. Finally, RIAA contends that "record companies make all of the investments to create sound recordings, market and distribute them, and are essentially the sole (and certainly the primary) outlet for musical works." *Id.* at ¶ 104.

[46] According to DiMA, "[d]igital music distributors play a most important role relative to 'technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communications.'" DiMA PCL at ¶ 52. They do this, DiMA contends, by offering "millions of songs in comprehensive catalogs through simple-to-use and elegant web sites that allow for easy browsing, as well as powerful search and cataloging tools…[and] compelling editorial content." *Id.* at ¶ 53. In addition, they contribute through servers that provide "massive storage capabilities, bandwidth, and transmission facilities…." *Id.* at ¶ 54. In short, DiMA asserts that the Judges should consider the fact that "DiMA member companies have developed an entirely new industry and educated consumers about entirely new ways to pay for music [as an alternative to piracy]." *Id.* at ¶ 58.

to be disruptive "if it directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for [the parties impacted by the rate] to adequately adapt to the changed circumstances produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license." 73 FR at 4097. The same analysis applies in this proceeding as well.

RIAA argues that the current statutory rate is already disruptive and, as a consequence, any increase such as that proposed by Copyright Owners must also be disruptive. *See* RIAA PFF at ¶¶ 1441-52. Copyright Owners respond that an increase in the mechanical rates, as they have proposed, would not have a disruptive impact on record companies because their aggregate profitability is on the rise and mechanicals constitute only a small fraction of their overall expense. Copyright Owners PCL at ¶ 98. Moreover, Copyright Owners argue that, with respect to DiMA companies, the digital market is growing rapidly. They point to the success of iTunes as evidence that DiMA members "can easily absorb the increases in the penny rate" that they seek. *Id.* at ¶ 100. DiMA, in turn, argues that the Judges should at a minimum avoid rates and rate structures that would adversely affect digital music distributors' ability to attain a sufficient subscriber base or generate sufficient revenue to reach certain financial targets. DiMA PCL at ¶ 63. DiMA contends that the rates proposed by Copyright Owners "would halt innovation in its tracks. Even if [the Copyright Owners' proposed rates] did not stop digital distribution entirely, [they] would stifle further entry [into the market]." *Id.*

Because the rates we have identified as reasonable are currently in place (as marketplace rates in the case of ringtones and as the statutory rate in the case of CDs and permanent downloads), the various arguments concerning the consequences of a rise in the applicable rates is inapposite. Furthermore, we find that the RIAA's contentions with respect to the disruptive impact of the current rates have little merit. RIAA's list of horribles allegedly attributable to the current mechanical rates is not supported by any substantial evidence of cause-and-effect. Even the RIAA admits that "high mechanical royalty rates did not cause all of these problems." *Compare* RIAA PFF at ¶ 1441 listing record industry disruptions *with* RIAA PFF at ¶ 1442. Further, the RIAA's proffered evidence fails to persuade us that reducing this one particular cost will alleviate all the claimed record industry adversity in any substantial way and fails to adequately weigh other cost-based or demand-based alternative explanations for the alleged adversity. Similarly, DiMA's claims related to lowering the bar for new market entrants are not adequately supported by evidence to indicate the degree to which the overall cost structure and pricing capabilities of such new entrants differ from existing market participants such as Apple iTunes. Thus, we find that RIAA and DiMA have failed to show that the current mechanical rates have caused and are anticipated to continue to cause an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for the parties impacted by the rate to adequately adapt to the changed circumstances produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music currently offered to consumers under this license. *SDARS,* 73 FR at 4097.

On the other hand, Copyright Owners contend that the "draconian" cut in royalties that RIAA and DiMA seek would cause disruption to the Copyright Owners. They contend that such a cut would have a disproportionate impact upon songwriters but also argue that a rate cut would "materially impact the ability of music publishers to play the vital role in the creation of music that songwriters depend upon to exercise their creative craft." *Id.* at ¶ 101. Again, inasmuch as the rates we have identified as reasonable are currently in place, these arguments concerning the consequences of a substantial cut in the applicable rates are inapposite. Furthermore, in analyzing the potential disruptive impact the rates we have adopted may have on the market we examined not only the rates but also the rate structure and have found that continuing the penny-rate structure rather than fostering disruption in the industry will likely minimize such disruption. *See supra* at Section IV.B.2.

The current compulsory rates for CDs and permanent downloads are rates that the copyright owners and copyright users have been paying since 2006. In addition, the evidence before us indicates that a ringtone rate derived from the Landes mastertone benchmark is comparable to the average rate that copyright owners currently receive and that copyright users currently pay. Therefore, we do not find from the record before us that these rates would have an adverse impact that is substantial, immediate and irreversible in the short-run.

5. Summary of Rates Determined

In conclusion, the Judges find that our consideration of the 801(b) policy factors indicates that both a nominal rate of 9.1 cents for physical products and permanent downloads and a nominal rate of 24 cents for ringtones are reasonable without further adjustment over the term of these licenses.

6. RIAA's Proposed General DPD Rate

As previously discussed, the parties to this proceeding are asking the Judges to establish royalty rates for physical phonorecords, permanent downloads and ringtones, the parties themselves having agreed to rates for limited downloads and interactive streaming. RIAA insists in its Proposed Conclusions of Law that we are obligated to establish a catch-all rate for DPDs (but not physical product) that are not permanent, limited downloads, interactive streaming or ringtones. RIAA PCL at ¶¶ 164-170. It concludes that such a catch-all rate–which it describes as a rate for "general DPDs"–is required by 17 U.S.C. 115(c)(3)(C) of the Copyright Act which directs us to establish rates and terms "for the activities specified by this section." RIAA submits that the correct rate for "general DPDs" should be the same as the one it has proposed for physical phonorecords and permanent downloads. For the reasons discussed below, we decline to adopt RIAA's proposal.

RIAA's interpretation of "the activities specified by this section" incorrectly conflates "activities" with its conception of musical products and services offered as digital phonorecord deliveries. The "activities" referred to in Section 115 are the making and distribution of phonorecords, *see* 17 U.S.C. 115 (preamble), not musical products and services. Our obligation to set rates and terms for the making and distribution of phonorecords is amplified only with respect to the distinction that we must draw between phonorecords that are incidental to a transmission that constitutes a digital phonorecord delivery and "digital phonorecord deliveries in general." 17 U.S.C. 115(c)(3)(C). Even RIAA does not suggest that the latter language creates a standalone category, separate from the music products and services currently offered or which *may* someday be offered, and known as a general DPD.[47] In sum, we cannot find any statutory obligation that requires us to set a rate for general DPDs.

