Copyright and the Music Marketplace

A REPORT OF THE REGISTER OF COPYRIGHTS

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The United States has the most innovative and influential music culture in the world, but much of the legal framework for licensing of music dates back to the early part of the twentieth century, long before the digital revolution in music. Our licensing system is founded on a view that the music marketplace requires a unique level of government regulation, much of it reflected in statutory licensing provisions of the Copyright Act. The Copyright Office believes that the time is ripe to question the existing paradigm for the licensing of musical works and sound recordings and consider meaningful change.

There is a widespread perception that our licensing system is broken. Songwriters and recording artists are concerned that they cannot make a living under the existing structure, which raises serious and systemic concerns for the future. Music publishers and performance rights organizations are frustrated that so much of their licensing activity is subject to government control, so they are constrained in the marketplace. Record labels and digital services complain that the licensing process is burdensome and inefficient, making it difficult to innovate.

While there is general consensus that the system needs attention, there is less agreement as to what should be done. In this report, after reviewing the existing framework and stakeholders' views, the Copyright Office offers a series of guiding principles and preliminary recommendations for change. The Office's proposals are meant to be contemplated together, rather than individually. With this approach, the Office seeks to present a series of balanced tradeoffs among the interested parties to create a fairer, more efficient, and more rational system for all.

A. Guiding Principles

The Copyright Office's study revealed broad consensus among study participants on four key principles:

- Music creators should be fairly compensated for their contributions.
- The licensing process should be more efficient.
- Market participants should have access to authoritative data to identify and license sound recordings and musical works.
- Usage and payment information should be transparent and accessible to rightsowners.

In addition to the above, based on the record in the proceeding, the Office has identified several additional principles that it believes should also guide any process of reform. These are:

- Government licensing processes should aspire to treat like uses of music alike.
- Government supervision should enable voluntary transactions while still supporting collective solutions.
- Ratesetting and enforcement of antitrust laws should be separately managed and addressed.
- A single, market-oriented ratesetting standard should apply to all music uses under statutory licenses.

The Office was guided by all of the above principles in developing its recommendations, which are summarized below.

B. Licensing Parity and Fair Compensation

Questions of licensing parity and fair compensation are closely tied to the relative treatment of music rights and rightsholders under the law. The Copyright Office believes that any overhaul of our music licensing system should strive to achieve greater consistency in the way it regulates (or does not regulate) analogous platforms and uses. With that goal in mind, the Office recommends the following:

- Regulate musical works and sound recordings in a consistent manner. The Office believes that, at least in the digital realm, sound recordings and the underlying musical works should stand on more equal footing. The Copyright Office's approach would offer a free market alternative to musical work owners, in the form of an opt-out right to withdraw specific categories of rights from government oversight in key areas where sound recording owners enjoy such benefits—namely, interactive streaming uses and downloads.
- Extend the public performance right in sound recordings to terrestrial radio broadcasts. As the Copyright Office has stated repeatedly for many years, the United States should adopt a terrestrial performance right for sound recordings. Apart from being inequitable to rightsholders—including by curtailing the reciprocal flow of royalties into the United States—the exemption of terrestrial radio from royalty obligations harms competing satellite and internet radio providers who must pay for the use of sound recordings. Assuming Congress adopts a terrestrial performance right, it would seem only logical that terrestrial uses should be included under the section 112 and 114 licenses that govern internet and satellite radio.

- Fully federalize pre-1972 sound recordings. As it concluded in its 2011 report on the topic, the Copyright Office believes that pre-1972 recordings—currently protected only under state law—should be brought within the scope of federal copyright law, with the same rights, exceptions, and limitations as more recently created sound recordings. The lack of federal protection for pre-1972 sound recordings impedes a fair marketplace. Record labels and artists are not paid for performances of these works by digital services, which (at least until recent court rulings under state law) were considered free from copyright liability on the sound recording side. At the same time, the owners of the musical works embodied in these sound recordings are paid for the same uses.

- Adopt a uniform market-based ratesetting standard for all government rates. While in some cases the law provides that the ratesetting authority should attempt to emulate a free market, in other cases it imposes a more policy-oriented approach that has led to below-market rates. There is no policy justification for a standard that requires music creators to subsidize those who seek to profit from their works. Accordingly, the Office calls for adoption of a single rate standard—whether denominated "willing buyer/willing seller" or "fair market value"—that is designed to achieve rates that would be negotiated in an unconstrained market.

