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Statutory Royalty Rates for Digital Performance of Sound Recordings: Decision of the Copyright Royalty Board

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Summary

The Copyright Royalty Board (CRB) announced new statutory royalty rates for certain digital transmissions of sound recordings for the period January 1, 2006, through December 31, 2010. Implementation of these new rates marks the expiration of a previous royalty rate agreement specifically designed to benefit "small" webcasters. This report surveys both the legislative history of this issue, *i.e.,* royalty rates for eligible nonsubscription webcasters, the Board's decision, and the public and congressional response.

To date, two similar bills, H.R. 2060 and S. 1353, both titled the "Internet Radio Equality Act," have been introduced into the Congress. The bills would nullify the CRB's decision, change the ratemaking standard, and institute transitional rates for the current rate cycle (which is retroactive to 2006). Although Congress has addressed the interests of small commercial webcasters in the past, the proposed legislation appears to emphasize rate parity among statutory licensees who utilize different transmission technology, *i.e.,* satellite, cable, and the Internet. The bills, however, permit webcasters to choose between different payment formats for the current cycle, including one based on percentage of revenue, a method sought by small webcasters.

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Contents

Statutory Licenses 1

Background 2

Copyright Royalty Board Rates 3

Rationale 5

Public Reaction 7

Congressional Response 7

H.R. 2060, 110th Cong., 1st Sess. (2007), the "Internet Radio Equality Act" 7

S. 1353, 110th Cong., 1st Sess. (2007), the "Internet Radio Equality Act" 9

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Statutory Licenses

The U.S. Copyright Act allows one who wishes to use copyrighted material, in certain instances, to obtain a statutory license to do so. Ordinarily, royalties and licenses for the use of protected material are the product of direct negotiations between copyright owners and users. When a statutory, or compulsory, license is available, a permitted user need only adhere to statutory requirements, including payment of established royalty rates, to use the work.

In 1998, in the Digital Millennium Copyright Act (DMCA),[1] Congress amended several statutory licensing statutes to provide for and clarify the treatment of different types of webcasting. Some transmissions of sound recordings are *exempt* from the public performance right, for example, a nonsubscription broadcast transmission;[2] a retransmission of a radio station's broadcast within 150 miles of its transmitter; and a transmission to a business establishment for use in the ordinary course of its business.[3] In contrast, a digital transmission by an "interactive service" is not exempt from the public performance right, nor does it qualify for a compulsory license. The owner of an interactive service — one that enables a member of the public to request or customize the music that he or she receives — must negotiate a license, including royalty rates, directly with copyright owners.

But, two categories of webcasting that *do* qualify for a compulsory license are specified "preexisting" subscription services (existing at the time of the DMCA's enactment)[4] and "an eligible nonsubscription transmission." A subscription service

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[1] P.L. 105-304 (October 28, 1995).

[2] A "broadcast" transmission is defined as a transmission made by a terrestrial broadcast station licensed by the FCC. 17 U.S.C. § 114(j)(3). FCC-licensed radio broadcasters argued unsuccessfully that simultaneous Internet streaming of AM/FM broadcast signals was exempt from the public performance license requirement for digital transmissions. Bonneville International Corp. v. Peters, 347 F.3d 485 (3d Cir. 2003).

[3] 17 U.S.C. § 114(d)(1).

[4] Pursuant to definition under § 114(j), qualifying "preexisting" services include

> "(10) A 'preexisting satellite digital audio radio service' is a subscription satellite digital audio radio service provided pursuant to a satellite digital audio radio service license issued by the Federal Communications Commission on or before

(continued...)

is one that is limited to paying customers. The broader category of webcasters who may qualify for the statutory license under 17 U.S.C. § 114(d) are eligible those who transmit music over the Internet on a nonsubscription, noninteractive basis.

A licensee under § 114 may also qualify for a statutory license under 17 U.S.C. § 112(e) to make multiple "ephemeral" — or temporary — copies of sound recordings solely for the purpose of transmitting the work by an entity legally entitled to publicly perform it.[5]

Background

The initial ratemaking proceeding for statutory royalty rates for webcasters for the period 1998 through 2005 proved to be controversial, perhaps reflecting in some degree the relative newness of both the DMCA and webcasting activity. A Copyright Arbitration Royalty Panel (CARP) issued a recommendation for the initial statutory royalty rate for eligible nonsubscription webcasters on February 20, 2002.[6] Small-scale webcasters objected to the proposed rates. In accordance with then-existing procedures, the Librarian of Congress, on the recommendation of the U.S. Copyright Office, rejected the CARP's recommendation and revised rates downward. Congress interceded as well with enactment of the Small Webcasters Settlement Act (SWSA) of 2002, P.L. 107-321. Although very complex, the law permitted more options than the royalty rates established by the Librarian's order. Qualifying small webcasters, for example, could elect to pay royalties based on a percentage of revenue or expenses rather than on a per-song per-listener basis. The rate agreement made pursuant to SWSA was published in the Federal Register[7] but not codified in the

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[4] (...continued)

> July 31, 1998, and any renewal of such license to the extent of the scope of the original license, and may include a limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service.
> "(11) A 'preexisting subscription service' is a service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998, and may include a limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service." *See* 37 C.F.R. Part 260.