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[47] The weakness of RIAA's interpretation of "activities specified by this section" is further underscored by its particular confinement to the category of DPDs. The sentence from which the phrase is drawn refers to a proceeding under chapter 8 to establish rates and terms for all of Section 115, not just DPDs. Pushing RIAA's argument to its logical conclusion would mean that we would have to set a general rate for both DPD and non-DPD phonorecords (*i.e.*, physical products).

Furthermore, and even more importantly, even if we were to accept RIAA's argument that such a rate must be set, RIAA (as well as DiMA and the Copyright Owners) has failed to present any evidence whatsoever to support a rate determination. All RIAA has given us is a proposal that the rate for general DPDs should be the same as that for physical products and permanent downloads, plus a couple of oblique references to Copyright Owners' witnesses mentioning the possible introduction of future hybrid musical products. RIAA PCL at ¶165. We cannot adopt rates for even one of these future products in the face of such an empty record, let alone a single rate applicable to a variety of such products, without acting arbitrarily and capriciously. *See Recording Industry Ass'n of America v. Librarian of Congress*, 176 F.3d 528, 535-36 (D.C. Cir. 1999)(Librarian acted improperly by adopting terms with no record evidence to support them); *accord, Nat'l Ass'n of Broadcasters v. Librarian of Congress,* 146 F. 3d 907, 924 (D.C. Cir. 1998)(Librarian must act with regard to the record). Nor do we see how a convincing record could be built at this time due to the speculative nature of the products and the consequent lack of evidentiary tools that we would possess to evaluate them in setting rates.

V. Terms

Like the webcasting and preexisting subscription and satellite digital audio radio services proceedings, the current proceeding requires the Copyright Royalty Judges to establish "terms of royalty payments" for the Section 115 license. 17 U.S.C. 115(c)(3)(C). Unlike the prior proceedings, however, authority to set the terms is divided between the Judges and the Register of Copyrights.[48] RIAA and Copyright Owners agreed that the Judges' authority to adopt their proposals was limited to provisions related to notice of use of copyright owners' works and

[48] The Register's current regulations for the Section 115 license are set forth in 37 CFR 201.18-19.

recordkeeping, though they disagreed as to whether the Judges have authority to adopt provisions related to late payments. On July 25, 2008, the Judges referred to the Register of Copyrights material questions of substantive law concerning the authority to adopt terms, and the Register delivered her decision on August 8, 2008. *See Memorandum Opinion on Material Questions of Substantive Law*, Docket No. RF 2008-1 (August 8, 2008); *see also*, 73 FR 48396 (August 19, 2008).

A. Proposals of the Parties

1. RIAA

RIAA initially proposed four terms in this proceeding. One of the requests proposed a term providing that when a DPD is not distributed directly by the compulsory licensee, it should be considered as distributed in the accounting period in which it is reported to the compulsory licensee, contrary to 37 CFR 201.19(a)(6) of the Register's rules which provides that a DPD is to be treated as made and distributed on the date that it is digitally transmitted. RIAA now considers this term as being outside the authority of the Judges to adopt and is no longer proposing it. *See* Second Amended Proposed Rates and Terms of the Recording Industry Association of America, Inc. at 7, n.2 ("RIAA Second Amended Proposal"). As this proposed term is no longer before us, the Judges do not consider it.

The other three terms are as follows. First, RIAA asks that we adopt a term permitting monthly and annual statements of account to be signed by a duly authorized agent of the compulsory licensee, notwithstanding 37 CFR 201.19(e)(6) and (f)(6)(i) which require that the signature be of a duly authorized officer of a corporation or, if the licensee is a partnership, a partner. RIAA PFF at ¶¶ 1770-71; RIAA Second Amended Proposal at 7. Second, RIAA requests that an audit performed in the ordinary course of business according to generally accepted auditing standards by an independent and qualified auditor serve as acceptable verification in lieu of 37 CFR 201.19(f)(6) which requires that each annual statement of account be certified by a licensed Certified Public Accountant. RIAA PFF at ¶¶ 1772-76; RIAA Second Amended Proposal at 7. Third, RIAA requests that the Judges issue a regulation "clarifying" that the Section 115 license extends to all reproduction and distribution rights that may be necessary to engage in activities covered by the license, including 1) the making of reproductions by and for end users; 2) reproductions made on servers; and 3) incidental reproductions made under authority of the licensee in the normal course of engaging in such activities, including cached, network, and buffer reproductions. RIAA PFF at ¶¶ 1777-78; RIAA Second Amended Proposal at 7.

RIAA makes two additional requests in its Second Amended Proposal that, while not stylized as terms, are similar in nature to the third request described above. These terms are offered as a part of RIAA's alternative rate structure which seeks to convert its percentage of revenue rate into a penny rate. The first calls for an interpretation of the statute related to locked content. "Locked content," according to RIAA,

> is a recording that has been encrypted or degraded so as to be accessible in non-degraded form only for limited previewing absent a purchase transaction. For example, a computer hard drive or an MP3 player might ship with a thousand or more locked recordings that would be available for the consumer to buy and unlock.

RIAA PFF at ¶ 1674 (*citing* testimony of Andrea Finkelstein and Mark Eisenberg); *see also*, RIAA Second Amended Proposal at 6. RIAA requests that the Judges determine that a locked content product is considered distributed for purposes of the Section 115 license, and the royalty becomes payable, when the product is unlocked by the consumer. RIAA PFF at ¶ 1676. The other term related to RIAA's alternative penny rate proposal is related to what RIAA describes as "multiple instances." Specifically, RIAA seeks a determination from the Judges that when there are multiple fixations of the same sound recording on the same product or as a la carte downloads as part of a single transaction, the price of the transaction should be used to determine the applicable rate category and all fixations should be considered one for purposes of the Section 115 license. RIAA PFF at ¶ 1678; RIAA Second Amended Proposal at 6. This clarification of the statute is necessary, according to RIAA, so that products such as DualDisc, where the same sound recording appears on a disc multiple times to enable the disc to be played on multiple devices or at different levels of sound quality, are paid for at the single penny rate and not "multiple instances" for all reproductions of the same recording. RIAA PPF at ¶ 1679.

2. Copyright Owners

Copyright Owners propose five terms, one of which seeks a clarification of the statute. The centerpiece of Copyright Owners' requests, and the one to which it supplied the most testimony, is the application of a 1.5% per month late fee from the day payment should have been made to the day payment is actually received by a copyright owner. Copyright Owners PFF at ¶ 842; Copyright Owners Amended Proposed Rates and Terms at 3 (July 2, 2008). A requested term related to this proposal is the recovery of reasonable attorneys fees expended by copyright owners to collect past due royalties. Copyright Owners PFF at ¶ 842; Copyright Owners Amended Proposed Rates and Terms at 4. And a third proposed term, which Copyright Owners claim is related to the late payment issue, is a 3% pass-through assessment where a compulsory licensee authorizes a digital music service to make and distribute DPDs. Copyright Owners PFF at ¶ 842; Copyright Owners Amended Proposed Rates and Terms at 3-4. A pass-through charge is necessary, according to Copyright Owners, because pass-through licenses result in an inability of music publishers to audit music services, result in payment delays, and prevent music publishers from establishing direct business relationships with music services. Copyright Owners PFF at ¶¶ 862-865.

