Before the
REGISTER OF COPYRIGHTS OF THE UNITED STATES OF AMERICA
Washington, D.C.

In the Matter of	)	
Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding	)	Docket No. 2006-3 CRB DPRA

VIEWS OF THE RECORDING INDUSTRY ASSOCIATION OF AMERICA, INC. REGARDING POSSIBLE LEGAL ERRORS CONTAINED IN THE COPYRIGHT ROYALTY JUDGES' FINAL DETERMINATION

The Recording Industry Association of America, Inc. ("RIAA") submits this statement in response to the Register of Copyrights' request for views regarding possible legal errors contained in the Copyright Royalty Judges' ("CRJs") Final Determination of rates and terms under the Section 115 compulsory license.

RIAA has been a participant in the proceeding before the CRJs to determine royalty rates and terms under the Section 115 compulsory license, and is a party to the partial settlement entered into by all the participants in that proceeding concerning the rates and terms for interactive streaming and limited downloads. As such, RIAA believes that the Register should correct one error of law in the Final Determination – corresponding to the Register's issue number 3 – but that the Register should not otherwise find that the issues identified in the Register's request require correction of the Final Determination. RIAA's views concerning each of the issues identified in the Register's request are set forth below.

1. Whether it was a material error of law for the CRJs to fail to refer to the Register as a novel question of substantive law the requests of the Digital Media Association ("DiMA") and the Recording Industry Association of America ("RIAA") for a determination as to the scope of the section 115 compulsory license with respect to intermediate copies made in the course of a digital phonorecord delivery ("DPD").

As a general matter, RIAA believes that referral of novel material questions of law pursuant to Section 802(f)(1)(B) is an important part of the rate-setting process. Because Section 802(f)(1)(B) is mandatory in character, failure to refer a novel question could be an error of law. However, such a failure could only constitute a *material* error of law when the Register would have answered the question differently than the CRJs, and the failure to refer thereby has a material effect.

When, during the pendency of a proceeding, neither the CRJs nor the participants perceive a question as sufficiently novel or material to implicate the provisions of Section 802(f)(1)(B), the Register should proceed very cautiously before substituting her judgment as to whether the question should have been referred earlier in the proceeding. Such an action has the potential to be very disruptive when the record of a proceeding is closed and there is no established process for addressing a perceived error. In addition, if findings that nonreferral constitute material error are not made very judiciously, they could have the unintended effect of encouraging both the CRJs and the participants to "over-refer" questions, which has the potential to waste the resources of the Office and the CRJs, increase costs, and introduce delay in proceedings. Accordingly, and particularly in the absence of a referral request, RIAA does not believe that the Register should, in her post-determination review, find that failure to refer a novel question was a material error of law except in those probably rare instances when it is clear both that the Register would have answered the underlying

substantive question differently and that the failure to refer thereby affected the outcome of the proceeding.

Here, no participant requested referral of a question concerning the scope of Section 115 with respect to intermediate copies made in the course of a DPD, and it was not a material error of law for the CRJs not to refer to the Register such a question *sua sponte*, for two reasons. First, this issue arose only in the context of terms proposed by RIAA and DiMA (and not opposed by the Copyright Owners), and those terms were fully consistent with copyright law as interpreted by the Office. *See Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries,* 73 Fed. Reg. 66,173, 66,180 (Nov. 7, 2008). Second, those terms ultimately were not adopted, based on the Register's opinion concerning the CRJs' authority to adopt the proposed terms. *See Division of Authority Between the Copyright Royalty Judges and the Register of Copyrights under the Section 115 Statutory License*, 73 Fed. Reg. 48,396, 48,399 (Aug. 19, 2008). Accordingly, failure to refer this matter was not material error.

2. Whether it was a material error of law for the CRJs to fail to refer to the Register as a novel question of substantive law DiMA's request for a determination as to whether "interactive streaming" constitutes a DPD under Section 115.