[5] The statutory license for ephemeral copies is based upon the copyright owners right to control reproduction of a protected work.

[6] In the Matter of Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings, *Report of the Copyright Arbitration Panel,* February 20, 2002, at [http://www.copyright.gov/carp/webcasting_rates.pdf]. For more background, see CRS Report RL31626, *Copyright Law: Statutory Royalty Rates for Webcasters*, by Robin Jeweler.

[7] U.S. Copyright Office, *Notification of Agreement Under the Small Webcaster Settlement Act of 2002*, 67 Fed. Reg. 78510-78513 (December 24, 2002), at [http://www.copyright.gov/ (continued...)

Code of Federal Regulations. However, by SWSA's own terms, its provisions were *not* to be considered in subsequent ratemaking proceedings.[8]

Subsequent to passage of the SWSA and the initial ratemaking proceeding, Congress substantially revised the underlying adjudicative process. Enactment of the Copyright Royalty and Distribution Reform Act of 2004, P.L. 108-419, abolished the CARP system and substituted a Copyright Royalty Board composed of three standing Copyright Royalty Judges.[9] Rates established pursuant to the original ratemaking determination and SWSA were to remain in effect through 2005. As required by law, the Copyright Royalty Board recently announced royalty rates for the period that commences (retroactively) from January 1, 2006, through December 31, 2010.[10]

Copyright Royalty Board Rates

The general process for statutory license ratemaking factors in a three-month period, during which interested parties are encouraged to negotiate a settlement agreement. In the absence of an agreement, written statements and testimony are gathered, discovery takes place, hearings are held, and the Copyright Royalty Board issues a ruling.[11]

Notice announcing commencement of the subject proceedings was published on February 16, 2005.[12] On March 9, 2007, the Copyright Royalty Board issued its decision, which was published as a Final Rule and Order on May 1, 2007.[13] The

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[7] (...continued)
fedreg/2002/67fr78510.html].

[8] P.L. 107-321, § 4(c): "It is the intent of Congress that any royalty rates, rate structure, definitions, terms, conditions, or notice and recordkeeping requirements, included in such agreements shall be considered as a compromise motivated by the unique business, economic and political circumstances of small webcasters, copyright owners, and performers rather than as matters that would have been negotiated in the marketplace between a willing buyer and a willing seller, or otherwise meet the objectives set forth in section 801(b)." Congressional findings in § 2(5)-(6) also emphasize that Congress makes no determination that the agreements reached between small webcasters and copyright owners are fair and reasonable or represents terms that would be negotiated by a willing buyer and a willing seller.

[9] For more background, see CRS Report RS21512, *The Copyright Royalty and Distribution Reform Act of 2004*, by Robin Jeweler.

[10] 17 U.S.C. § 804(b)(3).

[11] *Id.*

[12] 70 FED. REG. 7970 (2005).

[13] Library of Congress, Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings,* 72 FED. REG. 24084 (May 1, 2007). *See* 37 C.F.R. Part 380.

decision establishes rates for commercial and noncommercial webcasters.[14] Rates are as follows:

- For commercial webcasters: $.0008 per performance for 2006, $.0011 per performance for 2007, $.0014 per performance for 2008, $.0018 per performance for 2009, and $.0019 per performance for 2010. This includes fees for making an ephemeral recording under 17 U.S.C. § 112.[15]

- For noncommercial webcasters: (i) For Internet transmissions totaling less than 159,140 Aggregate Tuning Hours (ATH) a month, an annual per channel or per station performance royalty of $500 in 2006, 2007, 2008, 2009, and 2010. (ii) For Internet transmissions totaling more than 159,140 Aggregate Tuning Hours (ATH) a month,[16] a performance royalty of $.0008 per performance for 2006, $.0011 per performance for 2007, $.0014 per performance for 2008, $.0018 per performance for 2009, and $.0019 per performance for 2010. These rates include fees for making an ephemeral recording under 17 U.S.C. § 112.

- Minimum fee. Commercial and noncommercial webcasters will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part thereof.[17]

This rate structure does not make special provision for "small" webcasters, who were addressed in the SWSA by reference to revenues.

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[14] A noncommercial webcaster is a licensee that is tax exempt under § 501 of the Internal Revenue Code, 26 U.S.C. § 501 or which is operated by a state entity for public purposes. 37 C.F.R. § 380.2.