Copyright Owners' fourth request is related to the audits of compulsory licensees that they currently conduct. Specifically, Copyright Owners seek a term that requires the reporting for each specific activity licensed under Section 115 and, in the case of pass-through licenses, the identification of the online retailer through which the DPDs occurred. Copyright Owners PFF at ¶ 842; Copyright Owners Amended Proposed Rates and Terms at 4.

The fifth and final term[49] seeks a "clarification" of 17 U.S.C. 115(c)(2) as to when phonorecords are made and distributed and therefore when payment is calculated and becomes due. Copyright Owners request that we determine that the royalty fee becomes due on the date that a phonorecord is distributed, not the date on which it is manufactured. Copyright Owners PFF at ¶¶ 842, 867; Copyright Owners Amended Proposed Rates and Terms at 4.

3. DiMA

Consistent with DiMA's rate proposal of a percentage of revenue, DiMA proposes a definition of revenue which includes definitions of applicable receipts, a permanent digital phonorecord delivery, a licensee, a licensee's carriers and a licensed work. DiMA Second

[49] Copyright Owners also requested a particular definition of revenue, which it identified as a term, for the operation of its rate proposal for ringtones. Copyright Owners PFF at ¶ 842; Copyright Owners Amended Proposed Rates and Terms at 4. However, since the Judges are not adopting Copyright Owners' rate proposal for ringtones and instead are adopting a penny rate, consideration of a definition of revenue is not necessary.

Amended Proposed Rates and Terms at 1-3. Because the Judges are not adopting a percentage of revenue rate structure, consideration of these proposed terms is not necessary. This leaves DiMA with one proposed term which is another request for "clarification" of the statute. DiMA asks the Judges to clarify that the Section 115 license extends to, and includes full payment for, all reproductions necessary to engage in the activities permitted by the license, including masters, reproductions on servers, cached, network and buffer reproductions, and the making of reproductions by and for end users. *Id.*

B. Adopted Term: Late Fee

Section 803(c)(7) of the Copyright Act provides that a determination of the Copyright Royalty Judges may include terms with respect to late payment, and the Register of Copyrights has confirmed that we have authority to adopt terms for past due payments for this statutory license. *See* Memorandum Opinion on Material Questions of Substantive Law, RF 2008-1 at 11 (August 8, 2008), 73 FR 48399 (August 19, 2008). Consistent with our adoption of the same term for late payments in the *Webcaster II* and *SDARS* determinations, 72 FR 24084, 24107 (May 1, 2007)(*Webcaster II*), 73 FR 4080, 4099 (January 24, 2008)(*SDARS*), we are establishing a late payment fee of 1.5% per month measured from the date the payment was due as provided in the regulations of the Register. *See* 37 CFR 201.19(e)(7)(i).

RIAA argues that the marketplace for mechanical licenses with music publishers does not provide for late fees, noting their absence in Harry Fox Agency licenses[50] and certain licensing

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[50] Copyright Owners and RIAA presented conflicting testimony as to the extent that late payments occur under licenses issued by the Harry Fox Agency and to the extent that those late payments were covered by advances paid by certain record companies. *Compare* 5/19/2008 Tr. 7033-35 (Pedecine) (70 percent of total dollars owed was late, the average lateness of such payments was 80 days) with RIAA PFF at ¶¶ 1793, 1805 and 1812 (writers and publishers are the cause of most late payments and record companies pay advances to cover many late payment situations).

agreements executed by EMI Music Publishing and BMI Music Publishing, and submits that we are therefore precluded from adopting such a term. RIAA PFF at ¶¶ 1784-92; RIAA PCL at ¶¶ 219-20. Were the standard for considering terms under the Section 115 license willing buyer/willing seller, we might be given pause. However, we are directed by the terms of this license to establish reasonable terms that are consistent with the Section 801(b) factors. RIAA does not argue that a 1.5% per month late fee is violative of one or more of the Section 801(b) factors, nor that Section 801(b) requires a downward adjustment of the fee. As we said in *SDARS*, "[i]n determining an appropriate late fee, a balance must be struck between providing an effective incentive to the licensee to make payments timely on the one hand and not making the fee so high that it is punitive on the other hand." 73 FR at 4099 (also applying the Section 801(b) factors). We determine that the 1.5% late fee achieves this balance.

In further resisting a late payment fee, RIAA argues that late payments are often not the fault of the record companies and are often the result of songwriters and producers in certain genres of music failing to agree as to the appropriate "copyright splits"–*i.e.*, who and how many individuals have contributed copyrightable authorship to the creation of a musical work and are therefore entitled to royalties. RIAA PFF at ¶¶ 1793-1804. RIAA also faults music publishers for internal administrative failings which, according to RIAA, often result in record companies being unable to timely pay royalties to the correct recipients. RIAA PFF at ¶¶ 1793-1804. The reasons for why payments are late, however, represent the parties' disagreement with the payment requirements set forth in the statute and in the Register of Copyrights' regulations. *See* 37 CFR 201.19(e)(7), (f)(7). If users of the Section 115 license cannot possibly make payments in compliance with those requirements, then they must seek redress from the Congress or the

Copyright Office. They have no bearing on our determination where we have not been presented with testimony that a 1.5% per month late fee is so burdensome and unfair as to escape the bounds of reasonableness as defined by Section 801(b).

C. Terms Not Adopted

Putting aside the question of the Judges' authority *vis-à-vis* the Register of Copyright to adopt particular types of terms, the Judges determine that there are immensely practical reasons for not adopting the remaining terms that the parties propose. Two of RIAA's proposed terms–permitting duly authorized agents to sign statements of account and permitting annual statements of account to be verified by non-certified auditors–are contrary to express provisions set forth in the Register's regulations. *See* 37 CFR 201.19(e)(6) and (f)(6)(i) (statement of account must be signed by officer of a corporation or a partner), 17 U.S.C. 115(c)(5) and 37 CFR 201.19(f)(6) (annual statement of account must be certified by licensed Certified Public Accountant). Were the Judges to adopt these two proposals, members of the public seeking to use the Section 115 license would be required to choose between the Judges' and the Register's regulations in completing their statements of account or to determine whether compliance with both sets of regulations was required.[51] Given that RIAA failed to produce compelling evidence that the Register's regulations are so burdensome as to require the adoption of contrary provisions, we decline to adopt RIAA's proposed terms.[52]

The same reasoning applies to Copyright Owners' request for the reporting of royalties

[51] We also believe that RIAA's proposal would add an unnecessary layer of complexity to the regulatory process, encouraging, if not requiring, compulsory licensees to constantly cross-check the Judges' and Register's regulations for conflicting provisions.

