Before the
U.S. COPYRIGHT OFFICE
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of **Music Licensing Study: Notice and Request for Public Comment**	**Docket No. 2014–03**

COMMENTS OF MUSIC CHOICE

Introduction and Background

Music Choice appreciates the opportunity to respond to the Copyright Office's Notice of Inquiry ("NOI") on the current music licensing landscape and various legal and policy issues related to music licensing. As the very first digital music service, and one of the few early services to survive to the present day, Music Choice is in a unique position to provide a perspective informed by long experience.

Music Choice began as a residential cable radio service. It was started by David Del Beccaro in 1987 as a project within Jerrold Communications, which was a division of General Instrument Corporation. General Instrument was a cable/satellite equipment supplier, and the technology underlying the Music Choice service was initially developed to sell equipment to cable operators.

Jerrold started providing the Music Choice service to the public on a test basis in July 1988. After approximately four years of product development and market testing within Jerrold, Mr. Del Beccaro helped secure financing for the digital music service concept through a partnership of major cable and technology companies, and beginning in 1991 the company was spun off as a stand-alone entity called Digital Cable Radio Associates. At the same time, the cable radio service was launched nationwide.

When Music Choice first launched, it was an *a la carte* service, *i.e.*, the consumer paid specifically for the Music Choice service in the same way that some cable subscribers pay specifically for HBO today. Cable affiliates charged subscribers $9.95 per month in the early stages, during a time when the basic cable package generally cost around $20 per month and there were very few channels that a cable subscriber could purchase separately, aside from HBO and Showtime. The need to charge $9.95 per month arose, in part, from the fact that a separate digital audio tuner, in addition to the cable box, was required to transmit the service into the home. As the first digital music service, Music Choice had to create the necessary digital audio technology because it did not exist in the marketplace.

The service did relatively well for the first year. But once the most avid music fans had signed up for the service (representing a small, i.e., single digit, percentage of total homes), the cost of the service deterred additional subscribers while customer acquisition and retention costs remained high (as they always have been for music subscription services), and Music Choice's service proved to be unprofitable. As it became clear that Music Choice would take longer than anticipated to become profitable, and requiring additional capital investment to continue operations, Music Choice sought out new investors, specifically ones that would have a strategic interest in the success of the enterprise, such as music companies.

In 1993-94, when Music Choice took certain of the record companies (namely, Warner, Sony, and EMI) on as partners, there was no statutory obligation for Music Choice to pay for the performance of sound recordings. In connection with that investment, and for the purpose of creating purported evidence that there was a recognized value to the performance of sound recordings, the music company partners insisted that Music Choice agree to pay their affiliated record companies a license fee. At the time, Warner, Sony and EMI collectively controlled over two-thirds of the market for sound recordings and therefore had significant bargaining power. Moreover, Music Choice management had determined that the company could not stay in business without additional capital investment from new partners. Thus, Music Choice was desperate to add partners that would contribute capital to the company and the music companies were willing to do so – partially in trade for Music Choice agreeing to a royalty rate at the requested amount. The royalty rate requested by the labels was two percent of revenue, adjusted for the percentage of each record company's music played on the Music Choice service so that two percent would cover the entire record industry. The record companies viewed this as a good rate for the sound recording performance right because it was similar to the rates music publishers received for existing performance licenses.

Music Choice's business model underwent significant transformations as home entertainment technology and infrastructure continued to modernize. In the mid-nineties, with the introduction of the first cable television boxes that could receive a digital audio signal, Music Choice was able to eliminate the need to manufacture and sell separate digital audio receivers to cable subscribers. The ability to transmit the service to the cable operator's cable box allowed Music Choice to reach a much larger audience than it could when the service required the sale of a separate digital receiver. As Music Choice's market penetration into homes served by cable, satellite and other multi-channel video programming distributors ("MVPD's") increased in the mid-1990s, however, the price it was able to obtain from MVPDs as part of a bundled, basic cable package plummeted. That pricing trend continues today. The Music Choice service is now available in 56 million homes, accounting for a majority of digital MVPD subscribers, with 57 million monthly listeners on average. Yet at the same time, the average price per subscriber paid by the MVPDs has dropped significantly, as Music Choice has faced increasing competition from other MVPD channel providers.

Music Choice currently provides 50 channels of diverse audio programming as part of its residential music service. Each audio channel provides a distinct musical genre or sub-genre to the listener. Music Choice's residential service also includes a music video on demand ("VOD") service, and Music Choice Play, a video channel that features significant music-related original programming created by Music Choice as well as music videos licensed directly from record companies. The Music Choice residential service is transmitted to customers primarily by cable operators and other MVPDs as part of a bundled package of television channels (*e.g.*, the Music Choice service is included by MVPDs as part of their digital basic television service to their customers). In addition, Music Choice has developed a separate, commercial background music business line, which is also transmitted through MVPDs as well as sold by local dealers.

As noted above, Music Choice produces a large amount of original content, including audiovisual works for its video channel, and is therefore both an owner and user of copyrighted works. As such, Music Choice recognizes the important need to balance the rights of copyright owners against the public interest, including the interest in services that increase the public availability of copyrighted works, a need that has been repeatedly recognized by the Supreme Court. As the Copyright Office itself has previously observed:

> It has been a generally accepted principle in copyright law that the needs and concerns of the public must be acknowledged. *See, e.g., Fogerty v. Fantasy, Inc.*, 510 U.S. 517 (1994)("The primary objective of the Copyright Act is to encourage the production of original literary, artistic, and musical expression for the good of the public."); *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975)("Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts.").

United States Copyright Office, *STELA §302 Report* 16 n.24 (2011).

I. <u>Musical Composition Performance Licensing</u>

A. <u>Effectiveness of current process for licensing performance rights (Topic 5)</u>

The current process for collective licensing of musical composition performance rights through ASCAP and BMI works well, even if not perfectly, and should not be changed.

Musical composition performance rights are offered through licenses from three performing rights organizations ("PROs"): the American Society of Composers, Authors and Publishers ("ASCAP"); Broadcast Music, Inc. ("BMI"); and SESAC.

Each PRO aggregates and licenses a large collection of copyrights from various songwriters and music publishers to a wide variety of businesses that publicly perform music, such as local television and radio stations, bars, restaurants, and digital music services. The repertories of the three PROs are exclusive of one another but, collectively, represent nearly all commercially significant copyrighted musical composition in the United States and its territories.

If a licensee cannot reach agreement with ASCAP or BMI on the license fee for a proposed use, either party can file a petition in the United States District Court for the Southern District of New York to have the royalty rate set by the court. Notably, the PROs must allow the licensee to use the works in their respective repertories while the parties negotiate a license fee and while they litigate any disputes before the rate court.

In theory, allowing a PRO to perform these functions creates economies of scale for both licensees and copyright owners. On the one hand, licensees can access a large portfolio of copyrighted music through a single license – as opposed to contracting with each individual copyright holder. On the other hand, copyright owners benefit from the PRO's experience and resources in monitoring the market, negotiating licenses, and distributing the revenue.

B. Continuing vitality of ASCAP and BMI consent decrees and rate court

In practice, the benefits of working with collectives such as the PROs, as between licensees and copyright owners, tend to favor the copyright owners – so much so that oversight was quickly deemed necessary. For over seventy years, the United States Department of Justice (the "DOJ") has regulated the collective licensing of musical composition performance rights through consent judgments, which bind both ASCAP and BMI (the "Consent Decrees"). The DOJ, with court approval, periodically has modified and updated the Consent Decrees to address new problems and adapt to developing technologies and other changing market conditions.

In 1941, the DOJ filed a complaint against ASCAP, alleging that ASCAP's blanket license was an illegal restraint of trade under § 1 of the Sherman Act, eliminating competition among ASCAP's member-affiliate copyright owners and allowing them to fix prices for their music. *See* Complaint, *United States v. Am. Soc. of Composers, Authors & Publishers*, Civ. No. 13-95 (S.D.N.Y. 1941). Shortly after the complaint was filed, the case was settled by entry of a consent decree. Although liability was not conceded, the decree imposed extensive restrictions on ASCAP designed to minimize the inherent anticompetitive effects of collective licensing. These restrictions required ASCAP to (1) offer a per-program license, in addition to the blanket license; (2) issue a license upon request; and (3) allow membership to any composer of at least one work. *See United States v. ASCAP*, 1940–1943 Trade Cases ¶ 56,104 (S.D.N.Y. 1941).

The 1941 ASCAP consent decree was amended and expanded in 1950 in connection with *United States v. Am. Soc. of Composers, Authors & Publishers*, No. 42–245, 1950 WL 42273 (S.D.N.Y. July 17, 1950). Article IX(A) in the amended decree, referred to as the "Amended Final Judgment," established "rate courts" as a venue for applicants seeking a license from ASCAP who believe they are being overcharged " to apply to the District Court for the determination of a 'reasonable' fee. " *See Buffalo Broad. Co., Inc. v. Am. Soc. of Composers, Authors & Publishers*, 744 F.2d 917, 923 (2d Cir. 1984) (*citing Buffalo Broad. Co., Inc. v. Am. Soc. of Composers, Authors & Publishers,* 546 F. Supp. 274, 279 n. 6 (S.D.N.Y. 1982)). The Amended Final Judgment was further amended twice in 1960, and over a dozen more times over the subsequent forty years. The latest iteration of the ASCAP consent decree, issued in 2001, is referred to as "AFJ2." *See United States v. Am. Soc'y of Composers, Authors, Publishers,* No. Civ. 41-1395, 2001 WL 1589999, at *5 (S.D.N.Y. June 11, 2001). AFJ2 continues to provide rate court supervision over royalty negotiations. AFJ2 also prohibits ASCAP from discriminating in pricing or with respect to other terms or conditions between "similarly situated" licensees.

BMI's evolution followed a similar path. In 1941, shortly after BMI was formed to compete with ASCAP, BMI entered into a consent decree with the DOJ. *United States v.* BMI, 1940-1943 Trade Cases ¶ 56,096 (E.D. Wis. 1941). In 1966, the DOJ filed a complaint against BMI. The complaint alleged that BMI constituted a combination both to restrain trade and to monopolize, and was thereby able to, among other things, coerce composers to join BMI, harming competition. That same year, BMI and the DOJ settled the case by entry of an amended consent decree, with restrictions similar to the ASCAP consent decree. *See United States v. BMI*, 1966 Trade Cases ¶ 71,941 (S.D.N.Y. 1966). Since 1994, BMI has also been subject to the jurisdiction of a rate court, to which licensees or BMI may apply to determine a reasonable fee. *See United States v. Broadcast Music, Inc., et al.*, No. 64-3787, 1994 WL 901652, 1996–1 Trade Cases ¶ 71,378 (S.D.N.Y. Nov. 18, 1994).

Although the rate court process is not perfect, it is essential to the fair market collective licensing of musical composition copyrights. Having been forced to litigate a rate case against BMI that lasted several years, including two appeals, before finally settling with BMI, Music Choice is well aware of the costs and delays associated with rate court. Indeed, such costs are disproportionately burdensome on individual licensees, especially small companies like Music Choice. The PROs, on the other hand, fund these costs out of the royalty stream provided by the licensees, with any indirect burden spread among their vast constituencies of individual copyright owners. For this reason, among others, even with recourse to rate court, the pressure to accept supracompetitive rates is strong. This was certainly the case with Music Choice, which could not continue to endure the years of litigation costs and settled with BMI for a rate significantly higher than that paid by radio, or even webcasters.

Negotiating these licenses without recourse to a rate court would be even worse, however. ASCAP and BMI each control the rights to such a high percentage of the music played by Music Choice that there is simply no way for Music Choice to operate without licenses from both. The ASCAP and BMI repertories have no competition; one is not a substitute for the other. Nor is direct licensing a viable option, as discussed further below. Consequently, ASCAP and BMI would enjoy (and abuse) absolute market power if negotiations were not regulated by the rate courts, and Music Choice would have no choice but to pay any supracompetitive rates demanded by the PROs or go out of business. Recent history has repeatedly proven that, even when they are subject to rate court supervision, ASCAP and BMI consistently seek unreasonably high (i.e., above fair market) rates.