[15] In the Copyright Royalty Board's order denying rehearing, see *infra,* it authorized an optional transitional ATH fee for the years 2006 and 2007. 37 C.F.R. § 380.3(a)(ii).

[16] Aggregate Tuning Hours is defined, in part, as "the total hours of programming ... transmitted during the relevant period to all Listeners withing the United States from all channels and stations that provide audio programming[.]" 37 C.F.R. § 380.2(a).

[17] 37 C.F.R. § 380.3.

Rationale

The standard for establishing rates, set forth by statute, is known as the "willing buyer/willing seller" standard.[18] The Board's determination is informed by the initial royalty proceedings of the CARP, which it refers to as "Webcaster I." In essence, both the previous CARP and the current Copyright Royalty Board attempt to implement the statutorily mandated standard to reach a royalty rate. Explaining its interpretation of the governing language, the CRB wrote:

> Webcaster I clarified the relationship of the statutory factors to the willing buyer/willing seller standard. The standard requires a determination of the rates that a willing buyer and willing seller would agree upon in the marketplace. In making this determination, the two factors in section 114(f)(2)(B)(i) and (ii) must be considered, but neither factor defines the standard. They do not constitute additional standards, nor should they be used to adjust the rates determined by the willing buyer/willing seller standard. The statutory factors are merely to be considered, along with other relevant factors, to determine the rates under the willing buyer/willing seller standard.[19]

The Board considered the proposals of representatives for "small" webcasters that rates be structured as a percentage of revenue, but ultimately rejected them:

> In short, among the parties on both sides who have proposed rates covering Commercial Webcasters, only Small Commercial Webcasters propose a fee structure based solely on revenue. However, in making their proposal, this group of five webcasters clearly is unconcerned with the actual structure of the fee, except to the extent that a revenue-based fee structure — especially one in which the percent of revenue fee is a single digit number (i.e., 5%) — can protect them against the possibility that their costs would ever exceed their revenues.... Small Commercial Webcasters' focus on the amount of the fee, rather than how it should be structured, is further underlined by the absence of evidence submitted by this group to identify a basis for applying a pure revenue-based structure to them. While, at times, they suggest that their situation as small commercial

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[18] 17 U.S.C. § 114(f)(2)(B), provides in pertinent part:

> In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller. In determining such rates and terms, the Copyright Royalty Judges shall base [their] decision on economic, competitive and programming information presented by the parties, including —
>
> (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
>
> (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

[19] 72 FED. REG. at 24087.

> webcasters requires this type of structure, there is no evidence in the record about how the Copyright Royalty Judges would delineate between small webcasters and large webcasters.[20]

And, in a substantive footnote, the Board expressed its view that it lacks statutory authority to carve out royalty rate niches for the emergent business models promoted by small commercial webcasters:

> It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners. Furthermore, it would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act.[21]

In setting the rates, the Board looked to proposed "benchmark" agreements to determine what a hypothetical buyer and seller would agree to in the marketplace. It rejected the proposals advanced by the radio broadcasters and small commercial webcasters that the appropriate benchmark was the fee paid to performing rights organizations (PROs), such as ASCAP, BMI and SESAC, for the digital public performance of the underlying musical composition. It also rejected a proposal that analog over-the-air broadcast music radio be used as a benchmark, with reference to musical composition royalties paid by such broadcasters to the PROs. Based on the evidence before it, the Copyright Royalty Board found that the most appropriate benchmark agreements are those in the market for interactive webcasting covering the digital performance of sound recordings, with appropriate adjustments.[22]

In summary, the Copyright Royalty Board's decision, like that of its predecessor, the CARP, declines to delineate a separate class or to integrate a separate market analysis on behalf of "small" webcasters.

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[20] *Id.* at 24088-89 (footnotes and citations omitted).

[21] *Id.* note 8 at 24088.

[22] *Id.* at 24092.

Public Reaction

The expiration of the option to pay a percentage of revenues, to be replaced by a minium payment, per-song per- listener formula, was, predictably, not well received in the small webcasting business community, among others.[23] Some Members of Congress voiced concern as well.[24] But, the issue of whether the economic needs of small commercial webcasters should be factored into statutory royalty rates is more likely to be addressed as a policy matter by Congress, acting through legislatively articulated standards, rather than by the Copyright Royalty Board or a court reviewing its determination under extant law. Congress clearly had not made a final decision on this issue with enactment of the SWSA.

On April 16, 2007, the Copyright Royalty Board issued an order denying rehearing.[25] Parties affected by the ruling have thirty days from the date of publication of the final rule in the *Federal Register* to appeal to the U.S. Court of Appeals for the D.C. Circuit.[26]

Congressional Response

To date, two bills have been introduced, both of which would nullify the Board's decision.