As a general matter, RIAA believes that when a participant has requested referral of a legitimately disputed legal question that is material to a case, the possibility that the CRJs will be called upon to apply the relevant legal principle to disputed facts should not prevent referral. Instead, the CRJs should refer the legal question to the Register for an opinion on the question covering the range of the disputed facts at issue, so that the CRJs can then apply the correct legal principle to the facts as they find them. That is just what happened in the case of

the ringtone referral. *See Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding*, 71 Fed. Reg. 64,303 (Nov. 1, 2006).

Whether or not such an approach might have counseled granting DiMA's referral request, at this point, RIAA does not believe that the CRJs' failure to refer the question of whether interactive streaming constitutes a DPD is a material error of law. The Office has found that at least some interactive steams constitute DPDs. *See* 73 Fed. Reg. at 66,177. Therefore, the Copyright Act requires setting Section 115 rates and terms that encompass interactive streams. Such rates are in fact provided in the Final Determination. Thus, the failure to refer is of no present consequence and should not, therefore, be deemed to constitute a material error.

3. Whether it was a material error of law for the CRJs to fail to refer to the Register as a novel question of substantive law RIAA's assertion that the CRJs are obligated to establish a catch-all, or general, rate for DPDs.

RIAA believes that the CRJs are required to establish a Section 115 royalty rate structure that is comprehensive – that is, a structure that encompasses the full range of methods of phonorecord distribution that can be licensed under Section 115. RIAA believes that the CRJs erred by concluding that they need only set royalty rates for the music products and services currently offered, or specifically-identified products or services that may be offered, and in so doing can leave gaps in the Section 115 rate structure.

As RIAA described in detail in its prior submissions to the CRJs, *see, e.g.*, RIAA Proposed Conclusions of Law at ¶¶ 164-170, the statutory language is clear. Rate proceedings are to "determine reasonable rates and terms of royalty payments for the activities specified by this section." 17 U.S.C. § 115(c)(3)(C). The CRJs correctly found that such "activities" are "the making and distribution of phonorecords." Final Determination, at

61. However, the CRJs then proceeded to conclude that they did not need to set rates covering the full range of phonorecords potentially licensable under Section 115, but could focus on known categories of existing products and services. Just as the CRJs must set a royalty rate under Section 112(e), *see Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. 9,143 (Feb. 19, 2008), they must set Section 115 rates for all types of phonorecords licensable thereunder.

This is an important principle. Unlike Section 114, which permits out-of-cycle proceedings before the CRJs to set rates for new types of services, *see* 17 U.S.C. § 114(f)(1)(C), (2)(C), Section 115 rates are set only once every five years. A gap in the Section 115 rate structure makes the compulsory license effectively unavailable for phonorecords falling into the gap for the duration of the rate period.

More important than whether the CRJs' failure to refer this issue was a material error of law, the CRJs erred with respect to the underlying substantive question. The CRJs' decision to create categories of rates for specific types of products and services without a catch-all rate to ensure that the rate structure is comprehensive and that no activities fall outside the statutory rate structure is a material error of law. Accordingly, RIAA urges the Office to clarify that the Section 115 rate structure must be comprehensive.[1]

[1] The CRJs ultimately defined the categories of phonorecords for which they set rates differently than the categorization proposed by RIAA, which is what gave rise to RIAA's proposed "general DPD rate." Thus, the gap left by the CRJs – DPDs that do not qualify as permanent digital downloads, limited downloads or interactive streams – is different than the gap RIAA sought to fill with its proposed general DPD rate. In fact, RIAA understands that gap to be relatively small. However, in a rapidly-evolving digital music marketplace, in which it is impossible to predict the technological characteristics of the products the marketplace might demand in five years, establishing the principle of a comprehensive rate structure is nonetheless important.

4. Whether it was a material error of law for the CRJs to conclude that they have no discretion over a settlement establishing rates and terms, even to the extent of determining whether the provisions are contrary to law, unless a participant files an objection.

