Before the
United States Copyright Office
Library of Congress
Washington, D.C. 20559

In the Matter of Music Licensing Study: Notice and Request for Public Comment	Docket No. RM 2014-3

COMMENTS OF PUBLIC KNOWLEDGE AND THE CONSUMER FEDERATION OF AMERICA

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Public Knowledge and the Consumer Federation of America submit these comments in response to the Copyright Office's Notice of Inquiry, released March 17, 2014,[1] soliciting comments on various issues that impact the music licensing marketplace.

INTRODUCTION

The legal provisions that shape our music licensing system should encourage a competitive, innovative market of music platforms and services that are accountable to music fans and musicians. This requires a set of well-developed structures that promote efficient licensing practices that minimize costs for everyone while preventing anticompetitive conduct that discourages competition among and between intermediaries like record labels, publishers, collecting licensing organizations, and distribution services. It has been said that companies operating in the music industry today must navigate a labyrinth of music licensing to be successful.[2] Public Knowledge asks the Copyright Office to support policies that will simplify and strengthen music licensing mechanisms that promote the development of new competitive services while ensuring reasonable compensation for artists.

I. THE ULTIMATE GOAL: A BETTER MUSIC MARKETPLACE

The music licensing structures shaped or encouraged by copyright law should serve the overall goal of incentivizing the creation of new music and increasing the public's access to that music. As with the rest of copyright law, the Copyright Act's provisions related to music

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[1] Music Licensing Study: Notice and Request for Public Comment, 78 Fed. Reg. 14,739 (Mar. 17, 2014) (hereinafter "Music Licensing NOI").

[2] *See generally Music Licensing Reform: Hearing Before the Subcomm. on Courts, the Internet, and Intellectual Prop. of the H. Comm. on the Judiciary*, 109th Cong. 15 (July 12, 2005) (statement of Marybeth Peters, Register of Copyrights, U.S. Copyright Office), *available at* http://www.copyright.gov/docs/regstat071205.html [hereinafter Peters, *Music Licensing Reform Statement*].

licensing should promote cultural advancement for the benefit of the people who enjoy, experience, and create works every day.

To that end, music licensing structures should aim to create an ecosystem where artists can get their music out on the market and receive a fair price for it; users can choose between multiple competing, affordable services that give them access to music; and new distribution services can innovate without being beholden to gatekeepers. Importantly, a well-functioning music distribution system must serve listeners and musicians. Every company in the middle—from record labels to rights clearinghouses to online distributors—exists to help those two groups connect more efficiently.

The music licensing system should encourage a competitive, innovative market of new services that are accountable to musicians and their fans. When companies at every point in the distribution chain face competition (including disruptive competition), that competition pushes service providers to better answer the needs of users and creators alike. Record labels that face competition will be motivated to strike deals with bold new distribution channels and to offer more artist-friendly contract terms to the musicians they provide services to.[3] Similarly, music streaming services that face competition from new upstarts will be pressured to find novel, innovative ways to reach new audiences. Additionally, by supporting policies that prevent companies from gaining market power now, Congress and the Copyright Office can avoid the too-frequent pattern of consolidation begetting yet more consolidation.[4]

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[3] *See* Jodie Griffin, *Rewind, Reclaim: Copyright Termination in the Music Business*, PKTHINKS (Mar. 2014), *available at* http://www.publicknowledge.org/documents/rewind-reclaim.

[4] *See* John Bergmayer, *Yet More Media Consolidation Is Not the Cure to Problems Caused by Media Consolidation*, PUBLIC KNOWLEDGE (July 8, 2013), http://www.publicknowledge.org/news-blog/blogs/yet-more-media-consolidation-not-cure-problem.

But currently, the music licensing marketplace operates with too many bottlenecks that allow dominant companies to stifle competition and entrench their own gatekeeper positions without adding new value for musicians or their fans. Copyright law's music licensing provisions can help alleviate those bottlenecks and make music licensing more efficient and fair for all.

To relieve bottlenecks and encourage innovation, our music licensing system should encourage competitive, robust, and sustainable music distribution markets. This means, for example, music licensing structures should treat like services alike. This will prevent existing technologies or platforms from gaining an unearned advantage over newer, and potentially better, technologies simply by virtue of enjoying a privileged status under copyright law.

A. Online Music Services and Listeners

It is no surprise that digital distribution services are increasingly popular with consumers. Online services give users more flexibility in choosing when and where they access music, and often add new features and functionalities past what previous technologies could do. Consumer demand for online services has grown significantly, with the number of subscribers to both paid and unpaid music services expected to double over the next three years.[5] Recent research has found that 64% of people aged 12-24 and 34% of people aged 25-54 listen to online radio on at least a weekly basis.[6] In interactive streaming, Spotify recently announced it has more than 10 million paying subscribers and 40 million active users worldwide—up from 6 million paying

[5] Lucas Mearian, *Music Industry Sucks Life from Subscription Services*, COMPUTERWORLD (Feb. 14, 2014), http://www.computerworld.com/s/article/9246365/Music_industry_sucks_life_from_subscription_services (citing *Digital Music Subscription Services: 2013*, Generator Research (Nov. 12, 2013)).

[6] Paul Goldstein, *Selling Music Audiences to Advertisers is the Future of Recorded Music Revenue*, HYPEBOT (Apr. 30, 2014), http://www.hypebot.com/hypebot/2014/04/selling-music-audiences-to-advertisers-is-the-future-of-recorded-music-revenue-.html (citing Edison Research).

subscribers and 24 million active users one year ago.[7] An estimated 28 million people worldwide pay for a music subscription, up from 20 million in 2012 and 8 million in 2010.[8] And in 2013, global revenue from subscription and streaming platforms in particular jumped 51.3%, to more than $1 billion.[9]

With technologically-neutral policies, new music distribution platforms will have a fair shot at thriving in a sustainable way, which could unleash a robust online distribution market to the benefit of everyone. From the consumer's perspective, online music services allow users to access, discover, and re-discover music more easily than ever before. New digital music services also decrease the costs of manufacturing and distribution, which in a competitive marketplace would be passed on to consumers as cost savings or improved service.