[52] Likewise, we make no recommendation to the Register to alter or amend her current regulations on this point.

earned for each specific configuration of a licensed product. The Register's regulations governing both the monthly and annual statements of account already provide that each report identify the configuration of the product involved. *See* 37 CFR 201.19(e)(3)(ii) (monthly statement), 37 CFR 201.19(f)(4) (annual statement). We likewise decline to adopt Copyright Owners' request for identification of a digital music service provider operating pursuant to a pass-through license. Copyright Owners suggested that such a requirement might assist copyright owners' auditing efforts but failed to demonstrate that the effectiveness of auditing is foreclosed by the lack of such information.

Copyright Owners ask us to adopt a 3% surcharge on royalties for all pass-through licensing arrangements arguing that such a provision is necessary because these arrangements frequently result in late payments and eliminate music publishers' opportunities to interact with pass-through licensees. Copyright Owners PFF at ¶¶ 842, 862. We have already adopted a late fee requirement and decline to adopt an additional one[53] because of the nature of the licensing arrangement, which is permitted by 17 U.S.C. 115(a)(3)(A). To the extent that the proposed fee is not another late charge but is a request for a higher royalty rate for pass-through licenses, we decline to adopt the proposal because Copyright Owners failed to present any credible testimony or marketplace evidence supporting the 3% figure. For the same reasons, we also decline to adopt Copyright Owners' request for attorneys fees on the collection of late payments. *See* Copyright Owners PFF at ¶¶ 842, 866. In addition, Section 115(c)(6) enumerates the remedy for noncompliance by a compulsory licensee, which does not include the attorneys fees requested by Copyright Owners.

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[53] The surcharge is in effect a triple charge because the proposed fee is twice the amount of the late fee that

The remaining proposals of the parties fall within the rubric of requests for "clarification" of the statute. DiMA seeks a determination as to the scope of the license with respect to copies made in the delivery of digital music. DiMA PFF at ¶ 240; DiMA Second Amended Proposed Rates and Terms at 4. RIAA makes the same request, albeit proposing slightly different language. RIAA also seeks a determination that product containing musical works is not distributed (described by RIAA as "unlocked") until accessed by the consumer, plus a determination that multiple reproductions contained within a single product are considered only one licensed instance–and generating only one royalty fee–under the statute. RIAA PFF at ¶¶1674-76, 1678-82; RIAA Second Amended Proposal at 6. And Copyright Owners seek a ruling that the royalty obligation of the statute is triggered when a product is manufactured *and* distributed, as opposed to only manufactured. Copyright Owners PFF at ¶¶ 842, 867; Copyright Owners Amended Proposed Rates and Terms at 4. All of these requests suffer from the same infirmity: they require the Judges to interpret the scope, operation and/or obligations of the Section 115 license, which is inconsistent with our authority in the proceeding to establish rates and terms of royalty payments. *Accord*, *Memorandum Opinion on Material Questions of Law*, Docket No. RF 2008-1 at 10 (August 8, 2008); *see also*, 73 FR 48399 (August 19, 2008). We therefore decline to adopt them.

VI. Determination and Order

Having fully considered the record, the Copyright Royalty Judges make the above Findings of Fact based on the record. Relying upon these Findings of Fact, the Copyright Royalty Judges unanimously adopt every portion of this Determination of the Rates and Terms for the making

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we have adopted.

and distribution of phonorecords, including digital phonorecord deliveries ("DPDs"), under the compulsory license set forth in Section 115 of the Copyright Act.

SO ORDERED.

James Scott Sledge,
Chief U.S. Copyright Royalty Judge.

William J. Roberts, Jr.,
Copyright Royalty Judge.

Stanley C. Wisniewski,
Copyright Royalty Judge.

Dated: November 24, 2008

List of Subjects in 37 CFR Part 385

Copyright, Phonorecords, Recordings.

Final Regulations

For the reasons set forth in the preamble, the Copyright Royalty Judges are adding Part 385 to Chapter III of title 37 of the Code of Federal Regulations to read as follows:

PART 385–RATES AND TERMS FOR USE OF MUSICAL WORKS UNDER COMPULSORY LICENSE FOR MAKING AND DISTRIBUTING OF PHYSICAL AND DIGITAL PHONORECORDS

Subpart A – Physical Phonorecord Deliveries, Permanent Digital Downloads and Ringtones

Sec.

Subpart B – Interactive Streaming, Other Incidental Digital Phonorecord Deliveries and Limited Downloads

Sec.

Authority: 17 U.S.C. 115, 801(b)(1), 804(b)(4).

Subpart A – Physical Phonorecord Deliveries, Permanent Digital Downloads and Ringtones

§ 385.1 General.

(a) *Scope*. This subpart establishes rates and terms of royalty payments for making and distributing phonorecords, including by means of digital phonorecord deliveries, in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance*. Licensees relying upon the compulsory license set forth in 17 U.S.C. 115 shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations.

(c) *Relationship to voluntary agreements*. Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms of this subpart to use of musical works within the scope of such agreements.

§ 385.2 Definitions.

For purposes of this subpart, the following definitions apply:

Copyright Owners are nondramatic musical work copyright owners who are entitled to royalty payments made under this subpart pursuant to the compulsory license under 17 U.S.C. 115.

Digital phonorecord delivery means a digital phonorecord delivery as defined in 17 U.S.C. 115(d).

Licensee is a person or entity that has obtained a compulsory license under 17 U.S.C. 115, and the implementing regulations, to make and distribute phonorecords of a nondramatic musical work, including by means of a digital phonorecord delivery.

Permanent digital download means a digital phonorecord delivery that is distributed in the form of a download that may be retained and played on a permanent basis.

Ringtone means a phonorecord of a partial musical work distributed as a digital phonorecord delivery in a format to be made resident on a telecommunications device for use to announce the reception of an incoming telephone call or other communication or message or to alert the receiver to the fact that there is a communication or message.

§ 385.3 Royalty rates for making and distributing phonorecords.

(a) *Physical phonorecord deliveries and permanent digital downloads.* For every physical phonorecord and permanent digital download made and distributed, the royalty rate payable for each work embodied in such phonorecord shall be either 9.1 cents or 1.75 cents per minute of playing time or fraction thereof, whichever amount is larger.

(b) *Ringtones*. For every ringtone made and distributed, the royalty rate payable for each work embodied therein shall be 24 cents.

§ 385.4 Late payments.

A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment received by the Copyright Owner after the due date set forth in § 201.19(e)(7)(i) of this title. Late fees shall accrue from the due date until payment is received by the Copyright Owner.

Subpart B – Interactive Streaming, Other Incidental Digital Phonorecord Deliveries and Limited Downloads

§ 385.10 General.

