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**

REPLY AND FURTHER COMMENTS OF MUSIC CHOICE

Music Choice respectfully submits these comments in response to the Notice of Inquiry dated July 23, 2014 ("Second Request for Comments"), in connection with the Copyright Office's music licensing study announced in the Notice of Inquiry dated March 17, 2014 ("First Request for Comments").

PSS STATUS, AND THE SECTION 801(b) RATE STANDARD, SHOULD NOT BE PHASED OUT OR SUBJECT TO ANY SUNSET PROVISION

Topic 9 (First Request for Comments)

In their responses to the First Request for Comments, certain recording industry participants have argued that the pre-existing services that were grandfathered under the Section 801(b) rate standard, such as Music Choice, "have matured sufficiently that they no longer need or deserve to have their rates subsidized by artists and record companies, and should no longer enjoy a unique competitive advantage over other digital music services in the form of royalty rates that have been deliberately set below market." *See, e.g.*, Comments of the Recording Industry Association of America, Inc., *In re Music Licensing Study: Notice and Request for Public Comment*, Docket No. 2014-03, at 36 ("RIAA Comment"). This argument is wrong on several counts.

Notably, RIAA cites no authority for the proposition that PSS status should or was ever intended to sunset after the PSS had "matured sufficiently," or for any other reason. *Id.* This is because, to the contrary, when Congress grandfathered the PSS under the Section 801(b) rate standard, it intended that protection to continue indefinitely. Congress's intent to provide long-term protection of the PSS is clearly demonstrated by its decision to extend 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. For example, 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." H.R. Rep. No. 105-796 (1998) ("DMCA Conference Report"), at 89. Thus, Congress specifically provided that the Section 801(b) rate standard would be used far into the future, even if the PSS adapted their services to entirely new transmission media. Such long-term protection is wholly

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inconsistent with RIAA's argument that PSS status was meant to be a temporary, short-term accommodation.

This continuing protection is also consistent with the overall fairness purposes of Congress's grandfathering of the PSS. In particular, Congress recognized that the PSS were early pioneers, and had created the very first markets for digital music services under a very different copyright licensing landscape. Music Choice was the very first digital music service, and launched its original cable radio service several years before there was any sound recording performance right. It was in this context, with no sound recording royalties due at all, that Music Choice invested millions of dollars to launch and improve its service. Music Choice has continued to invest in its service after passage of the Digital Performance Right in Sound Recordings Act of 1995 ("DPRA") and the Digital Millennium Copyright Act ("DMCA"), through today, in reliance on the continued applicability of the Section 801(b) rate standard. Notably, even all these years later, Music Choice's residential music service has not recouped all of the money its partners have invested in the service.

Although Congress changed the rules for digital music services, first by creating the digital performance right and later by changing the rate-setting standard, in doing so it repeatedly recognized that the PSS' legitimate business expectancies and status as pioneers warranted continued application of the more flexible Section 801(b) standard. As the Register has previously recognized, 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 [Digital Performance Right in Sound Recordings Act], 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. These policy reasons for extending PSS status to Music Choice have not changed in any material way that would justify eliminating such status at this time.

Music Choice also notes that RIAA's suggestion that the PSS royalty rates are deliberately set below a fair market rate or are somehow subsidized by artists and record companies is patently false. Rather, the PSS royalty rates are determined by the policy-based standard of Section 801(b), which requires the Copyright Royalty Board ("CRB") to set reasonable rates, and specifically requires that the rates provide a fair return to copyright owners and authors. Typically, the Copyright Arbitration Royalty Panel ("CARP") and CRB have attempted to determine a range of reasonable, fair market rates and then used the policy factors to select one rate from within that range. Given that there is no functioning, competitive market for sound recording performance rights, however, the determination of what a fair market rate would be for such rights is exceedingly difficult. Therefore, the very notion that there is one correct "fair market" rate that may be determined for a given digital music service is absurd. In any event, to the extent there are circumstances justifying higher royalty rates, artists and record companies have had the opportunity to present such factors to the CRB to consider pursuant to the Section 801(b) standard; they simply have not done so, or not persuasively enough.