Particularly as Internet access spreads and music-playing devices become increasingly portable and connected, online music services allow audiences to access music in places previous technologies could not reach. Online music services also offer a panoply of music choices to users, allowing consumers to access the music that most resonates with them and encouraging deep musician-fan relationships. The global nature of the Internet allows a single niche online radio station to attract a geographically diverse listenership, and sophisticated music analysis technology helps users more easily access music that fits their specific tastes. This lets musicians

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[7] Bruce Houghton, *Spotify Shows Strong Growth: 40 Million Active Users, 10 Million Paid Subscribers*, HypeBot (May 21, 2014), http://www.hypebot.com/hypebot/2014/05/spotify-shows-strength-growth-40-million-active-users-10-million-paid-sunscribers.html.

[8] *Music Subscription Revenues Help Drive Growth in Most Major Markets*, IFPI (Mar. 18, 2014), www.ifpi.org/news/music-subscription-revenues-help-drive-growth-in-most-major-markets; Tim Ingham, *Beggars Assessing Streaming Royalty Rates as Income from Sector Soars*, MUSIC WEEK (Apr. 7, 2014), http://www.musicweek.com/news/read/beggars-assessing-streaming-royalty-rates-as-income-from-sector-soars/058145.

[9] *Music Subscription Revenues Help Drive Growth in Most Major Markets*, IFPI (Mar. 18, 2014), www.ifpi.org/news/music-subscription-revenues-help-drive-growth-in-most-major-markets.

with geographically diverse fan bases develop those audiences in a way that previous music distribution systems never could.

B. Online Music Services and Artists

> *"The single best thing that has happened in my lifetime in music, after punk rock, is being able to share music, globally for free. That's such an incredible development." – Steve Albini*

Artists also stand to benefit from the emergence of online music services. When online music platforms reach new listeners, future fans can discover their next favorite band. Online radio platforms could easily (and often do) incorporate ways for fans to learn more about the musicians they are listening to, and even can enable direct merchandising or ticketing opportunities. Online music services have also leveled the playing field to help unsigned and independent artists remove unnecessary middlemen and reach fans directly, if they so choose.

On a very basic level, new music platforms help artists by providing pathways to reach new audiences. Although the appropriate royalty levels will always be subject to some level of debate, it undeniable that online music distributors now collect a significant portion of many artists' royalties. For example, Spotify alone has paid out $1 billion to copyright owners since its inception.[10]

Digital distribution services also have the potential to give artists more control over their own careers. New services can make it easier for musicians to bring their works to market without relying on a record label to handle marketing, promotion, and distribution. For example, while it was traditionally near-impossible for musicians to convince a large record store to carry their albums without being signed to a record label, unsigned artists can now use the iTunes distribution service to sell copies of their recordings to the public. Musicians can now distribute

[10] Bruce Houghton, *Spotify Shows Strong Growth: 40 Million Active Users, 10 Million Paid Subscribers*, HypeBot (May 21, 2014), http://www.hypebot.com/hypebot/2014/05/spotify-shows-strength-growth-40-million-active-users-10-million-paid-sunscribers.html.

their music through an aggregator like CD Baby or Pure Play Music, which help artists with physical distribution, digital distribution, and music licensing. Artists can use these powerful distribution technologies to reach diverse audiences while maintaining control over the timing, length, and musical content of their professional projects.

New digital distribution services can also eliminate artists' need for a middleman to reach their fans. Advances in recording technology may allow a musician to make high quality recordings without a recording studio. New online social media platforms enable artists to promote their work and develop relationships with fans without a record label's marketing department. And online distribution tools and platforms allow artists to reach users via their own websites or on new platforms and distribute their music to fans directly.[11] An artist may still decide that she would prefer to "hire" a record label to perform those services in exchange for copyright ownership and a large chunk of future royalties, but digital disintermediation gives the artist a meaningful choice between a record label and an independent career.

Traditionally, technologies like AM/FM radio were limited in the number of people they could reach in any one location, and getting picked up by many individual distributors took time and resources independent musicians did not have.[12] As a result, often music owned or distributed by the major labels received a disproportionate amount of airplay. That trend is only exacerbated today by increasing consolidation in the ownership of local radio stations.[13] When the gatekeepers are removed from the equation with the help of new technologies, the music that gets played is chosen by the artists and their fans, not by the most powerful corporate executives.

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[11] *See, e.g.*, CASH Music, www.cashmusic.org.

[12] *See* Jim Ayre, *FMC on Payola and Localism*, FUTURE OF MUSIC COALITION (June 16, 2008), http://futureofmusic.org/blog/2008/06/16/fmc-payola-and-localism.

[13] *See False Premises, False Promises*, Future of Music Coalition (Dec. 13, 2006), http://futureofmusic.org/article/research/false-premises-false-promises.

Where they provide substantial value, intermediaries like record labels can still have a place in the business, but building more tools for artists gives them a meaningful choice in how to direct their own careers.

When new technologies help break down barriers for independent artists, a musician need not sign to a record label or give up her copyright to be distributed through the most popular platforms and, with effective statutory and collective licensing structures, she will be paid transparently at the same rate as a major label act. Make no mistake: online music services present an enormous opportunity to create sustainable platforms that are both artist- and consumer-friendly. Encouraging the sustainable and independent development of these services should be of concern to parties on all sides of the music business.

II. DELINEATING THE BOTTLENECKS IN MUSIC LICENSING

In Question 14 of its Notice of Inquiry, the Copyright Office asks how direct licensing impacts the music marketplace.[14] In Questions 20 and 21, the Copyright Office asks how licensing issues impact the investment decisions of creators, copyright owners, and distributors.[15] In response to those inquiries, these Comments will explain certain "bottlenecks" that occur in today's licensing markets to highlight areas where the licensing process can be made more equitable and efficient. In the areas where industry practices and the law have enabled would-be gatekeepers, different music licensing structures can maintain reasonable licensing practices and terms, and incentivize all actors to compete while encouraging innovation in the music marketplace.