(a) *Scope*. This subpart establishes rates and terms of royalty payments for interactive streams and limited downloads of musical works by subscription and nonsubscription digital music services in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance*. A licensee that makes or authorizes interactive streams or limited downloads of musical works through subscription or nonsubscription digital music services pursuant to 17 U.S.C. 115 shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations.

§ 385.11 Definitions.

For purposes of this subpart, the following definitions shall apply:

Interactive stream means a stream of a sound recording of a musical work, where the performance of the sound recording by means of the stream is not exempt under 17 U.S.C. 114(d)(1) and does not in itself or as a result of a program in which it is included qualify for statutory licensing under 17 U.S.C. 114(d)(2). An interactive stream is an incidental digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D).

Licensee means a person that has obtained a compulsory license under 17 U.S.C. 115 and its implementing regulations.

Licensed activity means interactive streams or limited downloads of musical works, as applicable.

Limited download means a digital transmission of a sound recording of a musical work to an end user, other than a stream, that results in a specifically identifiable reproduction of that sound recording that is only accessible for listening for –

(1) An amount of time not to exceed 1 month from the time of the transmission (unless the service, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use for another time period not to exceed 1 month), or in the case of a subscription transmission, a period of time following the end of the applicable subscription no longer than a subscription renewal period or 3 months, whichever is shorter; or

(2) A specified number of times not to exceed 12 (unless the service, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use of another series of 12 or fewer plays), or in the case of a subscription transmission, 12 times after the end of the applicable subscription.

(3) A limited download is a general digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D).

Offering means a service's offering of licensed activity that is subject to a particular rate set forth in § 385.13(a) (e.g., a particular subscription plan available through the service).

Promotional royalty rate means the statutory royalty rate of zero in the case of certain promotional interactive streams and certain promotional limited downloads, as provided in § 385.14.

Publication date means [INSERT DATE OF PUBLICATION IN THE **FEDERAL REGISTER**].

Record company means a person or entity that

(1) Is a copyright owner of a sound recording of a musical work;

(2) In the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under the common law or statutes of any State, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under title 17, United States Code;

(3) Is an exclusive licensee of the rights to reproduce and distribute a sound recording of a musical work; or

(4) Performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the copyright owner of the sound recording.

Relevant page means a page (including a web page, screen or display) from which licensed activity offered by a service is directly available to end users, but only where the offering of licensed activity and content that directly relates to the offering of licensed activity (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed activity is directly available to end users from a page if sound recordings of musical works can be accessed by end users for limited downloads or interactive streams from such page (in most cases this will be the page where the limited download or interactive stream takes place).

Service means that entity (which may or may not be the licensee) that, with respect to the licensed activity,

(1) Contracts with or has a direct relationship with end users in a case where a contract or relationship exists, or otherwise controls the content made available to end users;

(2) Is able to report fully on service revenue from the provision of the licensed activity to the public, and to the extent applicable, verify service revenue through an audit; and

(3) Is able to report fully on usage of musical works by the service, or procure such reporting, and to the extent applicable, verify usage through an audit.

Service revenue. (1) Subject to paragraphs (2) through (5) of the definition of "Service revenue," and subject to U.S. Generally Accepted Accounting Principles, *service revenue* shall mean the following:

(i) All revenue recognized by the service from end users from the provision of licensed activity;

(ii) All revenue recognized by the service by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed activity (i.e., advertising placed immediately at the start, end or during the actual delivery, by way of interactive streaming or limited downloads, as applicable, of a musical work); and

(iii) All revenue recognized by the service, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a relevant page of the service or on any page that directly follows such relevant page leading up to and including the limited download or interactive streaming, as applicable, of a musical work; provided that, in the case where more than one service is actually available to end users from a relevant page, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt,

(i) Include any such revenue recognized by the service, or if not recognized by the service, by any associate, affiliate, agent or representative of such service in lieu of its being recognized by the service;

(ii) Include the value of any barter or other nonmonetary consideration;

(iii) Not be reduced by credit card commissions or similar payment process charges; and

(iv) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed activity that they were unable to use due to technical faults in the licensed activity or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, exclude revenue derived solely in connection with

services and activities other than licensed activity, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Service revenue." By way of example, the following kinds of revenue shall be excluded:

(i) Revenue derived from non-music voice, content and text services;

(ii) Revenue derived from other non-music products and services (including search services, sponsored searches and click-through commissions); and

(iii) Revenue derived from music or music-related products and services that are not or do not include licensed activity.

(4) For purposes of paragraph (1) of the definition of "Service revenue," advertising or sponsorship revenue shall be reduced by the actual cost of obtaining such revenue, not to exceed 15%.

(5) Where the licensed activity is provided to end users as part of the same transaction with one or more other products or services that are not a music service engaged in licensed activity, then the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Service revenue" shall be the revenue recognized from end users for the bundle less the standalone published price for end users for each of the other component(s) of the bundle; provided that, if there is no such standalone published price for a component of the bundle, then the average standalone published price for end users for the most closely comparable product or service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used. In connection with such a bundle, if a record company providing sound recording rights to the service

(i) Recognizes revenue (in accordance with U.S. Generally Accepted Accounting Principles, and including for the avoidance of doubt barter or nonmonetary consideration) from a person or entity other than the service providing the licensed activity and;

(ii) Such revenue is received, in the context of the transactions involved, as consideration for the ability to make interactive streams or limited downloads of sound recordings, then such revenue shall be added to the amounts expensed by the service for purposes of § 385.13(b). Where the service is the licensee, if the service provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service hereunder as a result of revenue recognized from a person or entity other than the service as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service to calculate the additional royalties and indemnify the service for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

Stream means the digital transmission of a sound recording of a musical work to an end user –

(1) To allow the end user to listen to the sound recording, while maintaining a live network connection to the transmitting service, substantially at the time of transmission, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction;

(2) Using technology that is designed such that the sound recording does not remain

accessible for future listening, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction; and

(3) That is also subject to licensing as a public performance of the musical work.

Streaming cache reproduction means a reproduction of a sound recording of a musical work made on a computer or other receiving device by a service solely for the purpose of permitting an end user who has previously received a stream of such sound recording to play such sound recording again from local storage on such computer or other device rather than by means of a transmission; provided that the user is only able to do so while maintaining a live network connection to the service, and such reproduction is encrypted or otherwise protected consistent with prevailing industry standards to prevent it from being played in any other manner or on any device other than the computer or other device on which it was originally made.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in § 385.14(b).

§ 385.12 Calculation of royalty payments in general.

(a) *Applicable royalty.* Licensees that make or authorize licensed activity pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the minimum royalties and subscriber-based royalty floors for specific types of services provided in § 385.13, except as provided for certain promotional uses in § 385.14.