PARTIAL WITHDRAWAL SHOULD NOT BE PERMITTED

Topic 14 (First Request for Comments) and
Topic 4 (Second Request for Comments)

In its Second Request for Comments, the Copyright Office has asked for additional comments regarding the issue of potential publisher withdrawals from ASCAP and/or BMI. Also, in response to the First Request for Comments, various participants submitted comments arguing that publishers should have the right to selectively withdraw their songs from the PROs' repertories for certain types of licensees but not others. *See, e.g.*, Broadcast Music, Inc.'s Comments on Copyright Office Music Licensing Study, *Music Licensing Study: Notice and Request for Public Comment*, Docket No. 2014-03, at 8; RIAA Comment, at 40.

The consent decrees should not be modified to allow such partial withdrawals because allowing such conduct would undermine the fundamental underpinnings of the Final Judgments in *United States v. ASCAP*, 41 Civ. 1395 (S.D.N.Y.), and *United States v. BMI*, 64 Civ. 3787 (S.D.N.Y.) (collectively, "Consent Decrees").[1]

The PROs serve as a clearing house for music users to license songs without entering into separate, individual licenses with the many hundreds of thousands of different songwriters and publishers for millions of songs. The resulting efficiencies equally benefit publishers and songwriters, who are ill-equipped to negotiate or administer direct licenses with the many thousands of performance licensees, including local television and radio stations, webcasters, bars, and restaurants. Despite providing the economies of scale that individual copyright owners cannot otherwise achieve but need, the inherent anti-competitive problem with collective music licensing organizations is their abuse of the market power created by collective licensing. The Consent Decrees are thus necessary and premised on a compromise: the music publishers and songwriters are allowed to continue licensing collectively through the PROs, notwithstanding their market power and potential for anticompetitive effects, *but only subject to* the restrictions in the Consent Decrees, which are designed to help mitigate those effects. A hallmark of the Consent Decrees is that any music user must be granted access to ASCAP's or BMI's entire repertory – i.e., music users could obtain full public performance rights to works in a PRO's repertory. *See* AFJ2 § IX; BMI Consent Decree § XIV(A). Additionally, one of the more significant restrictions under the Consent Decrees is the prohibition against discriminatory terms. Allowing publishers to selectively avoid the regulatory oversight of the Consent Decrees so that they can use their market power to extract supra-competitive rates from targeted licensees, while maintaining the benefits of collective licensing through the PROs for other licensees (and even the benefits of collective administration through the PROs for directly licensed services) undermines these core principles.

Moreover, 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

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[1] Moreover, even if the Consent Decrees were modified to permit partial withdrawal, it is unclear whether publishers have the legal authority to partially withdraw the writer's share of the performance right from ASCAP or BMI. To the extent partial withdrawal would be possible, it would lead to less transparency and less money to the songwriters due to the publishers' accounting practices.

require regulatory oversight and rate supervision to mitigate the inherent anti-competitive effects of such collective licensing and prevent the collusive conduct the major publishers have demonstrated in the past. Major publishers in direct blanket licenses are effectively the same as PROs because each one (like each PRO) has aggregated from the original copyright owners (the songwriters) and 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 (or other form of regulatory oversight) if they were to withdraw their catalogs from any regulated PRO.

The PROs' and publishers' abuse of market power in the absence of rate court oversight is not merely hypothetical. The partial withdrawal strategy was devised by the major publishers, using the PROs as a conduit, expressly as a means to circumvent the Consent Decrees and abuse their market power. The *Pandora* rate case provides direct evidence of the actual conduct that resulted when certain major publishers thought they had the ability to selectively withdraw their catalogs with respect to only certain licensees. The rate court in that case found that the coordinated efforts between ASCAP and two major publishers – Sony and UMPG – resulted in the deliberate leveraging of market power – market power magnified from that which each holds individually – over Pandora to artificially create purported benchmark license agreements with higher rates:

> Pandora has shown that the Sony and UMPG licenses were the product of, at the very least, coordination between and among these major music publishers and ASCAP. *Sony and UMPG justified their withdrawal of new media rights from ASCAP by promising to create higher benchmarks for a Pandora–ASCAP license and purposefully set out to do just that*. They also interfered with the ASCAP–Pandora license negotiations at the end of 2012. UMPG pressured ASCAP to reject the Pandora license ASCAP's executives had negotiated, and Sony threatened to sue ASCAP if it entered into a license with Pandora. With only a few business days remaining in the year 2012, ASCAP refused to provide Pandora with the list of Sony works without Sony's consent, which Sony refused to give. Without that list, Pandora's options were stark. It could shut down its service, infringe Sony's rights, or execute an agreement with Sony on Sony's terms. Then, despite executing a confidentiality agreement with Pandora, Sony made sure that UMPG learned of all of the critical terms of the Sony–Pandora license. And LoFrumento admitted at trial that ASCAP expected to learn the terms of any direct license that any music publisher negotiated with Pandora in much the same way.