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[14] Music Licensing NOI at 14,743.

[15] *Id.*

Where licensing bottlenecks occur, licensors with market power can veto new services, use their catalogs as leverage to obtain partial ownership in new market entrants, or demand disproportionately high royalties, to the detriment of consumers and independent artists alike. Currently, online music services generally pay out 60-70% of their revenue for licensing fees, a percentage that some researchers have dubbed intrinsically unprofitable.[16] Under current licensing structures, some analysts predict online music services will need to turn to strategies like mobile deals, bundling, or selling user data to stay alive.[17] Meanwhile, others have estimated that a company like Beats Music could become profitable if it increased its paying subscribership to 5-10 million users.[18]

Heavy market concentration—whether among rightsholders, or distribution companies—thwarts a competitive and innovative music marketplace.[19] An online music market dominated by vertically integrated firms gives companies the ability and incentive to make it more difficult

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[16] Lucas Mearian, *Music Industry Sucks Life from Subscription Services*, COMPUTERWORLD (Feb. 14, 2014), http://www.computerworld.com/s/article/9246365/Music_industry_sucks_life_from_subscription_services (citing *Digital Music Subscription Services: 2013*, Generator Research (Nov. 12, 2013).

[17] Lucas Mearian, *Music Industry Sucks Life from Subscription Services*, COMPUTERWORLD (Feb. 14, 2014), http://www.computerworld.com/s/article/9246365/Music_industry_sucks_life_from_subscription_services (citing *Digital Music Subscription Services: 2013*, Generator Research (Nov. 12, 2013). Bundled options often appear in the form of music subscriptions included in mobile phone packages. *See* Bruce Houghton, *Sprint Partners with Spotify for Music*, HYPEBOT (Apr. 29, 2014), http://www.hypebot.com/hypebot/2014/04/sprint-partners-with-spotify-for-music.html. Recently, however, reports indicate Amazon may also be considering including a music subscription service in its Amazon Prime offering. One report has even compared this strategy in part to cable companies that bundle "hundreds of channels" the subscriber never watches. Paul Bonanos, *Business Matters: How Amazon Could Have 'Tens of Millions' of Paid Streaming Music Subscribers Instantly*, BILLBOARD (Apr. 10, 2014), http://www.billboard.com/biz/articles/news/digital-and-mobile/6049214/business-matters-how-amazon-could-have-tens-of-millions.

[18] Bruce Houghton, *Beats Music Added 1000 Subscribers Daily in First Month*, HYPEBOT (Mar. 20, 2104), http://www.hypebot.com/hypebot/2014/03/beats-music-added-1000-subscribers-daily-in-first-month-report.html.

[19] Rahcel Stilwell, *Which Public—Whose Interest—How the FCC's Deregulation of Radio Station Ownership Has Harmed the Public Interest, and How We Can Escape from the Swamp* (Mar. 2006), http://digitalcommons.lmu.edu/cgi/viewcontent.cgi?article=1511&context=elr.

for new services to gain entry, raise prices for consumers, and strike deals with the other largest market players, leaving independent artists out in the cold.[20] And when it comes to market concentration in the music business, there is much cause for concern. In recorded music, the market is dominated by three major labels—Universal Music Group (UMG), Sony Music Entertainment, and Warner Music Group—which control a combined 75% of the market, with UMG alone controlling 36.7% of the market.[21] Among publishers, Sony/ATV Music Publishing alone controls over 29.4% of the market, making it 30% larger than its nearest publishing competitor, Universal Music Publishing Group, and more than twice the size of Warner's music publishing operations.[22] Concentration among rightsholders is particularly threatening to emerging competition, because ownership of a huge catalog of copyrights makes it impossible for new distributors to launch without a license from those rightsholders. On the distributor side, Pandora has over 70% of the online radio market (and 9.28% of the overall U.S. radio market),[23] while Apple dominates the download market with nearly 800 million users and a growth rate of

[20] For example, Bloom.fm recently reported it has been banned from Apple's iAd network because it competes with Apple's iTunes Radio service. Bruce Houghton, *Apple Bans 'iTunes Radio Competitor' Bloom.fm*, HYPEBOT (Apr. 11, 2014), http://www.hypebot.com/hypebot/2014/04/apple-bans-itunes-radio-competitor-bloomfm-.html.

[21] *UMG and WMG See Gains in Recorded-Music Market Share in 2013, While Sony/ATV Dominates Music Publishing,* MUSIC & COPYRIGHT, INFORMA TELECOMS & MEDIA (May 6, 2014), https://musicandcopyright.wordpress.com/2014/05/06/umg-and-wmg-see-gains-in-recorded-music-market-share-in-2013-while-sonyatv-dominates-music-publishing/#more-1166. These numbers do not, however, include sound recordings owned by independent labels or musicians but distributed through one of the major labels. To the extent that the major labels' distribution contracts with smaller labels allow them to set (or refuse to set) prices and rates with digital distributors for those labels' recordings, those contracts increase the majors' leverage over digital distributors.

[22] *UMG and WMG See Gains in Recorded-Music Market Share in 2013, While Sony/ATV Dominates Music Publishing,* MUSIC & COPYRIGHT, INFORMA TELECOMS & MEDIA (May 6, 2014), https://musicandcopyright.wordpress.com/2014/05/06/umg-and-wmg-see-gains-in-recorded-music-market-share-in-2013-while-sonyatv-dominates-music-publishing/#more-1166.

[23] Olga Kharif and Andy Fixmer, *Apple Internet Radio Entry Could Put Pandora in Play*, BLOOMBERG (Sept. 20, 2012); *Pandora Announces April 2014 Audience Metrics*, Pandora (May 6, 2014), http://investor.pandora.com/mobile.view?c=227956&v=203&d=1&id=1927379.

710,000 accounts per day.[24] While relatively low switching costs help other distributors compete with these companies, concentration among distribution platforms can give online music services less incentive to offer lower prices and better services to listeners and more incentive to strike tougher deals with independent artists (or threaten to cut them out completely). Music licensing laws and regulations should therefore be structured with an eye toward decreasing market concentration on every side of the online music ecosystem.