For the past several years, both ASCAP and BMI have consistently lost rate cases because they requested rates that were deemed, by impartial federal judges based upon a full evidentiary record, to be supracompetitive and outside the reasonable range of fair market value. *See, e.g.*, *Am. Soc'y of Composers, Authors & Publishers v. MobiTV, Incorporation*, 681 F.3d 76, 88 (2d Cir. 2012) (affirming the district court's rate determination, which considered and rejected ASCAP's fee proposals.); *Broadcast Music, Inc. v. DMX Inc.*, 683 F.3d 32, 46 (2d Cir. 2012) ("[T]he district court, after making detailed findings of fact and carefully considering the issues, rejected ASCAP and BMI's overall proposals as unreasonable because they did not reflect rates that would be set in a competitive market.").

Indeed, the Second Circuit has confirmed the need for the rate courts because of the extreme pressure PROs are able to exert on licensees with their market power:

> The [consent decrees] were established as a result of the government's antitrust challenges to ASCAP and BMI's licensing practices. Their purpose was to, in part, promote free competition in the music licensing industry and minimize the "danger of unreasonable activity" resulting from ASCAP and BMI's market power and potential restraints on trade. *See K–91*, 372 F.2d at 4; accord Showtime, 912 F.2d at 570. The rate court mechanism must

> be considered within this context. *See Showtime*, 912 F.2d at 570. The ability of users of music rights to avail themselves of a reasonable rate through the rate court mechanism when ASCAP and BMI's market power might otherwise subject them to unreasonably high fees "would have little meaning if that court were obliged to set a 'reasonable' fee solely or even primarily on the basis of the fees [a PRO] had successfully obtained from other users." *Id.* "The disinfectant [of the rate courts] need not be a placebo." *Id.*

Id. at 49.

More recently, in the Pandora rate case, ASCAP and certain of the major publishers provided a preview of how they would behave if the Consent Decrees or the rate courts were eliminated. In that case, the ASCAP court found disturbing evidence of collusion and abuse of market power by ASCAP and its member publishers. *See In re Pandora Media, Inc.*, No. 12-8035, 2014 WL 1088101, at *35 (S.D.N.Y. March 18, 2014). In response to the string of rate court losses noted above, and at the insistence of certain of its major music publisher members, ASCAP had changed its membership rules to allow a member to selectively withdraw its catalog of music from ASCAP's repertory for only some types of "new media" licensees, such as webcasters, while allowing ASCAP to continue licensing those works to other licensees.

This strategy was specifically created to allow publishers to avoid rate court supervision for certain types of licensees that could be more easily managed and pressured, while allowing the publishers to keep all the benefits of collective licensing for other types of licensees (like radio and television stations, bars and restaurants) where the transaction costs of negotiating direct licenses would be prohibitive. Perversely, with respect to the "new media" direct licenses, the withdrawing publishers negotiated deals with ASCAP providing that ASCAP would continue to have the burden of administering the direct licenses after they were negotiated, but at a substantially lower fee than that charged to ASCAP members. *Id.* at *17. Although this strategy was widely opposed by songwriters as contrary to their interests, ASCAP eventually buckled to the pressure of the major publishers and amended its rules to allow partial withdrawal. *Id*. at **14-16.

Thereafter, major music publishers purported to withdraw their "new media" rights from ASCAP. After EMI Music Publishing ("EMI") withdrew, the withdrawal of Sony/ATV Music Publishing LLC ("Sony") and then Universal Music Publishing Group ("UMPG") followed. Although negotiations with EMI (which was subsequently sold and is now administered by Sony), the first to withdraw, were not contentious and carried forward the same top-line rate as Pandora's existing ASCAP license, later negotiations with Sony and UMPG were oppressive, and resulted in substantially higher royalty rates. *Id*. at **18-29.

Prior to its final rate decision, the court ruled that the purported partial withdrawals clearly violated the ASCAP consent decree, and were therefore legally ineffective. The court found that "under the terms of [the consent decree] ASCAP did not have the right to permit the partial withdrawals of rights at issue and thereby acquiesce to a regime in which some music users could not obtain full public performance rights to works in the ASCAP repertory." *In re*

Pandora Media, Inc., No. 12-8035, 2013 WL 5211927, at *7 (S.D.N.Y. Sept. 17, 2013). In a parallel rate case before the BMI rate court, that court similarly ruled that the purported partial withdrawals violated the BMI consent decree, but held that the result of that violation was that the withdrawing publishers had effectively withdrawn their catalogs completely from BMI's repertory, for all future licensees. *Broadcast Music, Inc. v. Pandora Media, Inc.*, No. 13-4037, 2013 WL 6697788, at *4 (S.D.N.Y. Dec. 19, 2013). In light of this ruling, all of the major withdrawing publishers opted to "withdraw their withdrawals" and return their catalogs to the BMI repertory for all licensees. http://www.bmi.com/licensing/entry/drw.

At trial, the ASCAP court was presented with benchmarks, including Pandora's direct licenses with Sony and UMPG. In its final rate decision, the court rejected these benchmarks, finding that "Sony and UMPG each exercised their considerable market power to extract supra-competitive prices." *In re Pandora Media, Inc.*, 2014 WL 1088101 at *35. Even worse, the court determined that the "evidence at trial revealed troubling coordination between Sony, UMPG, and ASCAP, which implicates a core antitrust concern underlying [the ASCAP consent decree] . . ." *Id*. Further, the court determined that "[b]ecause their [ASCAP, Sony, and UMPG] interests were aligned against Pandora, and they coordinated their activities with respect to Pandora, the very considerable market power that each of them holds individually was magnified." *Id*.

The examples of collusive and oppressive conduct by Sony, UMPG, and ASCAP could have been taken from a Martin Scorsese film. For example, the day after Pandora filed its ASCAP rate court petition, Zach Horowitz (Chairman and CEO of UMPG) personally called the law firm representing Pandora, warning "as a 'friend' of the firm" that the firm would suffer repercussions from its representation of Pandora in connection with its representation of writers and artists in other matters. *Id*. at *20. Mr. Horowitz continued to call the firm with similar veiled threats. At the same time, Mr. Horowitz was sending emails to ASCAP negotiators, as well as his counterpart Marty Bandier, CEO of his competitor Sony, and other key publishing industry leaders, reporting with glee on his attempts to pressure Pandora's counsel, including:

> My take: [Pandora's outside counsel] and Pandora are scared. They just want to settle with ASCAP and settle fast. Be strong. Time is on your side. Pandora is now under intense pressure to settle with ASCAP. They have to put this behind them. You can really push Pandora and get a much better settlement as a result. They are reeling. They will pay more, and a lot more than they originally intended, to do that.

Id. at *20. Mr. Horowitz later reported to John LoFrumento, CEO of ASCAP, that "Pandora's outside counsel 'has been spending hours on fallout from their repping Pandora. They are embarrassed. [Pandora's counsel] said they will withdraw from repping Pandora in the next few weeks if the [rate court litigation with ASCAP] doesn't settle." *Id*. Notably, Pandora's outside counsel for the ASCAP rate litigation subsequently moved, along with the representation of Pandora, to a different law firm.

Other anticompetitive conduct noted by the court included Sony's coercion of ASCAP to scuttle a deal it had finished negotiating with Pandora just so that it could not be finalized prior to the effective date of Sony's purported withdrawal from ASCAP (*Id*. at *21); veiled threats from Sony that it would "shut down Pandora" if Pandora did not agree to its royalty demands (*Id*. at *22); Sony's refusing repeated requests for lists of their catalogs so that Pandora could at least try to remove its music from Pandora's service if no agreement could be reached, even though Sony had such a list prepared and available (*Id*. at *23-25); Sony's inflexible demand for a 25% increase in Pandora's royalty rate (*Id*. at *25); Mr. Bandier's bragging to his Board of Directors that "Sony had leveraged its size to get this 25% increase in rate" (*Id*.); Sony's subsequent leak of key deal terms to the press (and therefore to other publishers), in violation of a confidentiality agreement (*Id*.); implicit threats from UMPG that it would put Pandora out of business if Pandora did not agree to its demanded rate, which was even higher than that demanded by Sony (*Id*. at *26); UMPG's knowledge and use of the confidential Sony deal terms against Pandora (*Id*.); and UMPG's provision of a list of UMPG's songs pursuant to an NDA that prohibited Pandora from using the information to remove UMPG's songs if no agreement was reached (*Id*. at *27-28).

The court first rejected the Pandora-Sony license as a benchmark: "In sum, the combination of the looming January 1, 2013 deadline and the lack of information about the Sony catalogue meant that Pandora was *compelled* to conclude a licensing agreement with Sony at the end of 2012." *Id.* at *38 (emphasis added).

With an even greater distaste for the Pandora-UMPG license, the court also rejected it as a benchmark: "there were virtually no meaningful negotiations between Pandora and UMPG because UMPG, controlling roughly 20% of the music market, began with and insisted upon a demand that *bore no relation* to the then-existing market price." *Id.* (emphasis added).

In the end, the court kept Pandora's rate the same as its rate during the prior license period, which both parties agreed was within the range of reasonable rates. *Id.* at **33, 49.

In the wake of their string of losses, ASCAP, BMI, and the major music publishers have issued press releases and talking points, claiming that the cases demonstrate that the consent decrees (and the rate courts) are no longer necessary and should be abolished. *See, e.g.*, http://www.ascap.com/press/2014/0314-ascap-statement-on-pandora-rate-court-decision.aspx. This claim could not be more obviously or completely wrong. The past several years of rate court decisions, culminating in the recent Pandora decision, all demonstrate the continued need for the consent decrees and the rate courts. Without the rate courts, ASCAP and BMI would have been free to demand the supracompetitive rates rejected by the courts and licensees' only options would be to either pay those unfair rates or go out of business. The publishers' argument is the equivalent of a driver repeatedly getting ticketed for running the same red light arguing that the high number of tickets proves that the traffic light should be removed.

The bottom line is that ASCAP, BMI, and the major music publishers have had (and continue to have) every opportunity to present evidence to neutral, sophisticated, federal judges in the rate courts to support their claims that the existing license rates are lower than fair market value. They have repeatedly failed to produce any such evidence. *See, e.g., Pandora Media, Inc.*, 2014 WL 1088101 at *49 ("The Court is sensitive to ASCAP's concerns and understands that the unique characteristics of the market for music licensing and the Consent Decree regime produce challenges for all parties. But, for the reasons already discussed, ASCAP did not show that the upshot of the negotiations conducted by either Sony or UMPG with Pandora was a competitive, fair market rate.”). The fact that they wish the rates were higher is not evidence of higher fair market value (except in the mind of a monopolist).

The Copyright Office has previously acknowledged that collective licensing by the PROs inherently raises antitrust issues requiring regulation and oversight. U.S. Copyright Office, *STELA §302 Report* 95-96 (“there is a significant risk that the collective may exploit its market power by charging supra-competitive rates or discriminating against potential licensees”). Indeed, ASCAP and BMI, themselves, have recently acknowledged the need for, adaptability, and continued vitality of the consent decrees. *Id.* at 94 (“ASCAP and BMI responded that their critics fail to acknowledge that the music collectives legally operate under carefully negotiated consent decrees that protect licensees and prevent [ASCAP and BMI] from engaging in anti-competitive behavior. They noted that ASCAP’s consent decree was recently amended based upon the comments from the same parties who criticized collective licensing in this proceeding.”). Nothing has changed since the time of these acknowledgments that would make them less true today. To the contrary, as demonstrated above, recent developments have only underscored the continued need for, and vitality of, the Consent Decrees and related rate courts.

Moreover, to the extent that any parties believe amendments should be made to the Consent Decrees, those Decrees have been amended dozens of times through negotiations between the affected parties and the DOJ, as supervised by the courts. The normal amendment process remains available, and is preferable to any action by Congress or the Copyright Office, particularly in light of DOJ’s and the federal court’s superior expertise in antitrust law and policy. It is antitrust law and policy, not copyright, that forms the basis of, and motivation for, the Consent Decrees.

C. Expansion of consent decrees

As noted above, the ASCAP and BMI consent decrees remain vital to the functioning of the musical composition performance licensing market, and should not be abolished or restricted. To the contrary, they should be expanded. Unlike ASCAP and BMI, SESAC – the third PRO – is not yet subject to any consent decree or rate court. This is due primarily to the fact that at the time the DOJ was active in pursuing ASCAP and BMI for antitrust violations, SESAC’s repertory was commercially insignificant.