> There is no need to explore which if any of these actions was wrongful or legitimate. Nor is there any reason to explore here the several justifications that ASCAP, Sony, and UMPG have given for at least some of this conduct. *What is important is that ASCAP, Sony, and UMPG did not act as if they were competitors with each other in their negotiations with Pandora. Because their 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*. But, since the UMPG and Sony license agreements constitute poor benchmarks even in the absence of coordination, it is not necessary to engage more deeply with the implications of this evidence.

In re Pandora Media, Inc., *supra*, 2014 WL 1088101, at *35 (emphasis added).

Other anti-competitive 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); Martin 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).

This strategy was specifically created to allow publishers to circumvent 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.

In its response to the First Request for Comments, BMI admitted that partial withdrawal is *intended* to circumvent the protections of Consent Decrees:

> BMI believes that its consent decree is outmoded. As a result of recent PRO rate court decisions that have found that partial withdrawals are not permitted by the PRO consent decrees, many publishers may find themselves compelled to choose between: (a) remaining with PROs and foregoing the competitive opportunities that may exist for their own licenses in the free market; or (b)

> withdrawing their catalogs from PROs entirely in order to explore activities prohibited by the PROs' consent decrees (see response to Question 7), and thus forego the efficiencies of blanket licensing.

BMI Comment, at 8. Indeed, as the District Court found in the *Pandora* decision, the major publishers' most important reason for partial withdrawal was to "leverage their market power to negotiate a significantly higher rate for a license to publically perform a composition." *In re Pandora Media, Inc.*, 2014 WL 1088101 at *14. At the same time as they were attempting to avoid rate court scrutiny, the major publishers sought to keep most of the benefits of collective licensing by cutting deals for ASCAP to continue administering the direct licenses, even after "withdrawal," at rates lower than those charged to ASCAP members. *Id.* at *17.

The withdrawing publishers were able to extract this perverse concession from ASCAP at the expense and to the prejudice of the smaller publishers. The *Pandora* decision explained the striking unfairness to the smaller publishers who did not – indeed, could not – selectively withdraw certain rights as Sony and UMPG had:

> As a result of the publishers' partial withdrawals from ASCAP, the burden on remaining ASCAP members to pay for all of the other functions that ASCAP performs for its members, including in LoFrumento's words at trial, "membership, legislative, legal, senior management, [and] international costs," increased. On the other hand, because ASCAP continued to administer the distribution of licensing revenues, the writers could continue to have confidence that they would actually receive the monies owed them by the withdrawing publishers. Finally, the Administration Agreements meant that the withdrawing publishers faced little downside in withdrawing new media rights. They could continue to enjoy the benefits of having ASCAP perform burdensome back-office tasks while licensing internet music entities directly.

Id. at *18. 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. Thus, not only would partial withdrawal weaken the PROs, but it would also harm the smaller publishers.

As logic and past behavior confirm, the safeguards of the Consent Decrees – which continue to be necessary – against anti-competitive conduct would be wholly undermined if publishers were permitted to selectively withdraw performance rights from the PROs for some music licensees but not others.

PERFORMANCE ROYALTY RATES ARE NOT THE CAUSE OF THE ALLEGED DECLINE SONGWRITER INCOME

Topic 18 (First Request for Comments) and
Topic 6 (Second Request for Comments)

In its Second Request for Comments, the Copyright Office has asked for comments on marketplace developments that have led to the inconsistent dynamic of PROs reporting record-high revenues and distributions while certain songwriters are reporting significant declines in income. Additionally, in their responses to the First Request for Comments, BMI and SESAC made the claim that songwriter income has declined in recent years. *See, e.g.*, BMI Comment, at 27-28; Comments of Sesac, Inc. in Response to Notice of Inquiry Regarding Music Licensing Study, *In re Notice of Inquiry Regarding Music Licensing Study*, Docket No. 2014-03, at 18 ("Substantial anecdotal evidence indicates that songwriter royalties in the United States have decreased in recent years for a number of reasons . . . .").