(b) *Rate calculation methodology*. Royalty payments for licensed activity shall be calculated as provided in paragraph (b) of this section. If a service includes different offerings, royalties must be separately calculated with respect to each such offering. Uses subject to the promotional royalty rate shall be excluded from the calculation of royalties due, as further described in this section and the following § 385.13.

(1) *Step 1*: Calculate the All-In Royalty for the Service. For each accounting period, the all-in royalty for each offering of the service is the greater of

(i) The applicable percentage of service revenue as set forth in paragraph (c) of this section (excluding any service revenue derived solely from licensed activity uses subject to the promotional royalty rate), and

(ii) The minimum specified in § 385.13 of the offering involved.

(2) *Step 2*: Subtract Applicable Performance Royalties. From the amount determined in step 1 in paragraph (b)(1) of this section, for each offering of the service, subtract the total amount of royalties for public performance of musical works that has been or will be expensed by the service pursuant to public performance licenses in connection with uses of musical works through such offering during the accounting period that constitute licensed activity (other than licensed activity subject to the promotional royalty rate). While this amount may be the total of the service's payments for that offering for the accounting period under its agreements with performing rights societies as defined in 17 U.S.C. 101, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed activity. In the latter case, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed activity

uses (other than promotional royalty rate uses) through the relevant offering, as determined in relation to all uses of musical works for which the public performance payments are made for the accounting period. Such allocation shall be made on the basis of plays of musical works or, where per-play information is unavailable due to bona fide technical limitations as described in step 4 in paragraph (b)(4) of this section, using the same alternative methodology as provided in step 4.

(3) *Step 3*: Determine the Payable Royalty Pool. This is the amount payable for the reproduction and distribution of all musical works used by the service by virtue of its licensed activity for a particular offering during the accounting period. This amount is the greater of

(i) The result determined in step 2 in paragraph (b)(2) of this section, and

(ii) The subscriber-based royalty floor resulting from the calculations described in § 385.13.

(4) *Step 4*: Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service by virtue of its licensed activity through a particular offering during the accounting period. To determine this amount, the result determined in step 3 in paragraph (b)(3) of this section must be allocated to each musical work used through the offering. The allocation shall be accomplished by dividing the payable royalty pool determined in step 3 for such offering by the total number of plays of all musical works through such offering during the accounting period (other than promotional royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than promotional royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work

royalty allocation in all calculations under this step 4 only (i.e., after the payable royalty pool as been determined), for sound recordings of musical works with a playing time of over 5 minutes, each play on or after October 1, 2010 shall be counted as provided in paragraph (d) of this section. Notwithstanding the foregoing, if the service is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices useable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service for making royalty payment allocations for the use of individual sound recordings.

(c) *Percentage of service revenue*. The percentage of service revenue applicable under paragraph (b) of this section is 10.5%, except that such percentage shall be discounted by 2% (i.e., to 8.5%) in the case of licensed activity occurring on or before December 31, 2007.

(d) *Overtime adjustment*. For licensed activity on or after October 1, 2010, for purposes of the calculations in step 4 in paragraph (b)(4) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes	Each play = 1.2 plays
(2) 6:01 to 7:00 minutes	Each play = 1.4 plays
(3) 7:01 to 8:00 minutes	Each play = 1.6 plays
(4) 8:01 to 9:00 minutes	Each play = 1.8 plays
(5) 9:01 to 10:00 minutes	Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 for each additional minute or fraction thereof.

(e) *Accounting*. The calculations required by paragraph (b) of this section shall be made in good faith and on the basis of the best knowledge, information and belief of the licensee at the time payment is due, and subject to the additional accounting and certification requirements of 17 U.S.C. 115(c)(5) and § 201.19 of this title. Without limitation, a licensee's statements of account shall set forth each step of its calculations with sufficient information to allow the copyright owner to assess the accuracy and manner in which the licensee determined the payable royalty pool and per-play allocations (including information sufficient to demonstrate whether and how a minimum royalty or subscriber-based royalty floor pursuant to § 385.13 does or does not apply) and, for each offering reported, also indicate the type of licensed activity involved and the number of plays of each musical work (including an indication of any overtime adjustment applied) that is the basis of the per-work royalty allocation being paid.

§ 385.13 Minimum royalty rates and subscriber-based royalty floors for specific types of services.

(a) *In general.* The following minimum royalty rates and subscriber-based royalty floors shall apply to the following types of licensed activity:

(1) *Standalone non-portable subscription – streaming only.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings only in the form of interactive streams and only from a non-portable device to which such streams are originally transmitted while the device has a live network connection, the minimum for use in step 1 of § 385.12(b)(1) is the lesser of subminimum II as described in paragraph (c) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month. The subscriber-based royalty floor for use in step 3 of § 385.12(b)(3) is the aggregate amount of 15 cents per subscriber per month.

(2) *Standalone non-portable subscription – mixed.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings either in the form of interactive streams or limited downloads but only from a non-portable device to which such streams or downloads are originally transmitted, the minimum for use in step 1 of § 385.12(b)(1) is the lesser of the subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month. The subscriber-based royalty floor for use in step 3 of § 385.12(b)(3) is the aggregate amount of 30 cents per subscriber per month.

(3) *Standalone portable subscription service.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings in the form of interactive streams or limited downloads from a portable device, the minimum for use in step 1 of § 385.12(b)(1) is the lesser of subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 80 cents per subscriber per month. The subscriber-based royalty floor for use in step 3 of § 385.12(b)(3) is the aggregate amount of 50 cents per subscriber per month.

(4) *Bundled subscription services.* In the case of a subscription service made available to end users with one or more other products or services as part of a single transaction without pricing for the subscription service separate from the product(s) or service(s) with which it is made available (e.g., a case in which a user can buy a portable device and one-year access to a subscription service for a single price), the minimum for use in step 1 of § 385.12(b)(1) is subminimum I as described in paragraph (b) of this section for the accounting period. The subscriber-based royalty floor for use in step 3 of § 385.12(b)(3) is the aggregate amount of 25

cents per month for each end user who has made at least one play of a licensed work during such month (each such end user to be considered an "active subscriber").

(5) *Free nonsubscription/ad-supported services.* In the case of a service offering licensed activity free of any charge to the end user, the minimum for use in step 1 of § 385.12(b)(1) is subminimum II described in paragraph (c) of this section for the accounting period. There is no subscriber-based royalty floor for use in step 3 of § 385.12(b)(3).