RIAA believes that the CRJs' determination regarding their lack of discretion in adopting settlements was correct and that their reasoning is fully supported by the statute. Section 801(b)(7)(A) unambiguously requires the CRJs to adopt a settlement when there is no objection to the settlement by a participant in the proceeding. It provides neither a process nor a standard for review of unanimous settlements. Instead, the statute expresses strong and unambiguous support for settlements, providing opportunities throughout the proceeding for participants to reach a settlement (thereby conserving judicial resources by obviating the need for the court proceeding). *See, e.g.*, 17 U.S.C. § 803(b)(3) (providing a negotiation period prior to the commencement of the proceeding); *id.* § 803(b)(6)(C) (providing for a settlement conference during the course of the proceeding); *id.* § 801(b)(7)(A) (referring to the CRJs' adoption of a settlement agreement reached at any time during the proceeding). The legislative history likewise makes clear that Congress intended to encourage and facilitate settlement. *See* H.R. Rep. No. 108-408, at 33 (2004) ("the Committee intends that the bill will facilitate and encourage settlement agreements for determining royalty rates . . . throughout the entire process under Chapter 8").

The Register should not supply a review process and standard not contemplated by the statute. Allowing the CRJs – or some third party that decided not to participate in a proceeding – to block or otherwise tinker with a unanimous settlement among the participants would be contrary to the unambiguous statutory language and Congress's clear intent, and would risk increased cost and disruption in the orderly setting of rates. Because Section

801(b)(7)(A) required the CRJs to adopt the settlement, the CRJs' decision was not in error in this regard.

* * *

Before turning to the details of issues 5-9, we wish to offer our view on the more general question of the Register's authority to review the terms of a settlement. As the CRJs indicated, *see* Final Determination at 19-20, the Register does not have authority to review issues 5-9 because the settlement is not "a resolution by the Copyright Royalty Judges of a material question of substantive law." 17 U.S.C. § 802(f)(1)(D). Moreover, given RIAA's position on issue 4 (that the CRJs were required to adopt the terms of the settlement), the Register should not reach issues 5-9 because each issue concerns a provision of a settlement that must be adopted.

Nevertheless, should the Office decide to address these issues, for the reasons stated below, RIAA believes that the CRJs did not err in adopting any of the provisions addressed in issues 5-9 of the Register's request for views.

5. Whether it was a material error of law for the CRJs to adopt a regulation in section 385.11, which states categorically that "An interactive stream is an incidental digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D)" when such a provision appears to include transmissions that do not result in delivery of a phonorecord within the definition of DPDs.

As discussed above, RIAA does not believe that the Register needs – or is authorized – to reach this question, as the relevant provision was part of a unanimous settlement reached by the participants and properly adopted by the CRJs. However, should she decide to do so, she should find that there was no material error in adopting section 385.11. The purpose of the questioned sentence in section 385.11 is to categorize "interactive streaming" as an incidental, rather than a general, DPD. This is evident from paragraph (3) of the definition of

"limited download" in the same section, which clarifies that limited downloads are general DPDs. Together, these parallel sentences serve merely to establish which of the statutory rate categories apply to activity that requires a license under the statute.

As the Register knows, RIAA has, based on its understanding of the law and facts, understood that copyright law requires that a service have Section 115 licenses to engage in the process of interactive streaming. However, whether or not that view is really correct in all cases, the regulations set forth in the Final Determination are simply rates and terms for licenses obtained pursuant to Section 115. *See* section 385.10. They do not purport to require licensing of *all* interactive streams, and so do not need to be read to conflict with provisions of the Copyright Act relevant to determining which activities require licensing. The question of which activities require licensing has been answered by the Office's interim rule defining the term DPD. *See* 73 Fed. Reg. 66,173. RIAA believes that the Office's interim rule is controlling as to that question, and thus that adoption of the quoted sentence was not a material error of law.

6. Whether it was a material error of law for the CRJs to adopt a regulation in section 385.16, which provides that "A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed activity, solely for the purpose of providing such licensed activity (and no other purpose)" (emphasis added), when 17 U.S.C. 115(a)(l) allows a person to obtain a compulsory license "if his or her primary purpose in making phonorecords is to distribute them to the public for private use, including by means of a digital phonorecord delivery" (emphasis added).