A. Licensing Sound Recordings

In order to launch a download or streaming service a company must obtain a license from sound recording copyright owners, which are often record labels. For many services today, users demand a comprehensive selection of songs, so it is especially critical to obtain licenses from the three largest record labels—Universal Music Group, Sony Music Entertainment, and Warner Music Group. Together these three companies control the vast majority of the market for sound recordings. As a result, when music licensing structures give the major labels the right to deny access to their catalogs, the labels have been able to make extraordinary demands of services that need their permission to launch new music offerings.

The market power of the major record labels is felt especially acutely by streaming services. Interactive streaming services must get record labels' direct permission to offer their catalogs to users, and non-interactive streaming services must either negotiate directly or operate under a statutory license, the rates for which have traditionally been set too high for licensees to earn a profit.[25] Although the existence of a statutory license, administered by the organization Sound Exchange, permits new services to obtain a license by following the terms stipulated in

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[24] Bruce Houghton, *One New Stat from Apple Shows Why iTunes is [Almost] Unbeatable*, HYPEBOT (Apr. 24, 2014), http://www.hypebot.com/hypebot/2014/04/one-new-stat-from-apple-shows-why-itunes-is-almost-unbeatable.html.

[25] *See* 17 U.S.C. § 114.

the law, in practice the rates set under the compulsory license have been high enough that webcasters have struggled to create a sustainable business model that depends on the statutory rates.[26]

New streaming services hold great promise for recording artists and consumers, but relatively nascent entrants in the market dependent on licenses from incumbent labels are vulnerable to anticompetitive behavior by the major labels. The major labels can thwart or seize control of innovation with anticompetitive behavior against new market entrants that cannot operate without sound recording licenses.

The major record labels have the incentive to try to stifle or seize control of new digital distribution platforms because those platforms begin to level the playing field among major labels, independent labels, and unsigned artists. Digital platforms are more likely to include unknown or niche music because, unlike their physical space predecessors, they are not constrained by strict time limits (like AM/FM radio) or space limits (like physical stores). As a result, the emergence of new digital platforms causes major record labels to lose one of their main selling points to musicians—namely, that they alone have the connections and influence that a musician absolutely needs to get his or her music out in the marketplace. Thus, the dominant incumbent labels are particularly incentivized to stifle digital platforms that will decrease their influence as compared to smaller competitors or unsigned acts.

As audience demand currently turns to a streaming, cloud-based model, new distribution services will have trouble launching without licenses from each of the major labels, and ultimately may never succeed if a single major label can withhold a significant percentage of the

[26] Lucas Mearian, *Music Industry Sucks Life from Subscription Services*, COMPUTERWORLD (Feb. 14, 2014), http://www.computerworld.com/s/article/9246365/Music_industry_sucks_life_from_subscription_services (citing *Digital Music Subscription Services: 2013*, Generator Research (Nov. 12, 2013)).

recorded music market even after other labels have started working with the service. Even in today's marketplace, a major label can wield sufficient power to demand that potential new digital music services pay the label hefty advances and a high percentage of future revenue, or give the record label an equity stake in the new company.[27] This sort of control puts the major labels in a position to "make or break" any new service, allowing them to hamper innovation and/or demand exorbitant terms and conditions. As a result, consumers must either miss out on potential new services or pay excessive fees for those services.

If a major label can undercut the success of a new digital music platform by withholding the rights to a substantial percentage of the market from that platform, it may be able to maintain its market dominance through anticompetitive conduct rather than innovating and competing against new market entrants. If a digital platform never launches because it would not have been able to attract enough users without the catalogs of the three major labels, an independent label would never have the opportunity to take advantage of that platform to promote its artists head-to-head against major label artists.

A major label could also license its copyrights to a new digital distributor, but demand payments in excess of its true market share, burdensome advance royalty payments, or exclusivity in return. For example, Beyond Oblivion, a digital music service founded in 2008 and backed by News Corp. and Allen & Co., aimed to provide users with a nearly unlimited selection of music on devices that held Beyond Oblivion software. The service filed for bankruptcy in late 2011 before it had even launched, but bankruptcy proceedings revealed that Beyond Oblivion

[27] These practices also hurt independent labels, which are left with a smaller slice of the pie after online services have acquiesced to the major labels' demands. Recently, the CEO of Merlin, an organization that represents independent labels, voiced concern that the major labels' practice of demanding disproportionately high royalties and enormous advances squeezes out independent labels' royalties while making it harder for new online services to enter the market. Janko Roettgers, *Merlin CEO: Major Labels are Setting New Music Services Up to Fail*, GIGAOM (Oct. 12, 2013), http://gigaom.com/2013/10/12/merlin-ceo-major-labels-are-setting-new-music-services-up-to-fail/.

owed outstanding debts of $50 million each to Sony Music Entertainment and Warner Music Group—an astonishing figure for a service that never distributed or publicly performed a single recording. These kinds of high advance royalties can hinder a digital startup from launching a successful and sustainable product. They also discourage investors, who must shoulder higher levels of risk for any digital music distribution service that requires direct licensing from record labels.

Finally, a large record label can use its ability to deny licenses as leverage to gain partial ownership in new digital music services.[28] These deals only serve to entrench incumbent power structures and stifle innovation in the online music business, and music licensing structures should certainly not force this result on the industry by making new services choose between unsustainably high compulsory license rates and private deals with the dominant copyright owners. Spotify, for example, is partially owned by all of the major record labels, and has been dogged with accusations of giving independent and unsigned musicians a lower royalty rate than major label musicians for the same number of streams. Even where major label ownership of distribution platforms does not lead to claims of direct discrimination, systematic vertical integration only contributes to a highly concentrated market where a new service must obtain the permission of its largest competitors in order to launch. For example, the music identification service Shazam has sold Warner Music Group's owner Access Industries, Universal Music Group, and Sony Music Entertainment each a $3 million stake in the company.[29] Access

[28] *See* Mark Cooper & Jodie Griffin, *The Role of Antitrust in Protecting Competition, Innovation, and Consumers as the Digital Revolution Matures: The Case Against the Universal-EMI Merger and E-Book Price Fixing* (June 14, 2012), http://publicknowledge.org/case-against-umg-emi.