Founded in 1932, SESAC for years focused on narrow sectors of the music performance market. *Meredith Corp. v. SESAC LLC*, No. 09-9177, 2014 WL 812795, at *5 (S.D.N.Y. Mar. 3, 2014). In 1992, after a change of ownership, SESAC significantly expanded its repertory. *Id.* It did so in part by recruiting from ASCAP and BMI high-profile composers and publishers, including ones whose music was embedded in syndicated television programs. *Id.* As a result of SESAC’s success in expanding its repertory, it is no longer possible to program around that repertory. This fact is amplified by SESAC’s refusal to disclose the identity of the songs it represents, or even provide evidence of its total market share compared to ASCAP and BMI. Music Choice has experienced SESAC’s abuse of market power first hand. After SESAC expanded its repertory, Music Choice had to obtain its blanket license. In the negotiation of every renewal, SESAC demands substantially higher fees and argues that the increase is justified by the increased size and value of its repertory. At the same time, SESAC has always refused to disclose (1) what percentage of the overall musical composition market is covered by its license and (2) a complete listing of which songs it represents. In 1999, Music Choice attempted to remove SESAC music from its playlists and pursue a direct licensing strategy for those songs, but was unable to do so because of the lack of information from SESAC. This led to threats of litigation by SESAC's outside counsel, and Music Choice was forced to enter into a settlement and license with SESAC. Again, in each subsequent renewal period SESAC has demanded outrageously high increases for each year. Music Choice contemplated pulling SESAC music again in 2007 due to these outrageous demands, but was simply unable to do it because SESAC refuses to provide the information necessary to pull all of the songs. At the same time, SESAC has strategically poached certain key songwriters from ASCAP and BMI by paying large advances and premiums, which also impacts Music Choice's ability to program around the loss of SESAC's repertory. Consequently, Music Choice has been forced to accept continual rate increases, far in excess of any increase in the fair market value of the SESAC repertory, and with no equivalent decrease in the rates Music Choice must pay ASCAP and BMI.

Music Choice is not alone in bearing the brunt of SESAC's anticompetitive conduct. As noted in the most recent ASCAP rate court decision, SESAC used many of the same tactics, including using licensees' inability to determine SESAC's actual market share, to extract supracompetitive rates from Pandora. *In re Pandora Media, Inc.*, 2013 WL 5211927 at **29-30, 39. Moreover, SESAC is currently subject to two antitrust lawsuits, brought by the Radio Music Licensing Committee ("RMLC") and the Television Music Licensing Committee ("TMLC"), respectively, seeking relief from SESAC's anticompetitive behavior. The court in the TMLC case recently denied in part SESAC's motion for summary judgment, finding, inter alia, that "[t]he evidence would . . . comfortably sustain a finding that SESAC . . . engaged in an overall anti-competitive course of conduct designed to eliminate meaningful competition to its blanket license." *Meredith Corp., et al. v. SESAC, LLC*, No. 09-9177, 2014 WL 812795, at *10 (S.D.N.Y. Mar. 3, 2014). In the RMLC action, the court recently found that radio broadcasters were likely to succeed on the merits of their antitrust claims against SESAC. http://www.billboard.com/biz/articles/news/legal-and-management/5855056/ruling-in-sesac-radio-music-license-committee-lawsuit.

Given the current state of SESAC's repertory, the same facts supporting the continued need for rate court regulation of ASCAP and BMI apply equally to SESAC, and SESAC should be subject to the same regulation and rate court supervision as the other PROs.

Indeed, as the recent Pandora decision demonstrates, even if the major publishers were to withdraw their catalogs from the PROs entirely and force music licensees to obtain direct licenses, each of the major (and even the larger independent) music publishers would also require regulatory oversight and rate supervision. Major publishers in direct blanket licenses are effectively the same as PROs because each one (like each PRO) controls a large enough catalog to render its blanket license necessary to a programmed music performance service like Music Choice, and most publishers (also like the PROs) administer licenses for many songs that they do not actually own. For example, recent estimates state that Sony/EMI controls approximately 26% of the market with Kobalt, UMPG, Warner/Chappell and BMG/Chrysalis controlling 17%, 16%, 14% and 6%, respectively. Notably, Kobalt (like ASCAP, BMI, and SESAC) acts entirely as an administrator of the songs in its catalog, and does not own any of the copyrights. Consequently, the same concerns over PRO conduct apply with equal force to the major publishers and therefore they should also be subject to conduct-regulating consent decrees if they were to withdraw their catalogs from any regulated PRO.

Based on the foregoing, not only should the consent decrees and rate courts remain in place, they should be expanded to cover all blanket licensing of musical compositions.

II. Sound Recording Licensing

A. Necessity, Effectiveness, and Scope of Statutory Sound Recording Licenses (Topics 6 & 17)

The inherent anti-competitive conduct and market failure described above in connection with the direct licensing of musical composition performance licenses applies equally to the direct licensing of sound recording digital performance rights. Indeed, the ownership of sound recording copyrights is even more concentrated than that of musical compositions. As with the larger music publishers, blanket licenses from at least all of the major record companies and the larger independents would be absolutely necessary (in the absence of a statutory license) for Music Choice to provide compelling programming. Each record company's catalog is unique, and no catalog is a substitute for any of the others, meaning that there is no competition between the various record companies for these rights. Consequently, the exemptions and licenses in Sections 112 and 114 remain essential to address that market failure by streamlining the licensing process and regulating the record companies' ability to abuse their market power to extract supracompetitive rates.

For the reasons stated above, Music Choice does not believe that the scope of the Section 114 license should be restricted. With respect to Section 112, the "ephemeral recording" provision, Music Choice submits that both the 112(a) exemption and the 112(e) license, as currently configured, are completely out of synch with the realities of how server, cache, buffer, and other intermediate copies are actually used by music services and valued in the marketplace. With respect to any copies of sound recordings (including the underlying musical compositions embodied therein) made solely for the purpose of facilitating an otherwise lawful public performance of that sound recording, all such copies should be subject to the Section 112(a) exemption.

The Copyright Office has previously acknowledged that intermediate copies made solely for the purpose of licensed music performances have no independent economic value:

> 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. The same copyright owners appear to be seeking a second compensation for the same activity merely because of the happenstance that the transmission technology implicates the reproduction right, and the reproduction right of songwriters and music publishers is administered by a different collective than the public performance right.

U.S. Copyright Office, DMCA Section 104 Report, 143 (Aug. 2001). Indeed, in addition to opining that such intermediate copies were likely fair use, the Register noted the Copyright Office's view that:

> section 112(e) can best be viewed as an aberration. As we indicated in 1998 to the affected parties who championed this provision as part of an overall compromise, we saw no justification for the disparate treatments of broadcasters and webcasters regarding the making of ephemeral recordings. Nor did we see any justification for the imposition of a royalty obligation under a statutory license to make copies that have no independent economic value and are made solely to enable another use that is permitted under a separate compulsory license. Our views have not changed in the interim, and we would favor repeal of section 112(e) and the adoption of an appropriately-crafted ephemeral recording exemption.

Id. at 144 n. 434.

Music Choice was not a party to the back-room negotiations that led to the "compromise" noted in the Register's analysis, and fully agrees with the Register's recommendation that the Section 112(e) license be abolished in favor of a broader 112(a) exemption. Although the Register was specifically discussing buffer copies in the DMCA Section 104 Report, the same reasoning applies to server and cache copies made solely to facilitate otherwise licensed or privileged performances. All such copies, like buffer copies, have no independent economic value incremental to the value of the performance, and should be subject to an appropriately-crafted exemption.

The absurdity of the Section 112(e) license reaches its apex in connection with commercial background music services, or Business Establishment Services ("BES") under the Copyright Act. As Music Choice's business evolved, it expanded into the BES market and its commercial background music service now comprises a small but important part of Music Choice's business. When it created the digital performance right for sound recordings, Congress specifically created an exemption for BES, codified at 17 U.S.C. §114(d)(1)(C)(iv), in recognition that such services did not pose any threat to record sales. Thus, Congress determined that sound recording copyright owners were not due any compensation for digital performances in the BES setting. As noted above, in connection with various negotiations between record companies and webcasters during the passage of the DMCA, the Section 112(e) license was created and expressly made applicable to BES activities. Subsequently, the record companies were able to obtain significant royalty rates for BES ephemeral copies, even though such copies have no independent value. In doing so, the ephemeral license for BES has been used as a back-door method to extract what is in essence a performance royalty (because, as noted by the Register, it is the performance that creates value), notwithstanding the performance royalty exemption of Section 114(d)(1)(C)(iv).

Marketplace evidence strongly supports the repeal of the Section 112(e) license in favor of an expanded ephemeral exemption. Indeed, even in a marketplace characterized by intense market power enjoyed by copyright owners, record company direct licenses commonly include the right to make server, buffer, and cache copies at no additional charge beyond the royalty payable for the performance of the recording. In the context of the Section 114 license, the "royalty" payable for the related Section 112 license has consistently been set, by industry agreement, as an allocated portion of the performance royalty. The Copyright Royalty Judges have never been presented with any marketplace evidence supporting an independent value for the server, buffer, cache or other ephemeral copies. Thus, an exemption for all such copies made solely for the purpose of facilitating a lawful performance is consistent with the Register's reasoning, economic and technological reality, and marketplace evidence.

In order to fully conform to these realities, however, the exemption would have to differ somewhat from the current Section 112(a) exemption. First, the limitation to a single copy would need to be eliminated. This limitation is unnecessary and inconsistent with the way server, cache, buffer, and other intermediate copies are actually used to facilitate digital music performances. In many instances, multiple server copies are necessary for the purposes of redundancy and to allow for transmission in varying bitrates, among other reasons. In no instance, however, do these multiple server copies have any value independent from their role in facilitating the lawful performance of music. Similarly, by their very nature, buffer and cache copies often require that more than one copy be made at the same time. Second, particularly with respect to server copies, the requirements that no further phonorecords be made from the server copies, and that such copies be destroyed after six months would have to be eliminated. One of the very purposes of server copies is to create any intermediate buffer and/or cache copies necessary to perform the recordings digitally. Moreover, the server copies (unlike buffer and cache copies) are not meant to be temporary. It simply makes no sense to require that server copies be deleted and then re-created every six months.

Allowing the entire performance license royalty payment to be allocated to the Section 114 license by expanding the Section 112 exemption in this way would also benefit artists. Under the current statutory regime, recording artists receive direct payment of half of the Section 114 royalty, but do not receive any direct payment for the portion allocated to the Section 112 license. Due to the terms of their agreements with the record companies and various record company accounting practices, this means that the vast majority of recording artists never see a penny of the portion of the performance royalty allocated to the Section 112 license. Given that, as noted above, all of the value flows from the public performance of the music, it is only fair that the entire performance royalty payment be distributed pursuant to Section 114 in the way that most benefits recording artists.

B. <u>Pre-1972 Sound Recordings</u> (Topic 10)

The sound recording industry can trace its history back at least to the invention of the phonograph in 1877 and the founding of the first record company, Columbia, in 1888. Although the recording industry, beginning as early as 1906, repeatedly lobbied Congress to extend copyright protection to sound recordings, Congress consistently resisted these entreaties. As a consequence, musical compositions (the melodies and lyrics comprising a song) embodied in a sound recording were protected by the Copyright Act from unlicensed copying and performance, but the sound recordings themselves were not. *See* Report of Register of Copyrights, Federal Protection for Pre-1972 Sound Recordings (the "Pre-72 Report"), December 2011, at 7-10. It was during this long historical period and in this legal landscape that both the recording and radio industries developed and thrived.

It was not until November 15, 1971, almost one hundred years after the invention of the phonograph, that Congress for the first time extended federal copyright protection to sound recordings, with the passage of the Sound Recording Amendment. Pub. L. No. 92-140, § 3, 85 Stat. 391, 392 (1971) (granting copyright protection to sound recordings created on or after February 15, 1972). Even then, however, sound recordings were granted only a limited copyright, comprising the exclusive rights of duplication and public distribution, but no right to exclude public performance. The passage of the Sound Recording Amendment was driven entirely by concerns about record piracy, which by 1971 had reached a volume in excess of $100 million. H.R. Rep. No. 92-487, 92nd Cong. at 2 (1971). At the same time, the patchwork of state laws used by record companies to combat this piracy in the absence of federal copyright protection was deemed inadequate to the task. *Id*.