(b) *Computation of subminimum I.* For purposes of paragraphs (a)(2), (3) and (4) of this section, and with reference to paragraph (5) of the definition of "service revenue" in § 385.11 if applicable, subminimum I for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service during the accounting period –

(1) In cases in which a record company is the licensee under 17 U.S.C. 115 and a third-party service has obtained from the record company the rights to make interactive streams or limited downloads of a sound recording together with the right to reproduce and distribute the musical work embodied therein, 17.36% of the total amount expensed by the service in accordance with U.S. Generally Accepted Accounting Principles, which for the avoidance of doubt shall include the value of any barter or other nonmonetary consideration provided by the service, for such rights for the accounting period, except that for licensed activity occurring on or before December 31, 2007, subminimum I for an accounting period shall be 14.53% of the amount expensed by the service for such rights for the accounting period.

(2) In cases in which the relevant service is the licensee under 17 U.S.C. 115 and the relevant service has obtained from a third-party record company the rights to make interactive

streams or limited downloads of a sound recording without the right to reproduce and distribute the musical work embodied therein, 21% of the total amount expensed by the service in accordance with U.S. Generally Accepted Accounting Principles, which for the avoidance of doubt shall include the value of any barter or other nonmonetary consideration provided by the service, for such sound recording rights for the accounting period, except that for licensed activity occurring on or before December 31, 2007, subminimum I for an accounting period shall be 17% of the amount expensed by the service for such sound recording rights for the accounting period.

(c) *Computation of subminimum II.* For purposes of paragraphs(a)(1) and (5) of this section, subminimum II for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used by the relevant service during the accounting period –

(1) In cases in which a record company is the licensee under 17 U.S.C. 115 and a third-party service has obtained from the record company the rights to make interactive streams and limited downloads of a sound recording together with the right to reproduce and distribute the musical work embodied therein, 18% of the total amount expensed by the service in accordance with U.S. Generally Accepted Accounting Principles, which for the avoidance of doubt shall include the value of any barter or other nonmonetary consideration provided by the service, for such rights for the accounting period, except that for licensed activity occurring on or before December 31, 2007, subminimum II for an accounting period shall be 14.53% of the amount expensed by the service for such rights for the accounting period.

(2) In cases in which the relevant service is the licensee under 17 U.S.C. 115 and the

relevant service has obtained from a third-party record company the rights to make interactive streams or limited downloads of a sound recording without the right to reproduce and distribute the musical work embodied therein, 22% of the total amount expensed by the service in accordance with U.S. Generally Accepted Accounting Principles, which for the avoidance of doubt shall include the value of any barter or other nonmonetary consideration provided by the service, for such sound recording rights for the accounting period, except that for licensed activity occurring on or before December 31, 2007, subminimum II for an accounting period shall be 17% of the amount expensed by the service for such sound recording rights for the accounting period.

(d) *Computation of subscriber-based royalty rates.* For purposes of paragraph (a) of this section, to determine the minimum or subscriber-based royalty floor, as applicable to any particular offering, the service shall for the relevant offering calculate its total number of subscriber-months for the accounting period, taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the promotional royalty rate as described in § 385.14(b)(2), except that in the case of a bundled subscription service, subscriber-months shall instead be determined with respect to active subscribers as defined in paragraph (a)(4) of this section. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber (or active subscriber, as the case may be) shall be used as the subscriber-based component of the minimum or subscriber-based royalty floor, as applicable, for the accounting period.

§ 385.14 Promotional royalty rate.

(a) *General provisions*. (1) This section establishes a royalty rate of zero in the case of certain promotional interactive streaming activities, and of certain promotional limited downloads offered in the context of a free trial period for a digital music subscription service under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the promotional royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission of interactive streams or limited downloads of a sound recording that embodies such musical work, only if –

(i) The primary purpose of the record company in making or authorizing the interactive streams or limited downloads is to promote the sale or other paid use of sound recordings by the relevant artists, including such sound recording, through established retail channels or the paid use of one or more established retail music services through which the sound recording is available, and not to promote any other good or service;

(ii) Either –

(A) The sound recording (or a different version of the sound recording embodying the same musical work) is being lawfully distributed and offered to consumers through the established retail channels or services described in paragraph (a)(1)(i) of this section; or

(B) In the case of a sound recording of a musical work being prepared for commercial release but not yet released, the record company has a good faith intention of lawfully distributing and offering to consumers the sound recording (or a different version of the sound recording embodying the same musical work) through the established retail channels or services described in paragraph (a)(1)(i) of this section within 90 days after the commencement of the first promotional use authorized under this section (and in fact does so, unless it can demonstrate that notwithstanding its bona fide intention, it unexpectedly did not meet the scheduled release date);

(iii) In connection with authorizing the promotional interactive streams or limited downloads, the record company has obtained from the service it authorizes a written representation that –

(A) In the case of a promotional use commencing on or after October 1, 2010, except interactive streaming subject to paragraph (d) of this section, the service agrees to maintain for a period of no less than 5 years from the conclusion of the promotional activity complete and accurate records of the relevant authorization and dates on which the promotion was conducted, and identifying each sound recording of a musical work made available through the promotion, the licensed activity involved, and the number of plays of such recording;

(B) The service is in all material respects operating with appropriate license authority with respect to the musical works it is using for promotional and other purposes; and

(C) The representation is signed by a person authorized to make the representation on behalf of the service;

(iv) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the promotional royalty rate by that service;

(v) The interactive streams or limited downloads are offered free of any charge to the end user and, except in the case of interactive streaming subject to paragraph (d) of this section of in the case of a free trial period for a digital music subscription service, no more than 5 sound recordings at a time are streamed in response to any individual request of an end user;

(vi) The interactive streams and limited downloads are offered in a manner such that the user is at the same time (e.g., on the same web page) presented with a purchase opportunity for the relevant sound recording or an opportunity to subscribe to a paid service offering the sound recording, or a link to such a purchase or subscription opportunity, except –

(A) In the case of interactive streaming of a sound recording being prepared for commercial release but not yet released, certain mobile applications or other circumstances in which the foregoing is impracticable in view of the current state of the relevant technology; and

(B) In the case of a free trial period for a digital music subscription service, if end users are periodically offered an opportunity to subscribe to the service during such free trial period; and

(vii) The interactive streams and limited downloads are not provided in a manner that is likely to cause mistake, to confuse or to deceive, reasonable end users as to the endorsement or association of the author of the musical work with any product, service or activity other than the sale or paid use of sound recordings or paid use of a music service through which sound recordings are available. Without limiting the foregoing, upon receipt of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular use of such work under this section violates the limitation set forth in this paragraph (a)(1)(vii), the record company shall promptly cease such use of that work, and within 5 business days withdraw by written notice its authorization of such use by all relevant third parties it has authorized under this section.