[29] Hannah Karp, *Warner, Universal, Sony Buy Stakes in Music app Shazam*, WSJ DIGITS (May 14, 2014), http://blogs.wsj.com/digits/2014/05/14/warner-universal-sony-buy-stakes-in-music-app-shazam/.

Industries also owns part of Beats Music and the music subscription service Deezer.[30] Increased vertical integration among the largest copyright owners and distribution and processing services only create new barriers to competition at each point in the supply chain, to the detriment of musicians and their fans alike.

B. Licensing Musical Compositions

To distribute, reproduce, and/or publicly perform a wide variety of musical compositions (often as embodied in sound recordings), a music service must obtain licenses from the major publishers and the performing rights organizations (PROs).

Particularly now that EMI Music Publishing has been purchased by a Sony/ATV-led consortium in a deal completed last year, the music publishing space is also highly concentrated. The music publishing business is dominated by three companies: Sony/ATV (29.4%), Universal Music Publishing Group (22.6%), and Warner Chappell (13.2%) hold a combined three-firm market share of more than 65%. Similar to the major labels, the major publishers' market share gives them the incentive and potential ability to use their catalogs as leverage against new distribution services that threaten their existing business models. However, in certain circumstances prospective licensees can use a statutory license to obtain the rights to reproduce and distribute songs.[31] This "mechanical" license is set under a different standard than that used for webcasting sound recordings, and has proven more successful in encouraging the creation and distribution of new works.

Any company, such as a streaming service, that needs to license public performance rights for all or most of the music in demand today will need to obtain licenses from the

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[30] Hannah Karp, *Warner, Universal, Sony Buy Stakes in Music app Shazam*, WSJ DIGITS (May 14, 2014), http://blogs.wsj.com/digits/2014/05/14/warner-universal-sony-buy-stakes-in-music-app-shazam/.

[31] *See* 17 U.S.C. § 115.

performing rights organizations (PROs) ASCAP, BMI, and SESAC. By consolidating public performance rights across the industry, the PROs have raised significant competition concerns.[32] Together the three PROs control almost all of the market for public performance rights, and ASCAP alone has a market share of 45-47%.[33] As a result, ASCAP and BMI both operate under antitrust consent decrees struck with the U.S. Department of Justice.[34]

The ASCAP and BMI consent decrees create a mechanism by which a judge in the U.S. District Court for the Southern District of New York determines a reasonable rate for a license when ASCAP or BMI and a licensee cannot agree on a rate. Additionally, the consent decrees establish that all of ASCAP and BMI's repertories will be available to licensees, and the PROs may not discriminate between similarly situated licensees.

The recent attempts of publishers to withdraw public performance rights for new media services from ASCAP and BMI illustrate how concentration in the industry has given the largest publishers and the PROs the incentive and ability to leverage their catalogs against new music services, absent guidance from structures like the ASCAP and BMI consent decrees. For example, in 2011, ASCAP attempted to change its Compendium to allow publishers to withdraw new media rights from ASCAP. This would allow affiliated record labels and publishers to combine their leverage by offering public performance rights and sound recording rights to digital music services at the same time, and also would allow publishers to exert their recently increased market power from consolidation in the industry. As the court noted in ASCAP's

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[32] *See In re Petition of Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395 (S.D.N.Y. Sept. 17, 2013); *Broadcast Music, Inc. v. Pandora Media, Inc.*, Nos. 13-cv-4037, 64-cv-3787 (S.D.N.Y. Dec. 19, 2013); *Meredith Corp. v. SESAC LLC*, No. 09-cv-9177 (S.D.N.Y. Mar. 3, 2014).

[33] It is difficult to be certain of the current market shares, but these are the number most commonly quoted for the PRO market. *See In re Petition of Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395 (S.D.N.Y. Mar. 18, 2014).

[34] *See United States v. Am. Soc'y of Composers, Authors & Publishers*, Civ. No. 41–CV–1395, 2001 WL 1589999 (S.D.N.Y. June 11, 2001); *United States v. Broadcast Music, Inc.*, 275 F.3d 168 (2d Cir. 2001).

subsequent litigation with Pandora, "Large publishers were in general enthusiastic about such a change, but the songwriters and independent publishers were less so."[35] Songwriters and at least some independent publishers expressed concern that withdrawing new media rights from ASCAP would make songwriters vulnerable to less transparent accounting and potential payments disputes with their publishers and would contribute to the overall problems caused by consolidation in the industry.[36] ASCAP chairman Paul Williams argued to songwriters that publishers negotiating directly would be able to use their market power to negotiate steep license fees, which ASCAP could then use to establish higher royalties in the rate court.[37] Courts have since denied both ASCAP and BMI's plans to allow publishers to withdraw their public performance rights for new media services while keeping those publishers' public performance rights for other uses. The episode does, however, demonstrate the publishers' incentive and willingness to coordinate with the PROs and use their increased market share to raise prices for musical composition licenses outside of traditional music licensing structures.

The PROs' recent rate court litigation illustrates what could happen without adequate structures to ensure efficient and fair licensing structures. The largest publishers and the largest PROs have been allowed to acquire enormous market power, which can be used to distort the normal incentives licensors would have in a competitive marketplace. Added to these anticompetitive incentives, if the largest publishers could license directly to new services with their affiliate major record labels, the new services would be even more beholden to the demands of these mega-copyright-owners. Having already allowed the market to grow this concentrated,

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[35] *In re Petition of Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395 (S.D.N.Y. Mar. 18, 2014).

[36] *Id.*

[37] *Id.*

our music licensing system must now account for this fact and ensure that parties can nevertheless achieve reasonable licensing terms in the market.