Congress declined to provide a public performance right for sound recordings, in part because its focus was on combating piracy but also because of concerns about disruption of the radio broadcasting industry that could be caused by requiring broadcasters to pay sound recording license fees, which had never been required before. Barbara A. Ringer, Copyright Law Revision, Study No. 26: The Unauthorized Duplication of Sound Recordings, at 37 (Feb. 1957); "Performance Rights in Sound Recordings," Subcommittee on Courts, Civil Liberties, and the Administration of Justice, House Comm. on the Judiciary, 95th cong., 2d Sess., at 54-55 (1978). (comm. Print No. 15) ("1978 Performance Rights Report"). Thus, even after the creation of a limited federal copyright for sound recordings, both the recording and radio industries continued to develop and thrive without radio broadcasters paying any royalties to sound recording copyright owners.

At the same time, the limited federal copyright extended to sound recordings was granted on a prospective basis only; sound recordings created prior to February 15, 1972 remained unprotected by federal copyright. The Copyright Act allows state law to protect such recordings. As the Register has previously noted, however, the various state laws protecting pre-1972 sound recordings do not recognize a public performance right in those recordings. Pre-72 Report, at 44. This makes good sense, because pre-1972 sound recordings have been publicly performed for almost one hundred years by radio broadcasters, without any demands for payment or claims of infringement.

Only very recently have record companies even attempted to advance any claims under state law based upon an alleged public performance right. In a classic "heads I win, tails you lose" tactic, the RIAA and several record companies have filed multiple suits against SiriusXM Satellite Radio and Pandora under various state laws, alleging violation of a public performance right. At the same time, SoundExchange has sued SiriusXM for not paying royalties for pre-1972 sound recordings pursuant to the Section 114 license. The recording industry has also been successful in having legislation introduced in Tennessee, which would expressly create a digital performance right for pre-1972 sound recordings if passed. All the while, the record companies have strenuously objected to any attempt to give them federal copyright protection for pre-1972 sound recordings so they may pursue these strategies under state law.

As a preliminary matter, Music Choice repeats that there is no, never has been any, and should never be any state law public performance right, or other right that would trigger liability for a programmed music performance service that includes pre-1972 sound recordings in its programming. Nonetheless, courts sometimes make mistakes, as do legislatures. If the record companies were to be successful, even in one state, in changing the law to their advantage, such change would pose an existential threat to Music Choice and other programmed music performance services. Such a change in the law would essentially eviscerate the Section 112 and 114 licenses, allowing record companies to demand direct license fees at the gunpoint of a mass infringement claim. As noted above and below, the record companies enjoy absolute market power in any direct license negotiations, due to concentration of ownership and a total lack of competition, and use that market power to extract supracompetitive rates for direct licenses under which no direct sound recording performance licensee has ever been able to generate a profit on an annual, much less cumulative, basis (as discussed below). Even under statutory licensing as a PSS, Music Choice has struggled to achieve modest profitability, and the other two PSS have exited the business. Any significant increase in the overall royalty burden, much less the massive increase that would be extorted by the record companies, would likely put Music Choice out of business.

Moreover, there is no effective way for a programmed music service like Music Choice to program around a lack of licenses for pre-1972 sound recordings (if such a license were necessary), for a number of reasons. First, Music Choice programs a number of popular channels that feature recordings that were at least initially released prior to 1972, and pulling all such recordings would be devastating to the quality of those channels.

Second, and perhaps more important, there is no reliable way for Music Choice to know which sound recordings truly are outside the scope of federal copyright (and therefore potentially within the scope of state law). Just because the original version of a sound recording was released prior to 1972 does not necessarily mean that the currently distributed version of that recording is outside the scope of federal copyright. To the extent a pre-1972 recording has not merely been re-mastered into a digital format, but has instead been remixed from multitrack sources, "sweetened," or otherwise processed in a way that creatively improves or otherwise substantially changes the sound of the recording, the new version of the sound recording is a derivative work created after 1972 and is protected by federal copyright. *See, e.g.*, United States Copyright Office, Compendium II: Copyright Office Practices, §496.03(b). Indeed, after the introduction of the compact disc format, the major record companies routinely registered the newer CD releases of pre-1972 recordings as such re-mixed derivative works in order to obtain copyright protection (in some cases even when the recordings had not truly been remixed). At this point, it is doubtful that the record companies even know, or can prove, which currently distributed recordings are truly unprotected by federal copyright. It is certainly impractical, to the point of being impossible, for Music Choice to know for sure. For this reason, although not legally required to, Music Choice has always paid SoundExchange for its use of potentially pre-1972 recordings, and reported such uses so that the record companies and artists in turn get paid for such use.

Third, to the extent different states' laws vary with respect to the creation of a new performance right for pre-1972 sound recordings, it would wreak havoc on a national music service such as Music Choice. Music Choice cannot program its channels differently for subscribers in different states and therefore would have to pull its service from any states that were to create a new performance right, which is virtually impossible to do as a national service. This would, in turn, potentially harm Music Choice's relationship with the various MVPDs who carry Music Choice's channels in multiple states, let alone the artists and songwriters who would lose the promotional value provided by Music Choice's service.

For these reasons, Music Choice suggests that the Section 112 and 114 exemptions and licenses be amended to provide an express safe harbor for licensees who choose to report and pay SoundExchange (or any other designated collective) for uses of pre-1972 sound recordings, so that such licensees may avoid the risk of improvident action by state courts and legislatures. If such a safe harbor could not be implemented, the only alternative would be to extend federal copyright, including the digital performance right and statutory limitations on that right, to pre-1972 sound recordings.

C. Distinction Between Interactive and Non-Interactive Services (Topic 11)

Although initially subject to dispute between the record companies and various early digital music services, the distinction between interactive and non-interactive digital music services was clarified in the Launch Media case. *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148 (2d Cir. 2009). In that decision, the Second Circuit correctly interpreted "interactive service" in light of the legislative purpose of the digital performance right and the Section 114 license, to mean a service over which users have sufficient control such that playlists become predictable enough to substitute for record sales. *Id*. at 164. Subsequent to this decision, the industry and licensing practices have adapted to this ruling. There is no compelling reason to disturb current industry practices by unsettling this understanding of the line between interactive and non-interactive services.

III. Direct vs. Statutory or Collective Licensing (Topic 14)

As a general matter, direct licensing is always preferable in functionally competitive markets and if licenses may be obtained efficiently. Even where statutory or collective licenses are appropriate, they should allow for direct licensing alternatives. That said, the actual markets for music performance rights are neither competitive nor efficient. For these reasons, when statutory or collective licenses are available, direct licenses are rare.

There is an inherent problem of market failure associated with the direct licensing of blanket music performance rights. One source of this failure is the many thousands of copyright owners, and therefore thousands of direct licenses that would need to be negotiated individually, engendering impossibly high transaction costs for such licensing. Another source is the inherent market power enjoyed by the larger copyright owners, which those owners have historically misused (or attempted to misuse) to extract supracompetitive license fees from licensees in unregulated markets. This problem is amplified in the digital music service markets by the fact that many licensees, like Music Choice, are modestly-sized companies that are dwarfed by the resources brought to bear by large music industry collectives like SoundExchange and the PROs (or even the major music companies) and cannot afford the oppressive costs of rate court litigation.

As noted above, in order to provide compelling programming, Music Choice needs to perform music that the public enjoys. The public's enjoyment of a given song has nothing to do with which company owns the respective copyright. Consumers do not typically know or care who owns the copyright, they only know whether they like the song. Nor is the music fungible. One copyright owner's song is not a substitute for another copyright owner's song in the context of performance rights. Music Choice needs to be able to program its channels based upon the quality of the songs, not the identity of the copyright owner; it cannot effectively "program around" any gaps that would be created by direct licensing from only certain copyright owners.

Consequently, Music Choice cannot selectively license music from only certain copyright owners; it must obtain broad rights from all, or almost all, of the relevant copyright owners. This inherent feature of music performance licensing leads to the two problems noted above. First, if performance rights were only available through direct licensing, Music Choice would have to negotiate independently with thousands of copyright owners. The volume of such negotiations would impose insurmountable transaction costs, both for Music Choice and the copyright owners (who would have to negotiate licenses with many different licensees in addition to Music Choice). Second, because there is no competition at all among copyright owners, and licenses are needed from (at least) all of the major music record labels and publishers, in unregulated direct licensing negotiations each of those major record labels and publishers enjoys absolute market power, which in turn allows each company to extract supracompetitive license rates.

Examples of the abuse of market power by music publishers were brought to light in the recent Pandora decision, as discussed above in Section I.B. The major record companies are no less abusive in their direct licensing negotiations. One of the few examples where music services must obtain direct sound recording performance licenses is interactive webcasting. The interactive services have had to agree to any rates demanded by the record companies to launch and maintain their entry into the market, because, as noted above, the services compete for users (and perhaps more importantly investors) based upon the size of their music catalogs. Therefore, an interactive service must have licenses with all the major labels and as many of the independents as possible. Moreover, interactive services have to obtain licenses with at least all of the major labels to secure venture capital financing to keep their businesses going.

Almost every one of the early, and many of the more recent, interactive services have gone out of business entirely. Examples include Pressplay, Ruckus, MusicMatch On Demand, MusicGremlin, Lala Media, Yahoo! Music Unlimited, iMeem, and Spiral Frog. Those that remain in business can only do so by obtaining repeated infusions of additional capital. A more recent example is Spotify which, despite significant venture financing and marketing exposure, has yet to become profitable. One might wonder why venture capital firms would put money into and continue to fund webcasting services with no hope of long-term profitability. The answer is that these firms are not primarily concerned with the long-term prospects of the companies either. Instead, they hope to make money by building up the perceived value of a company and then selling it at a higher price. Thus, as long as they can maintain the perception that these interactive services will someday be profitable, they believe they can flip the companies at a profit, either through an IPO or other sale.

On the seller side of the negotiation, the record labels do not particularly care whether the licensed interactive services ever turn a profit or even stay in business. At least up to this point, as interactive services have gone out of business, new services have entered the market with new venture capital funding, as described above. Moreover, the record labels typically demand very large advance payments and minimum guarantees from licensed interactive services. Because of these large advances and guarantees, the record labels wind up getting paid, irrespective of the health or survival of the licensed service. As long as venture capital keeps flowing into the market, the record labels can continue to siphon off that money in the form of these advances and guarantees, without regard to whether any of the licensed services can stay in business. Indeed, the very fact that the record companies demand such large advances and guarantees indicates that they know that the services will not stay in business for very long.

The record companies have repeatedly and publicly acknowledged this dynamic. For example, David Ring, one of the heads of UMG's global digital business division, spoke on this point in 2012 at the San Francisco MusicTech industry conference. He was appearing on a panel with Larry Marcus, who specializes in venture capital deals in the digital music market for Walden Venture Capital. In response to Mr. Marcus's noting that, from his experience in funding digital music services, the record company up-front payment and royalty demands created an "insurmountable" obstacle to profitability for the services, Mr. Ring countered that it was not the record industry's problem that venture capital firms were choosing to fund digital music services that did not have a sufficient revenue model to make them profitable.

A digital music industry trade publication, Digital Music News, reported the exchange between Mr. Marcus and Mr. Ring. This article prompted a former record company employee, who had worked in the industry for almost seventeen years at various labels and had been directly involved in early digital music service licensing, to submit a response. In that response, he described the record company licensing model for interactive subscription services as one of "extortion," and contrasted it with the ways in which the record companies used to work cooperatively with physical retailers to help them maintain healthy long-term businesses. In the ensuing comments section associated with his article, he explained:

> You know why the labels require huge advances? Because they can, because the law allows them to, especially with interactive streaming services, which are not covered under statutory licensing. And also because, and I know this because I sat in the meetings and heard it dozens of times, "get the advance, cash the check, get it on the books for this year, we need to show digital revenue, if these guys go out of business next year because they made a bad deal, f*** them, we cashed the check already."
>
> That mentality still prevails, it is not about working together to build a sustainable business that works for everyone in the chain. . . .
>
> The labels are not "funding companies that have no revenue model," that's a completely bulls*** spin on what actually happens. They're collecting a stiff toll on a bridge that an optimist wants to cross, and when he gets to the other side, he's broke and starves to death.

https://web.archive.org/web/20120713121441/http://digitalmusicnews.com/permalink/2012/120216retailers.