The music publishers and songwriters have attempted to use these anecdotal claims of declining songwriter income to support their argument that performance royalties have been set below "fair market value" in the rate courts. Music Choice empathizes with the songwriters and has helped support and promote many thousands of songwriters over its 25 years of programming music. However, songwriters' and music publishers' attempts to eliminate the Consent Decrees and rate courts governing public performance licenses are based upon false premises.

With respect to songwriters' alleged loss of income, Music Choice is unaware of any evidence supporting a substantial loss of songwriters' income on an industry-wide basis, especially with respect to performance license income. Anecdotal accounts from individual songwriters of lost income, cherry-picked for the purposes of supporting an argument for higher rates, are not necessarily representative of songwriters generally.

Indeed, ASCAP, BMI, and SESAC each have reported increased membership, revenues, and distributions over the past few consecutive years (with the exception of one temporary, small dip for BMI in 2012 due solely to settlement payments reversing overcharges to broadcasters in prior years). Moreover, overall music publishing industry revenues have increased from $3.9 billion in 2011 to approximately $4.2 billion in 2013, and by 2017 those revenues are projected to increase to approximately $4.4 billion, according to independent market research. Notably, typical music publishing agreements with songwriters provide for songwriters to get an equal, 50% share of revenue from music publishers (and an even higher percentage in co-publishing and administration deals, common for successful songwriters). If music publishing revenues are stable, or even increasing, yet songwriters claim that their revenues are sharply decreasing, either the songwriters are mistaken or the music publishers and PROs are failing to pass along the songwriters' proper shares. Either way, the answer is not to re-write the copyright or antitrust law to raise performance rates paid by licensees.

Music publishers' and songwriters' second premise, that the consent decree rate courts have imposed rates below fair market value, is also false. The legal standard employed for decades by the rate courts is, in fact, fair market value. ASCAP and BMI have had several different opportunities, in several different rate cases, to prove (if they could) that the higher rates they desire were consistent with fair market value. Time and time again, before two different, neutral,

sophisticated federal district court judges, the PROs failed to satisfy their burden of proof. Each of these decisions was appealed and affirmed by different panels of federal appellate judges. There can be no question that the current rates have been fairly determined to be fair market rates. The real grievance of the music publishers and songwriters is that they are not happy with the results of these cases. Of course, a seller would always prefer to be paid more than fair market value for their goods or services. But the rate courts, with all the procedural and substantive due process afforded therein, provide a far superior venue to determine fair market value (which is a fact-intensive issue often litigated in federal commercial cases) than a private arbitrator.

Music Choice's issue is not with the songwriters, but the way in which their story has been characterized by their trade associations and the major music publishers, along with the tendency to attribute all of their alleged troubles to one factor (performance royalties), rather than looking at all the factors. Indeed, to the extent that music publishers and songwriters have not done as well as they would have liked in recent years, the causes of any such underperformance have nothing to do with performance royalties (which, as noted above, have actually increased), but instead have been driven by a large number of unrelated factors, such as the recent extended recession (which affected everyone, including Music Choice) as well as changing music consumer dynamics. With less disposable income, it is natural that consumers would buy less music. Record sale revenues have been further decreased by the advent of digital single downloads, which have freed consumers from having to purchase a bundle of recordings (i.e, an album) that they do not want, and on-demand streaming services, which have in some cases supplanted the need to buy digital downloads. However, there is no data suggesting that Music Choice, or any other non-interactive music service, contributed to such sales and revenue declines – in fact, services like Music Choice promote the sale of songwriters' (and record companies') music and have been a source of additional, incremental revenue. Music Choice has had its own challenges with its average subscriber license fee revenue declining year over year, and no other music streaming service over the past 15+ years has ever turned a profit with most having failed. When so many music licensees have failed one can no longer blame such repeated failure on bad business models, but rather one must question the sustainability of existing royalty rates, particularly the sound recording performance rates. Notably, the industry players who have fared the best during this period are the music publishers and record companies, each of whom has remained profitable where digital music services have not.

CONCLUSION

Music Choice thanks the Copyright Office for this opportunity to provide further comments on the issues raised in the First and Second Requests for Comments, and looks forward to ongoing participation in the Copyright Act revision process.

Respectfully submitted,

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