C. Consequences for Distribution Markets

The potential bottlenecks explained above, if left unattended, could thwart promising new music services and prevent competition among online music distribution companies. As described above, when the largest copyright aggregators can wield outsized leverage against distribution services, those licensors can use their market power to demand high royalties, advance payments that squeeze out independent musicians, and partial ownership in the new company. When distribution companies must accept these kinds of terms as a price of entering the business, investors who might have otherwise contributed to more competing independent companies are discouraged from entering the space. Those distribution services that do launch may then not only be affiliated with the largest copyright owners in the industry, but will have few meaningful direct competitors. This only further entrenches the dominance of the companies that already have the upper hand.

For example, despite the great promise of online radio, many webcasters have left the business and a surprisingly small number have achieved a critical mass of market share. Notably, the companies that have lost their online radio businesses include large corporations like Yahoo! and Microsoft, in addition to many small entrepreneurial webcasters. When companies with deep technological expertise and enormous financial backing cannot create a profitable online radio service, small start-ups and independent companies have little chance of ever reaching a profit.

The financial difficulties of online radio companies in turn discourage investment in the field. As Union Square Ventures partner Fred Wilson noted, music services face extremely high startup costs compared to other industries, like software development.[38] A music startup may even need around $60 million just to arrange for the necessary licenses to launch its service.[39] As a result, this makes it more difficult for would-be music company founders to find funding for independent companies. Wilson did, however, predict that more advertising dollars would eventually enter the online radio space—but this prediction can only come true if online music services become sustainable enough to survive the transition.

As the Copyright Office considers what policies will be support a healthy and competitive music licensing market, it should remember how outsized bargaining power can be used to hamper innovation and entrench the dominant players. Setting a compulsory rate too high or otherwise unnecessarily driving companies to direct licensing deals would give the largest rightsholders the opportunity to stymie the progress of the online music marketplace and disadvantage independent labels and unsigned musicians.

III. LICENSING MECHANISMS THAT CAN ENCOURAGE A ROBUST MUSIC MARKETPLACE

When it comes to setting out affirmative plans to combat the potential harms discussed above, there can be multiple kinds of structures that can achieve reasonable and nondiscriminatory licensing terms. Music licensing structures should promote efficiency and ease of licensing to encourage the development of lawful services, while protecting competition among copyright owners and distribution services. This section will in particular examine how statutory licenses and collective licensing mechanisms can be used to promote a more robust marketplace, if deployed carefully.

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[38] Sarah Mitroff, *So You Want in on the Music Biz? Fred Wilson Has 4 Things to Tell You*, WIRED (Nov. 16, 2012), http://www.wired.com/business/2012/11/music-startups/.

[39] Eliot Van Buskirk, *5 Ways Major Label Music on SoundCloud Would Be Awesome*, EVOLVER.FM (Feb. 7, 2014), http://www.hypebot.com/hypebot/2014/02/5-ways-major-label-music-on-soundcloud-would-be-awesome.html.

A. Statutory Licenses

In Question 1 and 8 of its Notice of Inquiry, the Copyright Office asks whether the copyright law's various statutory licenses are still needed and effective.[40] In Questions 2 and 9, the Copyright Office asks about the effectiveness of the ratesetting processes and standards for the existing statutory licenses.[41] In Question 12, the Copyright Office asks what the impact of the different ratesetting standards is and whether those differences are justified.[42] In Question 17, the Copyright Office asks whether the music marketplace would benefit from modifying the scope of the existing statutory licenses.[43]

1. Statutory Licenses Can Promote Competition While Ensuring Compensation

If properly structured, statutory licenses can ensure artists and copyright owners receive reasonable compensation while encouraging the development of new services to expand the music marketplace. The statutory license remains an important tool at Congress's disposal to benefit musicians and their fans alike by creating a transparent and competitive marketplace.

As currently used in copyright law, statutory licenses have demonstrated several advantages for musicians and listeners. By requiring compensation while removing copyright owners' ability to veto a qualifying use, the statutory licenses in §§ 114 and 115 strike a balance in ensuring artist compensation while preventing the largest corporate copyright owners from creating artificial bottlenecks to benefit themselves.

Particularly considering the extreme concentration in the music recording and publishing industries, rights negotiations without the statutory licenses existing the background would likely

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[40] Music Licensing NOI at 14,742.

[41] *Id.*

[42] *Id.*

[43] *Id.* at 14,743.

only benefit the copyright owners (which is not to say that they would necessarily benefit the actual artist who sold those copyrights). After U.S. antitrust authorities have passively allowed the music industry to undergo decades of consolidation while statutory licenses ensured fees for certain uses remained reasonable, it would be a mistake to now remove those safeguards when the sound recording and music composition are so dramatically dominated by three firms in each major licensing area.

By providing a baseline for negotiations and clear terms and conditions when the parties do not wish to negotiate, statutory licenses also decrease transaction costs in the market. There are a number of reasons why negotiating directly may be infeasible: one party may be more obscure than the other, making it difficult for one to get the other to answer inquiries; the parties may be geographically diverse or speak other languages and lack the resources to hire representatives to handle negotiations for them; or the parties may simply not have the time to negotiate relatively small individual deals that could be economically worthwhile if the time and cost of negotiating were removed from the equation.

Finally, the statutory licenses in today's law benefit artists by establishing structures for transparency and direct payment to artists. Artists—particularly new artists—often have little to no leverage against record labels or publishers, and their contracts with those companies therefore favor the label or publisher. For example, an artist's record deal may withhold all royalties that run through the label until the artist has paid back the label's investment through the artist's portion of the royalties.[44] In addition, a record label contract may give accounting privileges to the record label and impose the costs and administrative burdens of an audit on the artist. This can lead to disheartening allegations of labels or other copyright owners using the

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[44] *See* Jodie Griffin, *Rewind, Reclaim: Copyright Termination in the Music Business*, PKTHINKS (Mar. 2014), *available at* http://www.publicknowledge.org/documents/rewind-reclaim.

advance-recoupment structure or opaque business practices against the artists they serve. But under a statutory license, the law can specify that artists will be directly paid a certain percentage of the fee (regardless of whether they are still in debt to their label), and can have those royalties administered transparently through a third party.