These two problems, of prohibitive transaction costs and abuse of market power, have traditionally been mitigated by either collective licensing (in the case of musical composition performance rights) or statutory licensing (in the case of sound recording digital performance rights). Each of these alternatives reduces transaction costs by streamlining the licensing process through the use of licensing collectives, and at least attempts to restrain copyright owners' abuse of market power by providing for mandatory licenses and judicial review of royalty rates and terms. Of course, rate court is and should be a last resort. Nonetheless, the very availability of rate court can help to level the playing field and may lead to agreement on rates without litigation.

IV. **What role could government play in facilitating alternative licensing models** (Topics 15 & 22)

One of the most significant challenges for licensees is the lack of access to any accurate or comprehensive source of copyright ownership information for musical compositions and sound recordings. Lack of access to such information has hindered licensing activities, both direct and collective, giving undue leverage to copyright owners. As noted above, SESAC has repeatedly used Music Choice's inability to identify and pull SESAC music (or obtain direct licenses) to extract rate increases far in excess of any proven increase in the size or fair market value of its repertory. In order to effectively enter into direct licenses and to negotiate fairly with these collectives, licensees need access to all pertinent rights ownership information for each musical composition and sound recording, including the identity and contact information for all copyright owners (including any ownership splits), administrators, and other entities (such as collectives) authorized to license each sound recording and musical composition. The various music copyright owners and the collectives through which they receive royalties (including SoundExchange, ASCAP, BMI, SESAC, and the Harry Fox Agency) have this information. They should be required to make this information updated and publicly available in searchable, electronic form. Providing this information should be a requirement under any statutory license or consent decree applicable to these copyright owners.

V. **Financial Performance, Investment, and Innovation**

A. Financial landscape of songwriters, composers, and recording artists (Topic 18)

Although the transition to digital has been disruptive to certain music industry models, record companies and music publishers have generally remained profitable. Although the recording industry has seen declines in sales and revenues in recent times, industries across the world have experienced similar declines. Moreover, there is no evidence or data suggesting that Music Choice, or any other non-interactive digital music services, contributed to such sales and revenue declines. Nor is there evidence that such digital music services have had any adverse effect on creativity, innovation or have in any other way decreased the incentives to create new music. The revenue received from non-interactive digital music services is additional, incremental revenue for songwriters, composers, and recording artists.

One of the greatest features of the Section 114 performance license is that the license fees are shared equally by record companies and artists, with payments distributed directly to the artists. This prevents the record companies from keeping the artists' share based on the typically onerous recoupment and accounting terms of the artists' recording contracts. Similarly, the PROs distribute half of the performance royalties directly to songwriters, which prevents the publishers from keeping any portion of the writer's share. Again, this revenue stream from digital music services like Music Choice to songwriters, composers, and recording artists is a new, incremental revenue stream, from music services that have not in any way lowered those authors' other revenue streams. To the contrary, as discussed below in Section V.B., Music Choice provides a strong promotional stimulus for those other revenue streams.

Notably, the new and additional revenue streams provided by non-interactive digital music services like Music Choice have been substantial. Such services cumulatively pay many hundreds of millions of dollars to the PROs and SoundExchange on an annual basis. Again, this is new revenue, which comes from services that do not decrease any of the copyright owners' other revenue streams. To the extent certain songwriters or recording artists have seen declines in their overall royalty income, it is likely due to a combination of (1) reduced record sales due to economic and other factors unrelated to the existence of non-interactive digital music services; (2) various creative accounting schemes that the record companies and music publishers have employed for decades to underpay artists and songwriters; and (3) unexplained failures of SoundExchange and the PROs to timely and equitably distribute the royalty payments they collect.

Examples of record company and music publisher exploitation of recording artists and songwriters are ubiquitous. Artists and their estates routinely sue to obtain unpaid royalties contractually owed to them. For example, songwriters Jackson Browne, J.D. Souther, and Jack Tempchin were forced to sue music publisher Warner/Chappell Music for over $10 million in unpaid royalties from various hits recorded by the Eagles. *See* http://www.billboard.com/articles/news/73339/songwriters-settle-eagles-royalty-suit.

In 2012, the estates of well known artists such as Count Basie, Sarah Vaughn, Woody Herman, Benny Goodman, Patty Page, Kitty Kallen, The Mills Brothers, Jerry Murad, Sister Rosetta Tharpe, Frankie Laine, Tony Martin and Les Brown alleged that UMG Recordings systematically cheated these legacy artists (and their estates) of a substantial amount of royalties due. *See The William J. Basie Testamentary Trust v. UMG Recordings, Inc. and Universal Music Group, Inc.*, Index No. 651518/2012 (Sup. Ct., N.Y. County 2012), Compl. at ¶ 209. More recently, in 2013, the heirs and successors of George Gershwin sued publisher Warner/Chappell Music after an audit reveled over $4 million in unpaid royalties. http://www.law360.com/articles/406821/gershwin-heirs-say-warner-owes-millions-in-royalties.

In *Allman et al. v. UMG et al.*, Index No. 650199/2006 (Sup. Ct., N.Y. County 2006), certain members of the Allman Brothers Band alleged that UMG Records and Polygram Records, Inc. willfully failed to pay royalties due under their recording agreements. Pursuant to an audit, the Allman Brothers determined that UMG had failed to pay one-half of approximately $2.5 million due to the artists. *Allman et al. v. UMG et al.*, Index No. 650199/2006 (Sup. Ct., N.Y. County 2006), Compl. at ¶ 1.

Indeed, from April 2011 through March 2012 along, at least fourteen separate lawsuits were filed on behalf of recordings artists who claimed to be cheated out of significant royalty payments by the major record companies from digital downloads. *See* http://ipandentertainmentlaw.wordpress.com/2012/03/09/recording-artists-suing-for-digital-royalty-accountings/.

Although many cases are filed by songwriters and recording artists for underpayment of royalties, far more cases go unlitigated. This is because, among other reasons, (1) the audit provisions in the authors' contracts are often very restrictive; (2) it is very expensive for an author to hire forensic accountants to conduct an audit; (3) once an audit begins, the record company or publisher uses various tactics, including accounting records that seem designed to obfuscate royalty revenues received and royalties due, to impede the audit; and (4) even after underpayments are established, authors often must accept pennies on the dollar for their claims because the cost of litigation against the record companies and publishers is so high.

In the words of the artists themselves, the recording industry is infamous for depriving artists of their fair share of revenue:

> "How To Sell 1 Million Albums and Owe $500,000" (Martin F. Frascogna, July 12, 2011, https://www.youtube.com/watch?v=NcwgdB0NltY.)
>
> * * * *
>
> I got something in the mail last week I'd been wanting for years: a Too Much Joy royalty statement from Warner Brothers that finally included our digital earnings. Though our catalog has been out of print physically since the late-1990s, the three albums we released on Giant/WB have been available digitally for about five years. Yet the royalty statements I received every six months kept insisting we had zero income, and our unrecouped balance ($395,277.18!)* stubbornly remained the same.
> Now, I don't ever expect that unrecouped balance to turn into a positive number, but since the band had been seeing thousands of dollars in digital royalties each year from IODA for the four indie albums we control ourselves, I figured five years' worth of digital income from our far more popular major label albums would at least make a small dent in the figure. Our IODA royalties during that time had totaled about $12,000 – not a princely sum, but enough to suggest that the total haul over the same period from our major label material should be at least that much, if not two to five times more. Even with the band receiving only a percentage of the major label take, getting our unrecouped balance below $375,000 seemed reasonable, and knocking it closer to -$350,000 wasn't out of the question.

So I was naively excited when I opened the envelope. And my answer was right there on the first page. In five years, our three albums earned us a grand total of…
$62.47
What the f**k?
I mean, we all know that major labels are supposed to be venal masters of hiding money from artists, but they're also supposed to be good at it, right? This figure wasn't insulting because it was so small, it was insulting because it was so stupid. (Tim Quirk, December 1, 2009, http://www.toomuchjoy.com/index.php/2009/12/my-hilarious-warner-bros-royalty-statement.)

* * * *

I've never made a dime from a record sale in the history of my record deal. I've been very happy with my sales, and certainly my audience has been very supportive. I make a living going out and playing shows. (Lyle Lovett, July 10, 2008, http://www.reuters.com/article/2008/07/10/us-lovett-idUSN1030835920080710.)

* * * *

The recording industry is a dirty business – always has been, probably always will be. I don't think you could find a recording artist who has made more than two albums that would say anything good about his or her record company. . . . Most artists don't see a penny of profit until their third or fourth album because of the way the business is structured. The record company gets all of its investment back before the artist gets a penny, you know. It is not a shared risk at all. (Don Henley, The Eagles, July 4, 2002, http://www.pbs.org/newshour/bb/entertainment-july-dec02-musicrevolt_7-4/.)

* * * *

What is piracy? Piracy is the act of stealing an artist's work without any intention of paying for it. I'm not talking about Napster-type software. I'm talking about major label recording contracts. . . . A bidding-war band gets a huge deal with a 20 percent royalty rate and a million dollar advance . . . . Their record is a big hit and sells a million copies . . . . This band releases two singles and makes two videos . . . . [The record company's] profit

> is $6.6 million; the band may as well be working at 7-Eleven . . . . Worst of all, after all this the band owns none of its work . . . . The system's set up so almost nobody gets paid . . . . There are hundreds of stories about artists in their 60s and 70s who are broke because they never made a dime from their hit records. (Courtney Love, Hole, 2000, http://archive.salon.com/tech/feature/2000/06/14/love/.)
>
> * * * *
>
> Young people . . . need to be educated about how the record companies have exploited artists and abused their rights for so long and about the fact that online distribution is turning into a new medium which might enable artists to put an end to this exploitation. (Prince, 2000, http://www.news24.com/xArchive/Archive/Prince-slams-record-companies-20000810.)

The major record companies and music publishers do not seem to have as much of a problem when it comes to compensating their own executives, however. The annual salaries for the following executives have been estimated at:

- $16.3 million for Lucian Grainge of Universal Music Group (http://www.hollywoodreporter.com/news/music-executive-salaries-hit-high-319557) (May 3, 2012);
- $10 million for Doug Morris of Sony Music Entertainment (http://www.forbes.com/sites/zackomalleygreenburg/2010/12/08/doug-morris-to-jump-from-universal-to-sony-jay-z-music-business/) (December 8, 2010);
- $4.3 million for Stephen F. Cooper of Warner Music Group (http://en.wikipedia.org/wiki/Stephen_Cooper_(businessman)) (February 24, 2014); and
- $2.25 million for Cameron Strang of Warner/Chappel Music (http://www.billboard.com/biz/articles/news/1483647/warner-musics-cameron-strang-gets-pay-raise-to-225-million-lyor-cohen) (December 28, 2012).

The copyright owner collectives also bear some responsibility for low payments to songwriters and recording artists. As recently explained by a recording artist member of SoundExchange who also owns his own independent record company, SoundExchange does not do a very good job of passing the royalties on to its members:

> In the PLAYS database where an artist can search for songs reported to SoundExchange to submit corrections, I discovered (over a year ago) that only 8 of my songs (NOT the most popular ones) were listed. 4 of them had incorrect information listed. Some distribution company I had never heard of was listed as the Rights

> Owner (and theoretically getting paid by SoundExchange royalties they had no right to collect). There was a simple way to submit changes. I submitted the changes.
>
> Over a year later those songs still have incorrect information.
>
> In addition, SoundExchange has only been paying me for 8 songs (when I have over 70 released). Fans have taken screen shots of their Pandora when my songs come up and tweet and Facebook me the images. 9 times out of 10 the song they show me is NOT one that shows up on my royalty statement from SoundExchange. This doesn't add up.
>
> * * * *
>
> I, along with thousands of other artists, are owed lots of money from SoundExchange, but SoundExchange seem more interested in lobbying congress to get better royalty rates than they do actually helping the members they are supposed to be fighting for.
>
> I am a perfect example of a pro-active SoundExchange member who is fed up. I am an artist who cannot seem to get paid what he is owed.
>
> SoundExchange need some help. They need to hire employees who actually care about musicians. No one I've spoken to, interacted with via email or met in person actually seems to give a damn about musicians. How ironic.
>
> What is the alternative? What are we supposed to do?

Ari Herstand, *SoundExchange Is Screwing Me Out Of Money And There's Nothing I Can Do About It*, http://www.digitalmusicnews.com/permalink/2014/05/08/soundexchange-screwing-me-out-of-money.