(2) To rely upon the promotional royalty rate, a record company making or authorizing interactive streams or limited downloads shall keep complete and accurate contemporaneous written records of such uses, including the sound recordings and musical works involved, the artists, the release dates of the sound recordings, a brief statement of the promotional activities authorized, the identity of the service or services where each promotion is authorized (including the internet address if applicable), the beginning and end date of each period of promotional activity authorized, and the representation required by paragraph (a)(1)(iii) of this section; provided that, in the case of trial subscription uses, such records shall instead consist of the contractual terms that bear upon promotional uses by the particular digital music subscription services it authorizes; and further provided that, if the record company itself is conducting the promotion, it shall also maintain any additional records described in paragraph (a)(1)(iii)(A) of this section. The records required by this paragraph (a)(2) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed activity in the ordinary course of business, but in no event for less than 5 years from the conclusion of the promotional activity to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (a)(2) with respect to a specific promotion or relating to a particular sound recording of a musical work, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(1)(iii)(A) of this section, which shall be provided within 20 business days, and provided that if the copyright

owner or agent requests information concerning a large volume of promotions or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(3) If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(1)(iii)(A) of this section by a service authorized by a record company with respect to a specific promotion, the service shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the service shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the service (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(4) The promotional royalty rate is exclusively for audio-only interactive streaming and

limited downloads of musical works subject to licensing under 17 U.S.C. 115. The promotional royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the promotional royalty rate (including without limitation interactive streaming or limited downloads of a musical work beyond the time limitations applicable to the promotional royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101 *et seq*. For the avoidance of doubt, however, except as provided in paragraph (a) of this section, statements of account under 17 U.S.C. 115 need not reflect interactive streams or limited downloads subject to the promotional royalty rate.

(b) *Interactive streaming and limited downloads of full-length musical works through third-party services*. In addition to those of paragraph (a) of this section, the provisions of this paragraph (b) apply to interactive streaming, and limited downloads (in the context of a free trial period for a digital music subscription service), authorized by record companies under the promotional royalty rate through third-party services (including websites) that is not subject to paragraphs (c) or (d) of this section. Such interactive streams and limited downloads may be made or authorized by a record company under the promotional royalty rate only if –

(1) No cash, other monetary payment, barter or other consideration for making or authorizing the relevant interactive streams or limited downloads is received by the record company, its parent company, any entity owned in whole or in part by or under common ownership with the record company, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration used to promote the sale or paid use of sound recordings or the paid use of music services through which sound recordings are available;

(2) In the case of interactive streaming and limited downloads offered in the context of a free trial period for a digital music subscription service, the free trial period does not exceed 30 consecutive days per subscriber per two-year period; and

(3) In contexts other than a free trial period for a digital music subscription service, interactive streaming subject to paragraph (b) of this section of a particular sound recording is authorized by the record company on no more than 60 days total for all services (i.e., interactive streaming under paragraph (b) of this section of a particular sound recording may be authorized on no more than a total of 60 days, which need not be consecutive, and on any one such day, interactive streams may be offered on one or more services); provided, however, that an additional 60 days shall be available each time the sound recording is re-released by the record company in a remastered form or as a part of a compilation with a different set of sound recordings than the original release or any prior compilation including such sound recording.

(4) In the event that a record company authorizes promotional uses in excess of the time limitations of paragraph (b) of this section, the record company, and not the third-party service it has authorized, shall be liable for any payment due for such uses; provided, however, that all

rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved. In the event that a third-party service exceeds the scope of any authorization by a record company, the service, and not the record company, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Interactive streaming of full-length musical works through record company and artist services*. In addition to those of paragraph (a) of this section, the provisions of this paragraph (c) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate through a service (e.g., a website) directly owned or operated by the record company, or directly owned or operated by a recording artist under the authorization of the record company, and that is not subject to paragraph (d) of this section. For the avoidance of doubt and without limitation, an artist page or site on a third-party service (e.g., a social networking service) shall not be considered a service operated by the record company or artist. Such interactive streams may be made or authorized by a record company under the promotional royalty rate only if –

(1) The interactive streaming subject to this paragraph (c) of a particular sound recording is offered or authorized by the record company on no more than 90 days total for all services (i.e., interactive streaming under this paragraph (c) of a particular sound recording may be authorized on no more than a total of 90 days, which need not be consecutive, and on any such day, interactive streams may be offered on one or more services operated by the record company or artist, subject to the provisions of paragraph (b)(2) of this section); provided, however, that an additional 90 days shall be available each time the sound recording is re-released by the record

company in a remastered form or as part of a compilation with a different set of sound recordings than prior compilations that include that sound recording;

(2) In the case of interactive streaming through a service devoted to one featured artist, the interactive streams subject to this paragraph (c) of this section of a particular sound recording are made or authorized by the record company on no more than one official artist site per artist and are recordings of that artist; and

(3) In the case of interactive streaming through a service that is not limited to a single featured artist, all interactive streaming on such service (whether eligible for the promotional royalty rate or not) is limited to sound recordings of a single record company and its affiliates and the service would not reasonably be considered to be a meaningful substitute for a paid music service.

(d) *Interactive streaming of clips*. In addition to those in paragraph (a) of this section, the provisions of this paragraph (d) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate of segments of sound recordings of musical works with a playing time that does not exceed the greater of

(1) 30 seconds, or

(2) 10% of the playing time of the complete sound recording, but in no event in excess of 60 seconds. Such interactive streams may be made or authorized by a record company under the promotional royalty rate without any of the temporal limitations set forth in paragraphs (b) and (c) of this section (but subject to the other conditions of paragraphs (b) and (c) of this section, as applicable). For clarity, this paragraph (d) is strictly limited to the uses described herein and shall not be construed as permitting the creation or use of an excerpt of a musical work in

violation of 17 U.S.C. 106(2) or 115(a)(2) or any other right of a musical work owner.

(e) *Activities prior to the publication date.* Notwithstanding paragraphs (a) through (d) of this section, in the case of licensed activity prior to the publication date, the promotional royalty rate shall apply to promotional interactive streams, and to limited downloads offered in the context of a free trial period for a digital music subscription service, that in either case are authorized by the relevant record company, if the condition set forth in paragraph (a)(1)(i) of this section is satisfied, subject only to the additional condition in paragraph (b)(1) of this section, and provided that a free trial period for a digital music subscription service authorized by the relevant record company shall be considered to be of 30 days' duration. In the event of a dispute concerning the eligibility of licensed activity prior to the publication date for the promotional royalty rate, a service asserting that its licensed activity is eligible for the promotional royalty rate shall bear the burden of proving that its licensed activity was authorized by the relevant record company and shall certify that the condition in paragraph (b)(1) of this section was satisfied.

§ 385.15 Timing of payments.

Payment for any accounting period for which payment otherwise would be due more than 180 days after the publication date shall be due as otherwise provided under 17 U.S.C. 115 and its implementing regulations. Payment for any prior accounting period shall be due 180 days after the publication date.

§ 385.16 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed activity, solely for the purpose of providing such licensed activity (and no other purpose).

§ 385.17 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

Dated: November 24, 2008

James Scott Sledge,
Chief, U.S. Copyright Royalty Judge.

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