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In the Matter of:

Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries

Docket No. RM 2008-8

BUSINESS MUSIC INDUSTRY'S COMMENTS

I. INTRODUCTION AND SUMMARY

Muzak LLC, DMX, Inc., Ecast Inc., TouchTunes Music Corporation and AMI Entertainment join together in providing these comments ("Comments") that reflect the common concerns between two segments of the business music industry – the background music services and the digital music jukebox services, (collectively, business-to-business "B2B music providers").[1] These Comments respectfully request the Copyright Office to reconsider going forward with the proposed rule set forth in the Notice of Proposed Rulemaking ("NPRM").[2] B2B music providers offer music programming to any business serving the public, including but not limited to retailers, restaurants, supermarkets, and health and fitness centers. As explained more fully below, the rule if adopted would be an incomplete solution that will cause substantial harm to the business music market. Specifically, if it became effective, the rule would:

- make legal liability certain for B2B music providers with respect to server and cache copies made in the course of a transmission

[1] Companies in the digital jukebox industry will likely put forward separate comments highlighting specific issues as they relate to this proposed rule.

[2] 73 Fed. Reg. 40802 (July 16, 2008) (Notice of Proposed Rulemaking). [hereinafter, "NPRM"].

- fail to consider that B2B music providers lack any cost effective forum to set a reasonable mechanical royalty rate for these copies
- force many B2B music providers to change long-standing business models and disrupt service or, in the alternative, face music publishers' lawsuits for copyright infringement
- force B2B music providers to reduce their libraries for music play to a fraction of their current library licensed through the PROs as they will only be able to play that music for which the publishers can actually clear the mechanicals
- exacerbate the harm from competitive new consumer-oriented entrants to the business music market, who can and will avail themselves of the 115 license to gain greater percentage of the business music market.

While these Comments present the shortcomings of the rule through the paradigm of B2B music providers, the chief shortcoming (the inability to clear all the mechanical rights) is equally applicable to all music services. This alone suggests that the proposed rule would accomplish little other than to assure there are more voices clamoring for a fix to the 115 license in the next Congress. But even then, there are no guarantees that those voices will sing in harmony for the same fix or that Congress will not once again turn a deaf ear to those petitions for one reason or another.

II. COPYRIGHT OFFICE IS WELL-INTENTIONED BUT CONGRESSIONAL INERTIA IS NOT A BASIS FOR VALID RULEMAKING

The B2B music providers appreciate the leadership that the Copyright Office demonstrates by its willingness to step in a quagmire where Congress has been unwilling to act. The Copyright Office has long recognized the problem that has existed in the music rights marketplace and called on Congress to fix the problem. In this Congress alone, the Register of Copyrights told Congress in a March 2007 hearing that the 115 license needed to be fixed and urged Congress to act.

During the hearing, the Register said that the music services operated in an environment where copyright owners sought to extract royalties for the services' online activities where only arguably a royalty right might be implicated.

> In the meantime, music services operate under the threat of further suits and without any guidance on how to proceed. A far simpler and more direct approach to the problem would be for Congress to amend the law to clarify which rights are implicated in the digital transmission of a musical work. For example, it may well be advisable to amend the law to clarify what constitutes a public performance in the context of digital transmissions, or to provide that when a digital transmission is predominantly a public performance, any reproductions made in the course of transmitting that performance will not give rise to liability.[3]

Notably, the Register, head of the very same agency issuing this NPRM, did not suggest in her testimony that a rulemaking would be a simpler and more direct approach to the very same problem that the Copyright Office intends to address in this NPRM. This testimony was but last year. And nowhere in her statement does the Register suggest that the Copyright Office sought to resolve these issues in an administrative rulemaking.

The Copyright Office suggests that it is issuing this NPRM due to Congressional inertia.[4] Valid agency rulemaking, however, requires more. The Copyright Office states that jurisprudence pertaining to the section 111 cable statutory license supports its authority to act.[5] The underlying issues in those decisions are likely distinguishable from those here affecting the substantive rights of parties. While the authority to promulgate the regulation may be questionable, these Comments do not seek

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[3] *Reforming Section 115 of the Copyright Act for the Digital Age Before the H. Comm. on Judiciary*, 110th Cong. (2007) (statement of Marybeth Peters, Register of Copyrights, Copyright Office).

[4] NPRM at 40805.