As discussed above, RIAA does not believe that the Register needs or is authorized to reach this issue. However, should the Register decide to reach this issue, RIAA does not think there is any inconsistency between section 385.16 and Section 115(a)(1). Section 385.16 addresses the use of copies used to deliver DPDs (e.g., server copies), and provides that such copies should only be used to deliver DPDs. By contrast, Section 115(a)(1)

addresses the commercial activities contemplated by a person who wishes to obtain a compulsory license in the first instance. In the case of a person who wishes to distribute DPDs, it requires that the person intend to operate a primarily consumer-oriented service rather than a primarily business-oriented service. *See* 71 Fed. Reg. at 64,316 (Nov. 1, 2006).

These two provisions are not in conflict, because they pertain to two completely different things. One addresses use of server copies – and it would allow a licensee who operates a primarily consumer-oriented service to use those server copies to distribute DPDs to both consumer and business customers. The other addresses the threshold question of eligibility for a compulsory license – and it would not allow a primarily business-oriented service to obtain a Section 115 license in the first place. Accordingly, there is no inconsistency in the provisions, and no material error of law in adopting section 385.16.

7. When the previous rates appear to cover all DPDs including promotional DPDs (except perhaps for those that would be considered incidental DPDs), was it a material error of law for the CRJs to adopt a regulation in section 385.14(e), which allows retroactive application of promotional royalty rates, when 17 U.S.C. 803(d)(2)(B) states that "In cases where rates and terms have not, prior to the inception of an activity, been established for that particular activity under the relevant license, such rates and terms shall be retroactive to the inception of activity under the relevant license covered by such rates and terms."

As discussed above, RIAA does not believe that the Register needs or is authorized to reach this issue. However, should she decide to do so, she should find that the CRJs' adoption of section 385.14(e), which contemplates retroactive application of promotional royalty rates, did not constitute a material error of law. Interactive streams, which are incidental DPDs, are the emphasis of the promotional royalty rate provisions of section 385.14. No rate has previously been set for incidental DPDs. *See* 37 C.F.R. § 255.6. As a result, retroactive application of the promotional royalty rates to interactive streams is clearly consistent with Section 803(d)(2)(B).

The other activity to which the promotional royalty rate would apply is limited downloads offered in the context of a free trial period for a subscription service. The marketplace has not accepted or applied the 9.1¢ statutory rate for that activity. Rather, marketplace agreements have provided that rates set in this proceeding for limited downloads will apply retroactively. Contemplating retroactive application of the promotional royalty rate thus simply recognizes marketplace reality. Moreover, and importantly, when the promotional royalty rate is applied retroactively as it will be, section 385.14(e) serves to negate the recordkeeping requirements that will apply on a going-forward basis, but could not, as a practical matter, be complied with retroactively.

As the Register knows well, the absence of a workable mechanical royalty rate structure for licensing subscription services has been an issue in the marketplace for many years. Parties to a voluntary settlement agreement should have the latitude to resolve ambiguities and problems such as this in a manner that is mutually agreeable to them. The resolution adopted – recognizing that the rates will be applied retroactively and providing relaxed recordkeeping requirements in connection therewith – is not materially inconsistent with the statutory scheme because RIAA is aware of nobody that has previously been paying on a current basis 9.1¢ for each limited download made in the context of a free trial period for a subscription service. Accordingly, it was not a material error to adopt section 385.14(e).

8. Whether it was a material error of law for the CRJs to adopt a regulation in section 385.15, which alters the timing of payments, when 17 U.S.C. 115(c)(5) states that "Royalty payments shall be made on or before the twentieth day of each month and shall include all royalties for the month next preceding."

As discussed above, RIAA does not believe that the Register needs or is authorized to reach this issue. However, should she decide to do so, RIAA believes she should conclude that there was no material error of law.