These structures redound especially to the benefit of independent artists. The opacity of industry negotiations can leave the smaller players out in the cold, but a statutory license ensures that even the smaller companies can expect the same baseline rate as the most powerful players in the business. This does not necessarily mean that their gross revenues will be the same, but just that their per-play rates will be much more equitable than if the smallest labels and published had tried to establish fees without a statutory license.

For these reasons, Congress should continue to use the existing statutory licenses to promote a healthy music marketplace while considering expanding statutory license to new uses like interactive streaming services.

2. Setting Ratemaking Standards for Compulsory Licenses

The benefits of statutory licenses listed above will only materialize if the rates of the statutory licenses are set wisely. A rate set too low could disincentivize the creation of new works. A rate set too high could give copyright owners an effective veto power, resulting in the various types of bottlenecks discussed in Section II above. If the statutory license rates are set too high, they will fail to meaningfully impact parties' negotiations, resulting in a proliferation of direct deals that may lack the benefits of statutory licenses, like direct artist splits and transparency.

Here, it is not wise to have the statute actually set the rate, but it is vitally important that the statute's rate-setting standards can predictably lead to reasonable rates. The § 801(b) standard for determining statutory license royalty rates is the best existing tool for determining reasonable online music royalties, and indeed should be used for terrestrial radio as well.[45] The § 801(b) standard is currently used to determine royalty rates for digital cable and satellite broadcasters, namely: Sirius XM, Music Choice, and Muzak.[46] This same standard is also used to set royalty rates in several other areas of the music industry, like mechanical reproduction royalties paid by record labels to songwriters, and for broadcasters' payments to performing rights organizations ASCAP, BMI, and SESAC.[47]

Section 801(b) directs the Copyright Royalty Board (CRB) to consider a set of factors in setting the relevant royalty rate:

> (A) To maximize the availability of creative works to the public.
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[48]

These factors balance considerations for the level of compensation that should be distributed to the artists with the public interest in the distribution of works and the impact of the rates on the companies that will have to pay them. The § 801(b) standard is also on its face more in line with the Constitutional purpose of copyright law—creating economic incentives with the

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[45] *See* 17 U.S.C. § 801(b).

[46] Glenn Peoples, *Business Matters: Let's Get Ready To Rumble! 2013's Dueling Internet Radio Royalty Bills*, BILLBOARD, (Sept. 27, 2012), http://www.billboard.biz/bbbiz/industry/digital-and-mobile/business-matters-let-s-get-ready-to-rumble-1007962272.story.

[47] *See* 17 U.S.C. §§ 114(f)(1)(B), 115, 116.

[48] 17 U.S.C. § 801(b).

ultimate purpose of encouraging artists and platforms to create new works and bring those works to market.[49]

In past ratemakings, the CRB has used evidence from relevant or similar markets to estimate the upper limit of the compulsory rate.[50] The CRB then applies the four factors of § 801(b) to adjust the rate as necessary.[51] The first two factors are generally interpreted in the copyright owners' favor, while the third presents an opportunity for all parties to put forth evidence of the economic value of their contribution to the supply chain. In the past, the royalty rates have been lowered under the fourth factor to avoid significant disruption to satellite radio, but would also present an opportunity for copyright owners to present evidence on, for example, any substitution effects the online marketplace has on other product markets. Either way, the fourth factor does not in itself protect companies in any part of the process from going out of business.[52]

The factors set out in § 801(b) are more likely to consistently reach reasonable royalty rates than the willing buyer/willing seller standard used for webcasting licenses under § 114. The § 801(b) is no guarantee, however, that rates will always be a simple low percentage; digital cable services, for example, must pay a minimum of $100,000 per year as part of their

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[49] U.S. CONST. art. I, § 8, cl. 8. *See also Mazer v. Stein*, 344 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'").

[50] Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008), http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf.

[51] 17 U.S.C. § 801(b)(1)(A)-(D); Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008).

[52] Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080 (Jan. 24, 2008) (CRB adjusting rates downward to avoid disruption to satellite companies); 63 Fed. Reg. 89, 25394, 25408 (May 8, 1998) ("The law requires the Panel, and ultimately the Librarian, to set a reasonable rate that minimizes the disruptive impact on the industry. It does not require that the rate insure the survival of every company.").

royalties.[53] And in certain circumstances the CRB has in the past determined that none of the § 801(b) factors justified lowering the rates from the market evidence presented by the parties.[54]

In contrast to the § 801(b) factors, the willing buyer/willing seller standard requires the CRB to envision the rate that would be paid in a hypothetical marketplace.[55] Section 114 also requires the CRB to consider the promotional or substitutional effects of the online radio service for the sound recordings, and the relative contributions of the copyright owner and radio service. Under the willing buyer/willing seller standard, the Copyright Royalty Judges (CRJs) look for the perceived economic value of the sound recordings, as demonstrated by the fees that two hypothetical parties in a competitive marketplace would willingly agree to. The difficulty with this standard is that the realities of the marketplace are far removed from a hypothetical negotiation between a willing buyer and a willing seller. For one thing, copyright law never granted a digital audio transmission right for sound recordings without either exempting webcasters or establishing a compulsory license. This means that a marketplace with online radio services and rightsholders with the power to withhold permission has never existed. Moreover, the monopolistic nature of the marketplace in these negotiations means that there is no competitive benchmark to compare the rates to, so it is very difficult to determine what an undistorted market would look like.[56] And as discussed above with the publishers' and PROs'

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[53] 37 C.F.R. § 382.2 (2008).

[54] Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding; Review of Copyright Royalty Judges Determination; Final Rule and Notice, 74 Fed. Reg. 15, 4510, 4523-4525 (Jan. 26, 2009), http://www.loc.gov/crb/fedreg/2009/74fr4510.pdf.

[55] 17 U.S.C. § 114(f)(2)(B) ("In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller."). *See also* 17 U.S.C. §§ 114(j)(6), (8).