[5] *Id.* at 40806.

so much to tell the Copyright Office it cannot issue this proposed rule, particularly when it seeks to fill a void in leadership that Congress and industry has been unable to fulfill, but these Comments are requesting that the Copyright Office consider the distorting and harmful effects the rule will have on the business music market and those services genuinely trying to make a business in it. Upon further consideration of these effects, which the Copyright Office surely does not intend to create, these Comments request that the Copyright Office reconsider the rule and recommit itself to advocating to lawmakers a comprehensive solution for services serving both the consumer and business markets.

III. THIS RULE WILL RESULT IN MARKET FAILURE IN THE BUSINESS MUSIC MARKET

A. While the Rule Offers 115 Licensees More Legal Certainty, It Merely Threatens to Expand Liability for B2B Music Providers

1. 115 licensees would get legal certainty with the benefit of access to the Copyright Royalty Judges

The NPRM proposes to offer certain benefits. As noted at the outset of the NPRM, it seeks to cure the legal uncertainty that music services have confronted for numerous years now. Specifically, the music services are forced to operate in an "environment in which it is not always apparent which rights must be cleared and how one can obtain them."[6] The NPRM goes on to suggest that this rule will provide legal certainty with respect to the "making of all phonorecords made during the course of a transmission without regard to whether that transmission also involves the delivery of a public performance."[7] Thus, the rule proposes to clarify that liability does indeed attach

[6] NPRM at 40806.

[7] *Id.*

to all of the copies, whether server or cache copies made in the course of delivering music, and liability also results even if the service is also paying a performance royalty.

The NPRM intends to extend another benefit to the parties, who now face the certainty of legal liability for these copies; they can avail themselves of the 115 license and the ratemaking determinations of the Copyright Royalty Judges ("CRJ").[8] While it does not propose to dictate when a license is necessary,[9] the NPRM asserts that this proposed rule "would make the use of the statutory license available to a music service that wishes to engage in such activity without fear of incurring liability for infringement of the reproduction or distribution rights."[10] The parties are free to continue their arguments before the CRJ over the value of these copies. In essence, to the extent parties are unhappy about the proposed rule, particularly the newly imposed liability, they are conciliated with the fact that they can now avail themselves of the 115 license – a statutory license designed to protect against market failure. As discussed below, the well-intended rule fails to consider the market failure it is about to create in the business music market.

2. B2B music providers would merely get expanded liability with no commercially reasonable solution to new royalty demands

If this proposed rule becomes effective, the B2B music providers would face a market failure. The proposed rule draws no distinctions between music providers serving the consumer market from those serving the business market. The rule is

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[8] NPRM at 40810.

[9] NPRM at 40805.

[10] *Id.*

applicable to all music services. The B2B music providers will confront certain legal liability for these copies. But there is no conciliation for this newly imposed liability as they remain outside the 115 license.

The B2B music providers have historically been excluded from the 115 license due to limitations set forth in the license. Section 115 states:

> A person may obtain a compulsory license only if his or her primary purpose in making phonorecords is to distribute them to the public for private use, including by means of a digital phonorecord delivery.[11]

B2B music providers have assumed that the business music market falls outside the private use limitation. Moreover, since B2B music providers tend to exclusively focus on this business music market, they have concluded that the "primary purpose" language excludes them from the 115 license.

The B2B music providers will, therefore, not be able to partake in any proceeding as the NPRM envisions where they can "argu[e] to the Copyright Royalty Judges that the royalty fees for certain of the licensed activities should be nominal or even free." Instead, they face intractable negotiations where music publishers will demand a substantial royalty.[12] And the music publishers will do so buttressed with this rule clarifying that server and cache copies implicate the mechanical right. With the threat of an infringement suit more likely, B2B music providers will have few choices but

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[11] 17 U.S.C. § 115(a).

[12] NPRM at 40805.

to shut down or pay royalty rates that music publishers may not deserve[13] or that B2B music providers can not afford to pay.

B. The Rule Threatens B2B Music Providers Engaged in Broadcasting

Because the NPRM does nothing about clearing the mechanical rights of all the music publishers, it threatens B2B music providers, who are predominately engaged in broadcasting (streaming). Assuming *arguendo* that B2B music providers could negotiate with the music publishers – their services would still be jeopardized as the NPRM does nothing about clearing the mechanical rights to all the music the services are broadcasting day in and day out. B2B music providers, who have built their business around a broadcast model, can clear the performance rights to all the music their

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[13] In August 2001, the Copyright Office addressed this issue of buffer copies in its DMCA Section 104 Report. At the time it noted:

> The economic value of licensed streaming is in the public performances of the musical work and the sound recording, both of which are paid for. The buffer copies have no independent economic significance. They are made solely to enable the performance of these works. The uncertainty of the present law potentially allows those who administer the reproduction right in musical works to prevent webcasting from taking place – to the detriment of other copyright owners, webcasters and consumers alike – or to extract an additional payment that is not justified by the economic value of the copies at issue.