With respect to the PROs, one sometimes hear complaints from songwriters that they have only been paid a small amount of money for thousands of plays of their song on a service like Pandora, with the implication that these payments are unfair. These stories, especially as spun by the publishers and industry press, are typically misleading. As a preliminary matter, these stories neglect to mention (or hide in footnotes) crucial information, such as whether there are any co-writers sharing in the revenue from the song, or how much the songwriter was paid for terrestrial radio airplay during the same period. This latter point is crucial for a number of reasons. One spin on terrestrial radio results in many thousands of listens. Consequently, any comparison between broadcasting and webcasting has to be adjusted to account for this difference. Second, many songwriters get paid nothing, even when their songs have been played extensively on certain types of services and revenue has been collected for those plays, because of the arcane distribution formulae employed by the PROs.

Most important, however, it bears repeating that these digital performance royalties provide a new, additional revenue stream, which does not come at the expense of other royalty streams. Thus, if the digital music services are driven out of business, the loss of those royalty payments will not be offset by any increase in other royalties. Blaming the digital music services that provide these new royalty streams for any overall revenue declines experienced by artists would be both unfair and inaccurate.

B. Are revenues from performance and sale of music fairly divided between "creators and distributors" of musical compositions and sound recordings? (Topic 19)

As a preliminary matter, the use of the term "distributor" to describe digital music services like Music Choice is inaccurate, rhetorically charged, and unfairly minimizes the substantial investment, innovation, and creative contributions made by these music services. Non-interactive, curated music performance services like Music Choice, are not mere "distributors" of music (such as the iTunes store and other digital download vendors that merely distribute digital copies of recordings for sale). In fact, Music Choice does not distribute music at all. Music Choice provides various channels of music-related programming, bundled together in subscribers' basic cable television package. The performance of sound recordings (and the underlying musical compositions) is an input to that programming, but the Music Choice residential service does not distribute copies of those sound recordings to its subscribers. Moreover, the value of Music Choice's service to subscribers is dramatically increased by the various technological and original creative elements contributed by Music Choice. For example, as the first digital music service, Music Choice had to create the technology necessary to transmit its performances to cable subscribers. In order to make the channels more compelling (and more promotional for record companies and artists, as explained below), Music Choice created the technology necessary to improve its on-screen displays, and then created the graphics and images to make those displays attractive. Music Choice also makes creative choices with respect to which kinds of artist facts to display, along with the artist and album identification data.

The programming of Music Choice's channels, the selection and ordering of the recordings played on each channel, is itself a highly creative contribution and provides significant value to the Music Choice service. Music Choice takes great pride in its programming, which is one of the key features differentiating Music Choice from its competitors (who all have access to the same music), and employs approximately 30 experts in the various genres covered by Music Choice's audio channels. In addition to the on-screen displays for its audio channels, Music Choice also produce a large amount of original content for both its audio and video channels. These include video recordings of live performances by recording artists when they visit the Music Choice studio to promote their records, and entirely original television shows for Music Choice's Music Choice Play video channel. Music Choice employs approximately 38 professionals in its creative/production and content development departments.

Even with respect to the portion of Music Choice's service comprising the performance of licensed sound recordings, performance and distribution are not interchangeable, either legally or factually. The legislative history of the Digital Performance Right in Sound Recordings Act of 1995 ("DPRSRA") makes clear that Congress sought to maintain the distinction between these two categories of rights. The Senate Report states

> The intention in extending the mechanical compulsory license to digital phonorecord deliveries is to maintain and reaffirm the mechanical rights of songwriters and music publishers as new technologies permit phonorecords to be delivered by wire or over the airwaves rather than by the traditional making and distribution of records, cassettes and CD's. The intention is not to substitute for or duplicate performance rights in musical works, but rather to maintain mechanical royalty income and performance rights income for writers and music publishers.

DPRSRA, S. Rep. No. 104-128, at 37 (1995). Using the term "distributor" to describe non-interactive digital music services like Music Choice only conflates performance rights with reproduction and distribution rights in contravention of Congress's intent.

Although the transition to digital, combined with an extended general economic downturn (and other factors), has impacted the gross revenues of record companies and music publishers, they have generally remained profitable. In reality, the causes of such revenue declines are numerous, including (among many other contributing factors) online music piracy, an extended recession and the resulting diminution of consumer discretionary spending, and increased competition for that shrinking consumer budget from other forms of entertainment.

Most digital music services have not fared so well during these challenging times. For example, in the entire history of digital music, no Internet streaming service (whether interactive or non-interactive) has ever managed to generate a profit on an annual basis, much less on a cumulative basis. This lack of profitability has persisted throughout an almost fifteen-year history of these streaming services, with all kinds of market entrants trying many different kinds of services and business models, yet none have been profitable. There can no longer be any doubt that the only explanation for this sorry state of affairs is that sound recording rates have been set too high. With respect to Music Choice, which was the first digital music service in the world, it lost money for the first several years of its existence, and then has struggled to achieve modest (but inconsistent) profitability in certain more recent years, while the other PSS (and certain other new subscription services that introduced similar services) have exited the market. Music Choice has survived by constantly innovating, from its creation of the very first digital music service, through later expansion into video programming, commercial background music, and the creation of large amounts of original programming.

As to the allocation of revenues between licensees and licensors, the very fact that most record companies and music publishers have remained profitable, while most digital music services have never made a profit (and many have gone out of business) speaks volumes. As noted above, the revenues received from non-interactive digital music services like Music Choice comprise a new, incremental revenue stream that was created by the passage of the DPRSRA in 1995. These revenues have not come at the cost of lower record sales, or any of the other existing revenue streams for music copyright owners. Any such decrease in revenues has been driven by other factors. Consequently, the revenues from digital music services, such as Music Choice, have actually been subsidizing the record companies and music publishers (and authors) by cushioning the impact of those unrelated revenue losses.

Indeed, to the extent Music Choice's music service has any impact on music copyright owners' core revenue streams, it only increases those revenue streams by promoting consumers' discovery and purchase of music. The promotional impact of Music Choice is recognized by the record companies, themselves, which provide Music Choice with free copies of every recording they release, and actively lobby Music Choice to play those recordings. Music Choice receives hundreds of phone calls, visits, and emails each month from artists and record labels' marketing and promotions employees, seeking to promote their recordings by getting airplay on Music Choice. Labels and artists do this because they know that Music Choice provides a national platform to break new artists and sell records. Indeed, the artists and labels often cite Music Choice's playing of a particular song or artist in their own promotional material.

Record labels and artists frequently give Music Choice verbal and written testimonials acknowledging the role Music Choice plays in promoting record sales and providing artists with greater exposure. Artists and representatives of the record labels also frequently visit Music Choice offices in person, often timed to coincide with a record release, to give programmers of the Music Choice channels a chance to listen to new music, speak with the artists and find out more about the music. Record labels even sometimes solicit Music Choice's input when they decide whether to sign new artists, particularly artists that Music Choice is playing.

Music Choice's promotional impact is enhanced by its on-screen display, which features key marketing information such as the artist's name and album title, as well as artist facts, album artwork, artist images and more. The on-screen display is designed to draw customers' eyes to the screen where they can quickly obtain all the information they need to make a purchasing decision.

Consumer studies have confirmed the promotional impact of Music Choice's service for record companies and artists. For example, in a study conducted by Arbitron, almost 40 percent of Music Choice listeners surveyed said that they had bought a record specifically because they heard it on Music Choice. The promotional impact is felt even more strongly in the key, younger, demographics, with the percentage of listeners indicating they had bought recordings because they heard them on Music Choice rising to 49 percent among 12-34 year olds, 55 percent among 12-24 year olds and 64 percent among 12-17 year olds. That study also found that 91 percent of Music Choice customers look at the screen to read the name of the artist performing, and 86 percent look to see the name of the song.

A recent Experian Simmons survey demonstrated that Music Choice listeners exhibit a strong propensity to purchase music. Importantly, it shows that Music Choice audio channel listeners, age 12 and above, are 69 percent more likely than the average person, age 12 and above, to have purchased 10 or more CDs or downloads in the past year.

Music Choice's promotional impact is not only strong, but is also widely felt; Music Choice provides its music channels to 56 million households nationwide, and averages 57 million monthly listeners. This promotional impact provides significant value to the record companies and artists (and by extension to the music publishers and songwriters whose songs are featured in the recordings played). Combining this value with the millions of dollars in royalties paid by Music Choice, and contrasting that value (and the continued profits experienced by the music copyright owners) with the limited profitability Music Choice has experienced, the inescapable conclusion is that Music Choice has not been allowed to keep a fair share of its revenues. Conversely, the record companies in particular have been allowed to take more than their fair share of those revenues.

C. The Impact of Licensing Issues on Copyright Owners' Ability to Invest in New Projects and Talent (Topic 20)

As noted above, the revenue received by copyright owners from Music Choice and other non-interactive digital music services is new, incremental income, and those services have not caused any decline in other revenue streams. Consequently, the license fees collected from licensed services increases copyright owners' ability to invest in new projects and talent. They simply have more money to invest than they would if these services were not in business.

Due to the strong promotional effect of Music Choice's service, as explained above in Section V.B, Music Choice provides additional revenue to the copyright owners beyond merely paying royalties. Music Choice drives both record creation and record sales, particularly in genres for which the labels most need the help. This is because Music Choice, due to its music channels' diverse array of genres that are outside of the top-40 mainstream, promotes artists who are not promoted by terrestrial radio and are therefore at the greatest risk of losing their recording contracts. Without the national promotion and resulting sales these artists get from Music Choice, some of these artists would likely lose their recording contracts and cease releasing records.

D. The impact of licensing issues on licensees' ability to invest in new "distribution models" (Topic 21)

It again bears repeating that performance services are not distribution platforms, as discussed above. Describing performance services as distributors is inaccurate and, worse, unfair.

As discussed above in Section V.B., sound recording rates are too high. Not only do high rates prevent entry and sustainability in the market but they have also impeded innovation. Although Music Choice has continued to innovate throughout its history, the many years of unprofitability, followed by years of inconsistent and modest profitability, have significantly constrained Music Choice's ability to maximize innovation and improvements. One recent example is directly tied to the sound recording royalty rates set by the Copyright Royalty Board.

During the last PSS rate proceeding, Music Choice testified that it planned on increasing the number of its audio channels from 46 to 300. Music Choice argued that the increase in genres played would increase the promotional impact for record companies and artists, and would also allow Music Choice to slow the decrease in per-subscriber fees (inherent in a mature market where Music Choice must compete with other cable content providers such as ESPN, Comedy Central, MSNBC, and many other) paid by MVPDs. Such a lessening in the decrease in per-subscriber fees would have translated to a relative increase in royalties to the record companies, because Music Choice's revenues would hopefully have been higher with the additional channels than they would have been without the additional channels.

The Copyright Royalty Judges, however, seized upon the planned channel expansion as a justification to increase Music Choice's royalty rate by more than 13%. Although there was no evidence in the record that the channel expansion would result in any more actual listening (after all, a subscriber can only listen to one channel at a time), the Judges held that the mere increase in songs "used" (irrespective of whether an actual additional performance occurs) warranted an increase in the percentage of revenue Music Choice must pay to the record companies. Although Music Choice fully expects this baseless increase to be reversed on appeal, it has been forced to pay the increased royalties in the meantime and the impact of that increase was a driving factor in cancelling the planned channel increase. As this demonstrates, even in profitable years, the margin is so slight that the royalty burden has a real and direct impact on Music Choice's ability to improve its service.

VI. RATESETTING PROCESSES

A. Consent decree rate courts (Topic 6)

Although all litigation is distracting and expensive, especially for a small company like Music Choice, rate cases before the ASCAP and BMI rate courts have been relatively free of procedural controversy. This is largely because the Federal Rules of Civil Procedure and Evidence apply. Those Rules are familiar and long-established. Moreover, the judges of those courts have implemented various practices to further streamline the cases without sacrificing due process. As noted below, the same cannot be said of the procedural rules in analogous rate proceedings before the Copyright Royalty Board.

B. Statutory licenses – Copyright Royalty Board (Topics 2 & 9)

Having participated in sound recording royalty rate proceedings longer than any other licensee, from the very first Section 114 CARP through the most recently concluded Section 114 CRB proceeding (as well as protracted PRO rate court proceedings), Music Choice strongly believes that the procedural rules for such proceedings are in dire need of improvement. As currently structured, CRB rate proceedings are not only incredibly expensive, but seem almost designed to prevent licensees from being able to present a case.