H.R. 2060, 110th Cong., 1st Sess. (2007), the "Internet Radio Equality Act". H.R. 2060 would expressly nullify the Board's rate determination and repeal the willing buyer/willing seller standard under § 114(f)(2)(B). It would replace the standard with objectives set forth under 17 U.S.C. § 801(b)(1), namely, that rates be calculated to realize the objectives:

> (A) To maximize the availability of creative works to the public.
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.

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[23] *See, e.g.,* Robert Levine, *A Fee Per Song Can Ruin Us, Internet Radio Companies Say,* THE NEW YORK TIMES, March 19, 2007 at C4. Doc Searles, *Internet Radio on Death Row,* posted March 8, 2007 at [http://www.linuxjournal.com/comment/reply/1000196]; Carey Lening, *Policy Group Advocates Tech-Neutral Competitive Sound Recording Royalty Rates*, 74 BNA Patent, Trademark & Copyright J. 93 (May 18, 2007).

[24] *Royalty Board Sets Webcasting Royalties, Lawmakers Quick to Respond,* 73 BNA Patent, Trademark & Copyright J. 1809 (March 9, 2007).

[25] U.S. Copyright Royalty Judges, *Order Denying Motions for Rehearing* at [http://www.loc.gov/crb/proceedings/2005-1/motion-denial.pdf].

[26] 17 U.S.C. § 803(d).

> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[27]

These standards apply to terms and rates for other compulsory license royalty payments, in general,[28] and to the preexisting subscription services eligible under § 114(d)(2).[29] Hence, it is the goal of the legislation to create "royalty parity"among the different delivery systems.[30] The bill would cap a minimum annual royalty at $500 for each service provider.[31]

For the period covered by the Board's decision, that is, from January1, 2006, through December 31, 2010, rates established by the bill would be as follows:

- 0.33 cents per hour of sound recordings transmitted to a single listener; or,
- 7.5 percent of the annual revenues received by the provider that are directly related to the provider's digital transmissions of sound recordings.

Providers could select their payment method. Hence, all nonsubscription, noninteractive Internet radio webcasters eligible for the statutory license under § 114(f) would have the option of paying pursuant to a per-hour, per-listener or percentage-of-revenue basis. For the next round of royalty rates, the Board would employ the more flexible standards under § 801, which are used in connection with preexisting subscription services under § 114(f)(1).

The bill would amend 11 U.S.C. § 118, entitled "Scope of exclusive rights: Use of certain works in connection with noncommercial broadcasting," which includes a compulsory license for noncommercial broadcasters, such as National Public Radio, to include digital performance of sound recordings, i.e., webcasting. It would broaden the scope of "nonprofit institution" to encompass college radio.[32] It includes a transitional rate of 1.5 times the total fees paid for applicable usage in the year 2004.

Finally, the bill requires analysis and reports on the competitiveness of the Internet radio market place and other matters by the National Telecommunications

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[27] 17 U.S.C. § 801(b)(1).

[28] Specifically, these objectives are designed to determine reasonable royalty payments under §§ 112(e), 114, 115, 116, 118, 119 and 1004. *Id.*

[29] The preexisting subscription services include satellite digital audio radio services. For more background, see Library of Congress, Copyright Office, *Designation as a Preexisting Subscription Service: Final Order,* 71 FED. REG. 64639 (November 3, 2006) available online at [http://www.copyright.gov/fedreg/2006/71fr64639.pdf].

[30] 153 CONG. REC. E874 (daily ed. April 26, 2007)(statement of Rep. Inslee).

[31] H.R. 2060, § 3.

[32] 153 CONG. REC. S5931 (daily ed. May 10, 2007)(statement of Sen. Wyden).

and Information Administration in the Department of Commerce, the Federal Communications Commission and the Corporation for Public Broadcasting.

S. 1353, 110th Cong., 1st Sess. (2007), the "Internet Radio Equality Act". Introduced in the Senate as a companion to H.R. 2060, S. 1353 takes the same general approach as the House bill. It has slightly different transition rates for noncommercial broadcasters under § 118, and omits the reporting requirements in the House bill.

The sponsors in both the House and the Senate emphasize that the goal of the legislation is to promote greater equality, that is rate parity, among webcasters who utilize compulsory licensing.[33] Unlike the SWSA, it is not directed solely at small commercial webcasters. It does not, however, reach the historically based exemption that terrestrial broadcasters receive from paying any copyright royalty for the performance of sound recordings.

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[33] A broader approach to technology-neutral music licensing is set forth in S. 256, 110th Cong., 1st Sess. (2007). For background, see CRS Report RL33922,*Platform Equality and Remedies for Rights Holders in Music Act of 2007 (S. 256): Section-by-Section Analysis* by Kate M. Manuel and Brian T. Yeh.