[56] *See The Performance Rights Act and Parity among Music Delivery Platforms: Hearing on S. 379 Before the S. Comm. on the Judiciary*, 111th Cong. (2009) (statement of Robert Kimball, Executive Vice President for Corporate Development & General Counsel, RealNetworks, Inc.) at 9,

attempts to selectively withdraw rights, the willing buyer/willing seller standard is vulnerable to gamesmanship from companies coordinating to raise rates in negotiations to be used as benchmarks for the statutory license.

There is, however, at least one way in which the § 801(b) standard could be improved. Section 801(b) currently only refers to copyright owners and copyright users, but not to artists directly.[57] Often the copyright owner of a sound recording will be a record label, but the label's interest in these proceedings may not always align with the actual creator. Future amendments to statutory licensing structures should include artists in the second and third factors of the § 801(b) standard.

B. Collective Licensing

In Question 7 of its Notice of Inquiry, the Copyright Office asks whether the consent decrees governing ASCAP and BMI are serving their intended purposes.[58] The Copyright Office also inquires whether the concerns that originally motivated the consent decrees still exist.[59]

A review of the ASCAP and BMI consent decrees' impact on the market reveals that they do still provide significant benefits to the licensing marketplace and the original reasons for the consent decrees still exist today. Moreover, the Copyright Office and Congress should continue to consider how collective licensing mechanisms—with appropriate safeguards against anticompetitive or otherwise abusive behavior—can benefit the music marketplace today.

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http://judiciary.senate.gov/hearings/testimony.cfm?id=4011&wit_id=8164. SoundExchange is the only entity with authority to license, collect, and distribute digital performance royalties for webcasting. SoundExchange Organization, http://www.soundexchange.com/about/.

[57] 17 U.S.C. § 801(b).

[58] Music Licensing NOI at 14,742.

[59] *Id.*

1. Collective Licensing Mechanisms Can Enhance Efficiency in the Market

Collective licensing offers the benefit of decreasing transaction costs, both in negotiating and in paying licensing fees. Collective licensing mechanisms should, however, include certain protections for licensees. For example, collective licensing structures must include protections against anticompetitive behavior, and collective licensing should not give rise to situations where licensees (particularly those operating digital services) pay twice for the right to digitally transmit a single work (a practice often referred to as "double dipping").[60]

Congress could maximize the benefits of collective licensing to facilitate the development of new online music services by taking steps to create digital music rights organizations (DMROs) to consolidate licensing for the reproduction, distribution, and public performance rights to nondramatic musical works, making it easy to find and obtain licenses. For example, in Public Knowledge's proposed Copyright Reform Act, Public Knowledge and the Samuelson Law, Technology & Public Policy Clinic explained that Congress could require competitive DMROs to offer blanket licenses to their entire catalogs of works, to offer reasonable and nondiscriminatory licensing terms, and to maintain an up-to-date searchable online database of the works they are authorized to license.[61]

New consolidated licensing shops[62] could make it much easier for licensees to obtain mechanical licenses for the development of new online music services. This proposal is strongly influenced by Former Register of Copyrights Marybeth Peters' recommendation to reform § 115 by creating music rights organizations, modeled after existing PROs, that would handle the

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[60] *See, e.g.,* Peters, *Music Licensing Reform Statement*.

[61] *See Copyright Reform Act, Streamlining Music Licensing to Facilitate Digital Music Delivery*, Prepared on Behalf of Public Knowledge, Daniel S. Park, Jennifer Lynch, Jennifer Urban, Berkeley Law (Mar. 2011), www.publicknowledge.org/files/docs/crastreamingmusiclicensing.pdf.

[62] Peters, *Music Licensing Reform Statement*.

licensing activities for all nondramatic musical works.[63] If properly restricted from engaging in anticompetitive conduct, PROs can be effective means of licensing the rights to a large number of works, because they collectively cover almost every musical work and they offer blanket licenses under nondiscriminatory terms.

Although, as discussed above and below, collective licensing mechanisms must be designed carefully to protect against abuse of market power, if a collective licensing mechanism has protections to ensure reasonable licensing terms, collective licensing can be a useful way to lower transaction costs for everyone and encourage the development of new services that help customers lawfully access the music of their choice.

2. Collective Licensing Under the ASCAP and BMI Consent Decrees

The ASCAP and BMI consent decrees have helped listeners, independent artists, and competitive new music services. The consent decrees have allowed diverse licensees—from local bars to online streaming services—to pay many artists at once while obtaining reasonable rates. The consent decrees have thus allowed industry players to making the licensing and payment process more efficient while minimizing the risk of anticompetitive practices by the largest PROs.

Moreover, the reasons for creating the consent decrees are still valid today. ASCAP and BMI are still by far the dominant players in the market for public performance rights. Without the consent decrees, these two PROs would have the ability to leverage their market power against innovative new services even more dramatically than the major labels or largest publishers have been able to. If anything, consolidation in the music industry as a whole has only increased significantly since ASCAP and BMI entered into the consent decrees, and they are if

[63] *Id.*

anything only more necessary to protect competition today than when they were created. Additionally, the coordinated plans described by Judge Cote in the rate court litigation between ASCAP and Pandora reveal that the publishers and PROs are well aware that they could potentially coordinate their negotiations to benefit each other at the expense of consumers, music delivery services, and independent publishers and songwriters.[64] To weaken or remove the consent decrees after such a clear warning would only be inviting less competition and innovation in the online music marketplace.

CONCLUSION

The policies that shape the music marketplace should be directly aimed at encouraging the creation and dissemination of new works for the benefit of everyone. To this end, music licensing structures should promote competition and encourage the development of music services that compensate artists and provide listeners will lawful options to access music. Public Knowledge and the Consumer Federation of America therefore ask the Copyright Office to support policies that will protect a robust and competitive music marketplace.

Respectfully submitted,

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[64] *See In re Petition of Pandora Media, Inc.*, Nos. 12-cv-8035, 41-cv-1395 (S.D.N.Y. Mar. 18, 2014).

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May 23, 2014