One of the key problems with rate proceedings before the CRB is the phasing and sequencing of the proceedings. Participating parties must submit their written direct cases, with their rate proposals and all testimony and evidence they intend to introduce at the hearing, at the very beginning of the proceeding and before any discovery has taken place. Given the importance of benchmark evidence to the rate-setting process, this strange litigation procedure significantly favors the copyright owner participants because they are typically already in possession of any potential benchmark licenses (because they issued them), while music service licensees have no access to that evidence. This allows the copyright owners to cherry-pick the evidence presented to the Judges.

Only after the written direct cases are filed do the parties have an absurdly short period for discovery. The scope of this discovery presents another key flaw, which seems designed to impede the creation of a complete record of evidence. Each party may only seek documents directly related to *the other side's written direct case*. Unlike discovery in any court litigation, the parties may not obtain documents that would be helpful or relevant to their own, affirmative case.

Next, the parties have the live hearing for the direct phase of the proceeding, where they are generally limited to introducing the testimony and evidence included in their written direct filings. After that hearing has concluded, the process repeats itself in the rebuttal phase. Again, the parties must file their written rebuttal case before any rebuttal phase discovery takes place. After the written statements are filed, an even shorter rebuttal discovery period commences, again limited to information directly related to the other side's written rebuttal statement. This is followed by the rebuttal phase hearing, in which the parties are again strictly limited to presenting the testimony and evidence contained in their written statements. The rebuttal phase is followed quickly by the filing of proposed statements of fact and conclusions of law, and closing argument, after which the Judges issue their determination.

The partition of the proceeding into separate direct and rebuttal phases, combined with the limited scope of discovery, create a "two ships passing in the night" quality to the proceedings. Moreover, the Copyright Act requires that the first seven to eight months of every proceeding be taken up by a "voluntary negotiation period," followed by a period to prepare the written direct cases. This delay at the beginning, combined with the tight statutory deadlines by which the Judges must issue their rate determination and the inefficiencies of having separate direct and rebuttal periods (each with their own discovery, written pleadings, and hearings), results in there never being adequate time allocated to the parties for each procedural task. This actually results in litigation costs increasing, while decreasing the quality of the evidentiary record upon which the Judges must make their determinations.

In particular, the time allocated for discovery, 60 days for direct phase document requests, interrogatories and depositions, is woefully inadequate in cases of such complexity. Some parties routinely use the unrealistically short discovery period to effectively deny discovery. For example, in every single sound recording rate proceeding, the licensees request production of various license agreements from SoundExchange. In every proceeding, notwithstanding the fact that a protective order has already been entered to allow outside attorneys' eyes treatment of confidential documents, SoundExchange always refuses to produce most of the agreements on confidentiality grounds and forces the licensees to make a motion and get an order from the Judges compelling production. The Judges always grant such an order, because of the protective order. Nonetheless, because SoundExchange waits to lodge its objections until the documents are due, and then it takes time for the services to file and brief the motion to compel, and then additional time for the Judges to rule, SoundExchange does not wind up producing all of the documents until well after the discovery period is closed, and sometimes documents are still being produced on the eve of the hearing. In cases involving dozens of witnesses, hundreds of exhibits, and complex expert economic testimony, a 60 day discovery period is simply inadequate.

On a related point, given the number of witnesses and the number of participants in most proceedings, the Copyright Act's limitation on depositions to ten per side (spread between direct and rebuttal discovery) is clearly insufficient. Even though they have different licenses and different rates, the PSS and PSDARS (Sirius XM) are lumped together in the same rate proceeding. In the last such proceeding, SoundExchange presented 18 witness statements, ten of which were expert witness statements. Between them, Sirius XM and Music Choice had to share only ten depositions. The parties' inability to depose witnesses with respect to eight of the eighteen witness statements severely hampered their ability to cross-examine these witnesses during the hearings.

Another significant problem with the CRB procedures, particularly as they have been interpreted by the Judges, involves protective orders. By their very nature, parties to rate proceedings must produce a considerable amount of commercially sensitive, economic and other confidential information. This is particularly true of non-public companies like Music Choice. The Copyright Royalty Judges have set a very high bar for the protection of such information, a bar much higher than is set in federal court. Moreover, the Judges often make rulings during the hearings themselves, denying protection for internal financial documents and business agreements with confidentiality provisions merely because they recently expired or relate to periods more than a year or two in the past. Despite the Judges' views on these matters, such information often remains commercially sensitive for many years after the date of the original source document. For example, the terms of earlier agreements are frequently carried forward into new agreements covering later time periods. Yet the Judges have denied protection to the earlier agreements due simply to the fact that they have expired. Participants are thus faced with the option of withdrawing important evidence from the record entirely or allowing sensitive information that it has kept confidential to be made publicly available. Indeed, sometimes the participant does not even have a choice, such as when an opposing party is the one introducing a document produced in discovery into evidence. The cost of participation in rate proceedings should not include the risk that confidential business information may be publicly disclosed. A standardized blanket protective order, similar to that employed by the Trademark Trial and Appeals Board, would be helpful.

There is a litany of other particular problems with the current CRB procedures. Indeed, the topic is worthy of its own separate Notice of Inquiry. Music Choice understands that the CRB procedures, and the former CARP procedures upon which they were based, were created with the goal of streamlining the proceedings and making them more efficient and less expensive than traditional litigation. Given the stakes involved, often affecting the fates of entire industries, perhaps that goal was naïve. It is now clear, from decades of experience, that the procedural rules do nothing to limit the disruption or expense of rate proceedings, and the parties (particularly large trade organizations like SoundExchange, which can pool industry resources and even pay the litigation expenses out of royalty streams received from the licensees) hyper-litigate these proceedings. This dynamic places extreme pressure on licensees, and particularly smaller companies like Music Choice, to settle and accept supracompetitive rate increases in light of the costs and risks of rate cases.

CRB rate proceedings are actually more expensive (or certainly no less expensive) than federal court proceedings before the ASCAP and BMI rate courts, but they are far less efficient. Moreover, federal court litigation has several additional benefits, including a body of published precedent, interpreting the rules of procedure, and robust appellate review. Ad hoc procedural and discovery rulings by the CRB are not publicly available (at least not in any usable way by counsel who are not participating in the specific proceeding in which a given ruling is issued).

As noted above, proceedings before the ASCAP and BMI rate courts have operated for decades, without such procedural problems or controversy, and at equal or lesser expense to participants. Music Choice suggests that many of the procedural problems it has experienced in CRB rate proceedings could be easily solved by making relevant portions of the Federal Rules of Evidence applicable (either directly or by adapting them into analogous CRB regulations) in such proceedings, perhaps with minor specific modifications. For example, it may be advisable to keep the relaxed hearsay rule in the current regulations. The Federal Rules' provision for third-party subpoenas would also provide a major improvement. Under the existing Copyright Act provisions and regulations, it is almost impossible for participants to obtain third-party discovery. This presents a significant problem, particularly when copyright owners are represented by trade organizations, allowing the copyright owners to cherry pick which of them will provide testimony (and therefore be subject to discovery). The Federal Rules provide significant protections for non-parties, while still allowing limited discovery when necessary.

In addition to moving to a Federal Rules –based procedure, other measures should be taken to make CRB rate proceedings more like traditional federal court litigation. For example, like ASCAP and BMI rate court cases, copyright owners should have the burden of proof as to a reasonable rate. Also, the proceeding should no longer be bifurcated into two phases, but should commence with the copyright owners' filing of a rate proposal, followed by full discovery and one final hearing. Finally, given the amount at stake in most rate proceedings, rate determinations should be subject to the same standard of review applicable to federal civil litigation, as opposed to the more limited review provided by the Administrative Procedures Act.

C. Songwriter's Equity Act (Topic 6)

Section 114(i) of the Copyright Act provides that: "License fees payable for the public performance of sound recordings . . . shall not be taken into account in any . . . proceeding to set or adjust the royalties payable to copyright owners of musical works for the public performance of their works." 17 U.S.C. § 114(i).

As noted above, the rates for the sound recording performance license have been set far too high. Nevertheless, major publishers have been fixated on the higher rates that record companies – often their corporate affiliates – receive. As described in the Pandora rate-setting decision, publishers like Sony simply could not ignore the gap:

> We were struck by the vast disparity between what record companies received from digital music services for the sound recording rights that they conveyed and what was paid for the performance right.

See In re Pandora Media, Inc., *supra*, 2014 WL 1088101, at *14. The court described the force behind this fixation as the "publishers' envy at the rate their sound recording brethren had extracted . . . ." *Id.* at 43.

It was the publishers and songwriters, however, who lobbied *to get* the Section 114(i) restriction on using sound recording rates as evidence in the ASCAP and BMI rate courts in the first place. *See Id.*, at *12 n. 30 ("Publishers lobbied for this provision in Congress because they were concerned that the sound recording rates would be set below the public performance rates for compositions and drag down the latter. ASCAP also supported the enactment of the provision, for the same reason.").

In the first PSS proceeding, which was the very first Section 114 rate proceeding, the Register (whose reasoning was adopted by the Librarian of Congress) agreed with the CARP that the rate paid by the PSS to the PROs for the musical composition performance right was a usable benchmark for the sound recording right, but ultimately determined that the sound recording rate should be *lower* than the aggregate PRO rate. When it came time to determine the sound recording rates for webcasters and PSDARS, however, the CARP and later the CRB were (wrongly) persuaded that the markets for sound recording and musical composition performance rights were drastically different, and consequently rejected the PRO benchmark and set the sound recording performance fees at rates *many times higher* than the equivalent rates for the public performance of musical compositions.

This error was repeated many times, and all of the current sound recording rates are premised upon this faulty reasoning. *See, e.g., In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2000-9 (CARP) (DTRA), Report of the Copyright Arbitration Royalty Panel, at 41 (February 20, 2002) ("[m]usical works and sound recordings do not compete in the same market, and they have different cost and demand characteristics."); *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 Fed. Reg. 24084, 24094-95 (May 1, 2007); *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080, 4089-4090 (January 24, 2008)("substantial empirical evidence shows that sound recording rights are paid multiple times the amounts paid for musical works rights in most digital markets."). These erroneous rulings were urged by SoundExchange, on behalf of its record company members, which argued that the sound recording right should be set many multiples higher than the equivalent musical composition rights "because the sound recording is simply more valuable to the consumer, and therefore to the service, than is the musical work. It is also because, as the record amply reflects with virtually unrebutted evidence, the production of sound recordings demands far greater investment, costs and risk than does the production musical works." *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, Docket No. 2006-1 (CRB) (DSTRA), Proposed Findings of Fact of SoundExchange, Inc. at ¶ 28.

Music Choice strongly believes that the Register and Librarian of Congress got this issue right the first time, in the first PSS proceeding, and that the sound recording performance right is worth slightly less than the comparable musical composition performance right. Given that the current sound recording performance rates were set so very high specifically based upon the fundamental (and fundamentally wrong) premises that (1) the musical composition performance right is completely non-comparable to the sound recording performance right, such that the PRO rates cannot be used as benchmarks for the Section 114 license and (2) the sound recording performance right is inherently worth a vast multiple more than the musical composition performance right, it would be manifestly inequitable to now allow music publishers to use the improperly inflated Section 114 rates as benchmarks. It would be even more inequitable to allow them to do so by repealing the very Section 114(i) limitation that they insisted be part of the law.

The absurdity of the music publishers' argument is easily demonstrated by considering, even for a moment, what the real world effect would be from allowing them to use the inflated Section 114 rates as benchmarks. Although it is difficult to know precisely what various non-public webcasters pay as a percentage of revenue for the sound recording performance rights, based upon reporting in trade publications, conversations with webcasting executives, and financial statements of the few publicly traded webcasters, they pay somewhere between 40 and 55 percent of their revenue for sound recording rights (some pay even more). If those webcasters had to pay the same rates to music publishers, they could easily be required to pay 100 percent or more of their revenue for the music licensing rights. This is the absurd result that music publishers seek when they argue that they should be paid rates equal to the current, inflated sound recording performance rates.

Even if it were appropriate to eliminate Section 114(i) (it is not), sauce for the goose should be sauce for the gander: it should not be eliminated until after such time as the current PRO rates are again used as benchmarks to set the sound recording performance royalty rate. The simple fact is that the disparity in rates between the Section 114 license and the PRO licenses does not prove that the PRO rates are too low; it proves that the Section 114 rates are too high.