DMCA Section 104 Report at XXVI. The Copyright Office explained further in the report:

> the sole purpose for making these buffer copies is to permit an activity that is licensed by the copyright owner and for which the copyright owner receives a performance royalty. In essence, there appears to be some truth to the allegation made by some commenters that copyright owners are seeking to be paid twice for the same activity. Demanding a separate payment for the copies that are an inevitable by-product of that activity appears to be double dipping . . . .

Id. at 140.

services want. In contrast the "Harry Fox Agency [("HFA")] can license only a fraction of the works licensed by the PROs."[14] Thus, burdening the B2B music providers with a mechanical royalty obligation instantly cuts the library of available music to a fraction of what these services previously could offer their customers.[15]

But assuming a service was still willing to go forward with a fraction of the music library it previously had, and willing to pay the royalty demands of HFA, the NPRM still wrecks havoc on the service. The relatively short period of time before the rule becomes effective would make it impossible to determine efficiently which music could be cleared through HFA. Thus, the NPRM will force B2B providers, who have built a business around a broadcasting model, into the dilemma of either shutting down the service until they can clear the mechanical rights or continuing the service at the risk of some unknown rights holder bringing a lawsuit for copyright infringement.

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[14] *Copyright Office's Views on Licensing Reform Before the H. Comm. on Judiciary*, 109th Cong. 15 (2005) (statement of Marybeth Peters, Register of Copyrights, Copyright Office) (explaining that while the Harry Fox Agency claims to license 90% of the *commercially significant music* distributed in the United States, DiMA asserts that means only 65% of *available music*).

[15] This reduction in play of non-HFA music would create a less desirable product, reduce B2B revenues, and cause a corresponding loss in royalty payments to the PROs. If the NPRM has a goal to improve the welfare of copyright owners, then these Comments question the wisdom here as it would seem the NPRM is engaged in the proverbial mistake of "addition through subtraction." Nevertheless, if the overall welfare of copyright owners is somehow improved, the Comments question which copyright owners benefit more from such a result, since HFA represents the major publishers.

IV. THE RULE WOULD EXACERBATE COMPETITION ISSUES EXISTING IN THE BUSINESS MUSIC MARKET

A. B2B Music Market is Being Cannibalized by Music Service Providers Who Are Primarily in the Consumer Market

The competitive landscape of the business music market is changing. Increasingly, the music played in health and fitness centers may be music programming offered by an SDAR provider, while music played in a bar or restaurant may be music from a webcaster served to patrons over broadband Internet connections. These newer consumer-oriented entrants to the business music market may not be looking to compete head-to-head for the business music customer, as their business models remain focused on attracting individual consumers. Nevertheless, these entrants are willing to pick up incremental revenue and listenership from a myriad of businesses–as diverse as sole proprietorships to franchised organizations–wherever they can be found. While it is unclear how much of the business music market these entrants have already acquired, in the aggregate competition from these consumer-oriented entrants is certainly proving very painful to the bottom-line of genuine B2B music providers as any loss in customers further reduces revenue in a business with substantial fixed costs and addressable markets that do not include individual consumers.

B. These Same Music Providers Will Avail Themselves of the 115 License and Expand Further in the B2B Music Market

While the NPRM will burden the newer consumer-oriented entrants with the mechanical royalty as well, they will still be able to avail themselves of the 115 license. The new entrants' business models remain focused on individual consumers such as residential customers. Even though they have some business customers, they will avail themselves of the 115 license as they will argue that the primary purpose of

their music service is to deliver music to these individual customers for private use. And so long as this is the case, the newer consumer-oriented entrants will be able to increase their market share of the business music market under the auspices of the 115 license.

The B2B music providers impacted by this rule will find it difficult to fend off these predatory newer consumer-oriented entrants. In the short-term, if B2B music providers are forced to disrupt their business models as well as negotiate and clear rights never before required then these consumer-oriented entrants have a perfect opportunity to acquire some of the B2B customers, who would be denied quality service while their B2B music provider is retooling. In the long term, the higher mechanical payments that the B2B music provider has to pay would put them at a competitive disadvantage vis-à-vis the consumer-oriented entrants, that will have lower-and-more certain payments under the statutory license. Consequently, the newer consumer-oriented entrants to the business music market will make further inroads into a market which they have done little to earn.