As a practical matter, any change in the rate structure requires some period of implementation for payors and payees alike, and the royalty rate structure adopted in the parties' settlement is particularly complex. Section 385.15 merely provides a reasonable period for implementation of the new rate structure. This provision does not override the timing scheme established by Section 115(c)(5), which remains in effect once the initial transitional payment is due.

The Register and Librarian have previously recognized the need for a period to implement new rates. *See Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, 67 Fed. Reg. 45,240, 45,274 (July 8, 2002) (providing a time lag between adoption of rates and the date the first payment is due, even though 17 U.S.C. § 114(f)(4)(C) provides that royalty payments in arrears "shall be made on or before the twentieth day of the month next succeeding the month in which royalty fees are set"). The effect of section 385.15 is similar.

Envisioning the need for an implementation period for a new rate structure, Section 803(d)(2)(B) allows either the CRJs or the participants in a proceeding to determine when existing rates will be replaced. *See* 17 U.S.C. § 803(d)(2)(B). The need for an implementation period is even more acute when the rates must be applied retroactively, because not only must computer systems be adapted to the new rate structure, but the retroactive accounting actually must be completed (in this case covering a period of up to about seven years). The Office should avoid any interpretation of the law that gives the CRJs and parties discretion to determine the effective date of (and hence the implementation period for) replacement rates, but no discretion to determine the date by which the more complex project of making a retroactive accounting must be completed.

Section 385.15 is a term that "insure[s] the smooth administration of the license." *See determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25,394, 25,411 (May 8, 1998), *quoted in* 73 Fed. Reg. at 48,398. It is just the kind of provision contemplated by Congress when it authorized terms to be litigated notwithstanding the detailed provisions of Section 115. *See* S. Rep. 104-128, at 40 (1995) ("By 'terms,' the Committee means such details as how payments are to be made, *when*, and other accounting matters. While these details are for the most part already prescribed in section 115 . . . the bill allows for additional such terms to be set by the parties or by CARP's in the event that the foregoing provisions . . . are not readily applicable to the new digital transmission environment." (emphasis added)). Adoption of section 385.15 is thus not a material error of law.

9. Whether it was a material error of law for the CRJs to adopt a regulation in section 385.12(b)(4), which allows for calculation of royalty payments in the absence of play information when 17 U.S.C. 115(c)(5) requires the Register to prescribe regulations "under which detailed cumulative annual statements of account" shall be filed, and that "regulations covering both the monthly and annual statements of account shall prescribe the form, content, and manner of certification with respect to the number of records made and distributed."

As discussed above, RIAA does not believe that the Register needs or is authorized to reach this issue. However, should she decide to do so, RIAA believes there is no inconsistency between the cited regulations and the statute (or for that matter the Office's regulations implementing the statute). Section 385.12(b) provides a detailed methodology for calculating royalties for interactive streaming and limited downloads. Plays (or in the absence thereof, other allocation data) are just one of many types of inputs to the rate formula, along with revenues, payments to record companies, payments to performing rights organizations and more. The end result of applying the rate calculation methodology (whether or not that

ultimately involves the use of play data) is a per-work mechanical royalty payment for the relevant accounting period. Determining that payment – and the inputs that go into calculating it – is clearly within the grant of authority to the CRJs to set "rates." *See* 17 U.S.C. § 115(c)(3)(C).

Whether or not a payment is calculated with reference to play data, the payment must be reported in a statement of account that complies with the applicable regulations. In fact, the accounting regulations do not even mention reporting of information about plays. Hence, there is no inconsistency between the rate calculation methodology specified in the parties' settlement and the applicable accounting regulations,[2] and no material error of law in the adoption of section 385.12(b)(4).

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For the foregoing reasons, the Register should clarify that the Section 115 rate structure must be comprehensive as described above in connection with issue number 3, but the Register should not otherwise find that the issues identified in the Register's request require correction of the Final Determination.

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[2] If there were an inconsistency, it would seem that it is the accounting regulations that are suspect. The authority to set rates has been delegated to the CRJs, so the Office does not have authority to prescribe a contrary rate, or circumscribe the range of rates that can be adopted by the CRJs, in its accounting regulations.