VII. PLATFORM PARITY

A. Objection to the term "platform parity"

As a preliminary matter, "platform parity" is a loaded term, which is not helpful in objectively framing the issues relating to statutory rate-setting standards. The term sometimes carries the implication that music performances have one, inherent value and that all types of music services should pay the same (or similar) rates. This premise is fundamentally wrong, and is inconsistent with basic economic principles, which, in truly competitive markets, expect to find segmented markets and price differentiation among different buyers and sellers operating different types of services with different business models, cost structures, consumer demand, and price sensitivities, among other factors. This is particularly true where, as with the market for music performance licenses, marginal costs approach zero.

B. Impact of different rate-setting standards (Topic 12)

The NOI's framing of this issue is problematic to the extent it describes the various statutory licensees as "delivery platforms." This is another inaccurate and loaded term, which unfairly minimizes the significant contributions that many licensees make to their services. Music Choice is not a mere technical conduit for the "delivery" of music. As noted above, Music Choice makes significant creative contributions to the programming of its channels, and contributes substantial original content to those channels.

With respect to the use of different standards for different digital music service licensees, there is good historical justification for why the PSS rates are set using the Section 801(b) policy standard. Music Choice (and the other original PSS) launched the first digital music services, and provided music transmissions to the public, years before there was any performance right for sound recordings. At that time, the PSS paid publishers and songwriters through the PROs, but had no obligation to pay the record companies. That legal landscape changed with the passage of the DPRSRA in 1995. Responding to record industry concerns regarding the potential displacement of record sales from then-nascent technology that would allow interactive, or on-demand, digital performances of sound recordings that could substitute for the purchase of physical records, Congress granted a limited public performance right for sound recordings.

Because this expansion of rights was again driven by concerns over threats to record sales, and also because Congress continued to recognize the promotional value of radio airplay to those record sales, the new performance right was limited in several ways, including by limiting the scope of the exclusive right only to digital performances. S. Rep. No. 104-128, at 13(1995) ("DPRSRA Senate Report") ("[T]he Committee has sought to address the concerns of record producers and performers regarding the effects that new digital technology and distribution systems might have on their core business without upsetting the longstanding business and contractual relationships among record producers and performers, music composers and publishers and broadcasters that have served all of these industries for decades. Accordingly, the Committee has chosen to create a carefully crafted and narrow performance right, applicable only to certain digital transmissions of sound recordings."). Another fundamental way in which Congress limited the new digital performance right for sound recordings was by making that right subject to a compulsory license for those digital music services unlikely to pose any significant harm to record sales.

In enacting the DPRSRA, Congress agreed with the record industry's claim that interactive, on-demand music services were likely to be highly substitutional for the sale of legitimate copies of sound recordings. H.R. Rep. No. 104-274, at 14 (1995) ("DPRSRA House Report"); DPRSRA Senate Report at 16. For this reason, the digital performance right with respect to such interactive services was made absolutely exclusive, meaning that interactive services would have to obtain direct licenses from each copyright owner and that copyright owners could refuse entirely to license such services.

The DPRSRA was meant to balance the protection of the recording industry's core business of the distribution and sale of recordings with the public's interest in fostering new technologies for the enjoyment of music. DPRSRA Senate Report at 15; DPRSRA House Report at 14. Thus, Congress limited the exclusive digital performance right by creating a compulsory license in Section 114 of the Copyright Act for non-interactive subscription music services so that copyright owners could not refuse to license these non-interactive services. DPRSRA, § 3, 109 Stat. 336, 338, 340-42 (1995). The overarching purpose of the compulsory license is to balance the legitimate concerns of record companies regarding potential displacement of revenues from their core business with the encouragement of new technologies and markets for sound recording performances. In the first PSS proceeding, the Register specifically held that this Congressional purpose requires the setting of a rate that "affords the copyright owners some control over the distribution of their creative works through digital transmissions, then balances the owners' right to compensation against the users' need for access to the works at a price that would not hamper their growth." *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings (Final Rule and Order)*, 63 Fed. Reg. 25394, 25409 (May 8, 2008) ("*Librarian's PSS Determination*"). *See also Id*. at 25408 (citing DPRSRA Senate Report at 15-16 and noting "Congressional intent not to hamper the arrival of new technologies.").

As noted above, at the time the DPRSRA was passed, there were already a small number of digital, non-interactive subscription services in operation, including Music Choice, which had been in business for several years without any statutory obligation to pay royalties to sound recording copyright owners. The DPRSRA changed the rules for these businesses. Thus, while creating an entirely new revenue stream for the recording industry at the expense of these businesses, one of the specific reasons cited by Congress for creating the compulsory license (and other limitations on the new performance right) was to ensure that it would remain economically feasible for those few existing music services to continue their current uses of sound recordings. DPRSRA Senate Report at 16; DPRSRA House Report at 14. Further to this legislative purpose, Congress provided that the rates for the Section 114 license would be set, in the absence of industry agreement, using the multi-factor policy based standard set out in Section 801(b)(1) of the Copyright Act. DPRSRA, 109 Stat. at 340-41.

In 1998, Congress again modified the legal landscape in which digital music services operate, in response to the record industry's concerns that certain non-subscription digital music services, i.e., webcasters, had not been expressly addressed in the DPRSRA or the Section 114 license. Digital Millennium Copyright Act, Pub. L. No. 105-304, § 405(a), 112 Stat. 2860, 2890 (1998) ("DMCA"); H.R. Rep. No. 105-796, at 80 (1998) ("DMCA Conference Report").

With the passage of the DMCA, Congress also changed the Section 114 rate-setting standard for future subscription and non-subscription services otherwise eligible for the Section 114 license to a hypothetical, willing buyer – willing seller standard. DMCA, § 405(a), 112 Stat. at 2896. *See also Memorandum Opinion of the Register of Copyrights*, Docket Nos. RF 2006-2 and RF 2006-3 (Oct. 20, 2006), at 3 ("*Register's PSS Opinion*"). At the same time, however, Congress "grandfathered" the three PSS, Music Choice, DMX and Muzak, that were already in operation at the time the DMCA was passed, allowing the PSS to keep the 801(b) policy-based rate standard rather than be subjected to the new marketplace standard. DMCA, § 405(a), 112 Stat. 2894-95; *Register's PSS Opinion* at 3.

Similar to its purpose in the DPRSRA, Congress continued to apply the Section 801(b) policy standard to the PSS, even while it moved future market entrants to a marketplace standard, in recognition of the PSS' legitimate business expectancies as pioneers who launched the very first digital music services under a different legal and licensing landscape than those that would enter the market in the future. DMCA Conference Report at 81; *Register's PSS Opinion* at 12-14. The legislative history of the DMCA expressly states that the reason for continuing to apply the policy-based standard of Section 801(b) to the PSS was "to prevent disruption of existing operations by such services." DMCA Conference Report at 81.

In deciding a novel question of law referred to her by the Copyright Royalty Judges in the second PSS proceeding, the Register of Copyrights (agreeing with arguments made by SoundExchange) further amplified this legislative history, explaining that Congress "understood that the entities so designated as preexisting had invested a great deal of resources into developing their services under the terms established in 1995 as part of the [DPRSRA], and that those services deserved to develop their businesses accordingly." *Register's PSS Opinion* at 13.

As also noted by the Register, "[g]randfathering provisions are frequently included in statutes to ensure continuity and to reward the investment and efforts of those [such as the PSS] who were the first to take on the struggles and risks of novel enterprises or methods." *Id*. at 14.

Congress's intent to provide long-term protection of the PSS' investments by treating them differently than later market entrants is further evinced by its extension of PSS status not only to the PSS' existing services in their existing transmission media, but also "to any new services [offered by the PSS] in a new transmission medium where only transmissions similar to their existing service are provided. Thus, if a cable subscription music service making transmissions on July 31, 1998, were to offer the same music service through the Internet, then such Internet service would be considered part of a preexisting subscription service." DMCA Conference Report at 89.

The legislative history of the Section 114 license applicable to the PSS, as discussed above, evinces a specific Congressional intent to protect the unique business expectancies of the PSS, even as against later market entrants, which is inapplicable to other statutory licensees and is the very reason why the 801(b) policy standard must continue to be applied to the PSS.

That said, Music Choice understands that the "willing buyer – willing seller" standard selectively applied to later digital music services, particularly as that standard has been interpreted by the CRJs, has proven to be unworkable and has led to the imposition of cripplingly high rates bearing no relationship to hypothetical competitive fair market rates. Fair market rates are typically defined as rates to which a willing buyer and seller would agree in a functionally competitive market where both buyers and sellers have adequate information and a real ability to say no. Obviously, the market for blanket performance licenses for large catalogs of music can never fit this definition. Each major record company or music publisher individually inherently has extraordinary market power in any such licensing negotiation, for several reasons. First, rights to each major's catalog is necessary for a programmed music service, so the licensee is effectively under compulsion to obtain the license. Its only other option is to exit the business. Second, the music copyright owners' catalogs are not substitutes for one another and therefore there is no competition between the copyright owners that would typically be necessary to yield fair market rates.

The market failure inherent in the blanket licensing of musical copyrights leads to the problem of benchmarks. To the extent that a marketplace direct license potential benchmark exists, it is almost certain to contain supracompetitive rates and terms. Although such potential benchmarks may be simplistically labeled as "willing buyer – willing seller" benchmarks because a particular buyer did, in fact, enter into the license, such a license does not reflect fair market value. As noted above, a buyer that has no choice other than to either except the terms offered or exit the business cannot truly be considered a willing buyer.

The ASCAP and BMI rate courts have implemented a fair market, willing buyer-willing seller standard in a way that at least attempts to correct for these inherent benchmarking problems by engaging in a rigorous evaluation of whether proposed benchmarks were the product of excessive market power. If such market power is found, the courts adjust for that problem, if possible, or reject the benchmark if adjustment is not possible. Perhaps because the ASCAP and BMI rate courts are the product of antitrust actions against the PROs and are presided over by federal judges experienced in antitrust law, the PRO rate courts have been very effective in analyzing these issues and making determinations of fair market value for musical composition performance licenses.

The CRJs have, thus far, been less inclined to perform any substantial analysis of market power effects or anticompetitive conduct. This has led to their use of benchmarks that were clearly the result of the record companies' exercise of market power to extract supracompetitive rates, such as the interactive webcasting benchmark. The use of such benchmarks has, in turn, led to webcasting rates set so high that no webcaster has been profitable, and many have exited the market.

The Section 801(b) policy-based rate standard, currently applicable to the record companies for their mechanical licenses and to PSS and PSDARS, is a superior standard. As a preliminary matter, it has been in use longer than the willing buyer – willing seller standard. It also has the benefit of being policy driven and flexible. These attributes are particularly desirable in a market that has never had competition, willing buyers or willing sellers. Instead, the Section 801(b) standard looks to the policies that the statutory license is meant to serve, such as the opening of new markets for the enjoyment of music, and the factors that typically drive true fair market value negotiations, including a fair return to copyright owners and a fair profit for licensed services.

There are, however, ways in which the Section 801(b) standard may be improved and clarified, based upon the manner in which that standard has been interpreted by the CRJs in prior cases. As noted above, the CRJs have not tended to scrutinize potential benchmarks for the influence of excessive market power. The standard should provide guidance that, to the extent marketplace benchmarks are used, only comparable benchmarks resulting from arms-length negotiations, without the influence of excessive market power may be considered. The standard should also clarify that the Judges may not assume (as they have sometimes done), without specific supporting evidence, that a particular benchmark rate already incorporates or furthers the specific Section 801(b) policy factors merely by virtue of being part of a marketplace agreement. Finally, the CRJs have consistently failed to consider the promotional value of the licensed services when setting rates pursuant to Section 801(b) on the grounds that such promotional effect was not sufficiently or precisely quantified. This is inconsistent with Section 801(b), which requires consideration of the services' promotional impact. It is typically difficult, if not impossible, to precisely quantify promotional impact in a way that may be converted into a specific adjustment to a benchmark or proposed rate. Promotional value should, however, have at least a directional effect in selecting a rate from within a given range of reasonable rates, and the standard should be clarified to provide that guidance.

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CONCLUSION

Music Choice thanks the Copyright Office for this opportunity to provide its unique perspective on the various music licensing issues raised in the NOI, and looks forward to ongoing participation in the Copyright Act revision process.

Respectfully submitted,

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