V. CONGRESS NEEDS TO PROVIDE A COMPLETE SOLUTION

A. This rule, if it were valid, would force the Copyright Office to pick winners and losers in the marketplace

If the rule were to become effective, it would have disparate impact on similar parties. It would impose liability on all music service providers, but offer relief to only those music service providers in the consumer market. Distinctions could be drawn between music providers serving the consumer market and those serving the business market that could offer ad-hoc justification for the disparate result. However, such distinctions would be

illusory as the evidence shows newer consumer-oriented entrants to the business music market do not comport to such a theory. To the extent the rule proposes a partial solution favorable to the music providers in the consumer market, it leaves the spoils of the business market to the new entrants–a result these Comments hope nobody believes is warranted. Thus, these Comments suggest that if the Copyright Office goes forward with this rule, it will indeed be favoring a solution for the consumer music market at the expense of the business music market and choosing new entrants as heirs to the business music market.

This rule would also pick winners and losers in music services in choosing a business model. Music services have struggled to develop their business and develop lawful services within the existing imperfect framework. The sale and distribution market ("download") has long been infirmed as the 115 license has been unable to create a robust marketplace. Very few services have been able to clear the rights needed to offer consumers the array of music they desire, and they have managed only to do so after making an enormous investment into clearing the rights. But even after making such an investment, no service can claim to have cleared all the rights to the music that consumers may want. Disputes over hybrid products such as interactive streams and limited downloads have raised further questions over the adequacy of the 115 license. The NPRM is in complete agreement on this overall point.

In contrast to the download market, music services operating in the broadcast market have found it to run smoothly overall. The various different types of services are able to clear the performance rights they need in order to

operate their services. And they can do so for 100% of the available music, as royalties for the services' online activities can be collected by the performance rights organizations (ASCAP, BMI, and SESAC). As previously mentioned, the B2B music providers tend to have broadcast business models, and even assuming they can enter into a deal with HFA for the mechanical rights, this rule would leave them with a fraction of the music library they once had. This will be equally true for all music services in the broadcast market. Therefore, to the extent that the proposed rule saddles the music services in the broadcast model with the burdens of the download market, these Comments would suggest that the Copyright Office is not in fact picking any winners or losers. Instead, it is risking one healthy – albeit less profitable – model in order to save an infirmed model that certain industry players believe hold the solution to the crisis in the music industry today.

B. Only Congress Can Provide a Comprehensive Solution to All Music Providers

In light of the issues that this proposed rule creates, particularly for the B2B music providers, and the number of issues left to be resolved, Congress is the only body that can offer the music industry a comprehensive solution. Rulemaking, when valid, can only do so much as agencies have power to engage in (i.e., legislative power that has been delegated to them). But even then, rulemaking as a substitute for legislation offers at best a piecemeal approach. This proposed rule and its shortcomings present the quintessential limitations of agency rulemaking. The pronounced basis to promulgate this rule, the Copyright's Office's authority to administer the 115 license, raises question on the validity of the rule as it is effectively imposing new royalty

obligations on parties not previously subject to the license. Certainly, Congress has the power to do what the proposed rule seeks to do. Moreover, Congress knows how to delegate legislative power to the Copyright Office to sort out the problem here. The Congress, however, has not done so at this point. Instead, it has exercised its prerogative over the issues, which has included oversight hearings and false starts with legislation. As the NPRM correctly concludes, Congress has failed to act. For many, including the Copyright Office, the status quo is frustrating. Nevertheless, seeking a short-cut as currently presented in the NPRM does little to fix the problem and puts much at risk – hardly a manner in which an agency is expected to administer a public good with which it is entrusted.

Only an act of Congress can at one time present a solution to the issues presented in these Comments. Congress can decide (1) whether the mechanical right is implicated by limited downloads, interactive streaming and even streaming generally; (2) whether B2B music providers should be able to avail themselves of the 115 license; or alternatively, how the playing field can be leveled between newer, consumer-oriented entrants to the business music market, who can and will avail themselves of the 115 license, and the B2B music providers, who are excluded from the 115 license; and (3) if the mechanical right is implicated by streaming, whether a designated agent should be created to clear the mechanical rights for all available music.

VI. CONCLUSION

The Copyright Office has demonstrated tremendous leadership to propose this rule – which it believes to set the industry on a course out of the crisis it perceives. The rulemaking process is designed to give an agency the benefit of the perspectives of everyone that would be affected by a proposed rule. For the reasons stated herein, these

Comments hope that upon further reflection, the Copyright Office will have the courage to reconsider the rule and return to prodding Congress for a comprehensive solution that provides some amount of benefit to all the services.

Respectfully submitted,

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