C. Government's Role in Music Licensing

The government's involvement in the music marketplace is unusual and expansive relative to other kinds of works created and disseminated under the Copyright Act. In many cases, it compels copyright owners to license their works at government-set rates. Regulation of music publishers and songwriters is particularly pervasive: the two most significant areas of their market (mechanical and performance licensing) are subject to mandatory licensing and ratesetting. Antitrust concerns have been the traditional rationale for government intervention. To be sure, where particular actors engage in anticompetitive conduct in violation of antitrust laws, that conduct should be addressed. But compulsory licensing does more than that—it removes choice and control from all copyright owners that seek to protect and maximize the value of their assets.

Regardless of the historical justifications for government intervention, the Copyright Office believes that in today's world, certain aspects of the compulsory licensing processes can and should be relaxed. The below recommendations offer some ideas for how that might be accomplished in the various areas of the market where there is government involvement.

Performing Rights Organizations ("PROs") and the Consent Decrees

Many important issues have been raised in the Department of Justice's ("DOJ's") parallel consideration of the American Society of Composers, Authors and Publishers ("ASCAP") and Broadcast Music, Inc. ("BMI") consent decrees. The Office endorses that

review, and—in light of the significant impact of the decrees in today's performance-driven music market—hopes it will result in a productive reconsideration of the 75-year-old decrees. At the same time, the Copyright Office observes that it is Congress, not the DOJ, that has the ability to address the full range of issues that encumber our music licensing system, which go far beyond the consent decrees. In the area of performance rights, the Office offers the following recommendations:

- Migrate all ratesetting to the Copyright Royalty Board ("CRB"). The Copyright Office believes that allegations of anticompetitive conduct are worthy of evaluation (and, if appropriate, remedial action) separate and apart from the determination of fair rates for musical works. Each of these two critical policy objectives merits government attention in its own right. Accordingly, the Office proposes that the function of establishing rates for the public performance of musical works—currently the province of federal district courts under the consent decrees—be migrated to the CRB. Industry ratesetting is, of course, a primary function of the CRB, and the CRB has the benefit of experience assessing a broader spectrum of rate-related questions than the federal rate courts, as well as specific expertise in copyright law and economics.

- Repeal section 114(i). Regardless of whether PRO ratesetting is migrated to the CRB, as further discussed below, the Copyright Office endorses the proposal that the prohibition in section 114(i) that currently prevents ratesetting tribunals from considering sound recording performance royalties be eliminated. Originally designed as a protective measure to benefit songwriters and publishers, it appears to be having the opposite effect.

- Streamline interim ratesetting and require immediate payment of royalties. Under the consent decrees, anyone who applies for a license has the right to perform musical works in a PRO's repertoire—without paying the PRO any compensation—pending the completion of negotiations or rate court proceedings resulting in an interim or final fee. The problem is exacerbated by the substantial burden and expense of litigating even an interim rate in federal court. The Copyright Office believes that to the extent a licensing entity is required to grant a license upon request, there should be a streamlined mechanism to set an interim royalty rate, and that the licensee should have to start paying immediately.

- Permit opt-out from PROs for interactive streaming. The Office believes that music publishers should be able to withdraw specific categories of licensing rights from their authorizations to the PROs. At least for now, the Office believes that withdrawal of performance rights should be limited to digital rights equivalent to those that the record labels are free to negotiate outside of sections 112 and 114—essentially, interactive streaming rights for digital services. Publishers that chose to opt out would be required to provide a list of their

withdrawn works and other pertinent information to a central source, such as the general music rights organization ("GMRO") discussed below. In addition, the Office believes that songwriters affiliated with that publisher should retain the option of receiving their writer's share of royalties directly through their chosen licensing collective.

- Allow bundled licensing of mechanical and performance rights. Industry participants support increased bundling of rights—*i.e.*, reproduction, distribution, and performance rights—in unified licenses to facilitate greater licensing efficiency. Although bundling of sound recording rights occurs as a matter of course, various legal restrictions have prevented that same development on the musical work side. The Office believes that the government should pursue appropriate changes to the legal framework to encourage bundled licensing, which could eliminate redundant resources on the part of both licensors and licensees. This could include allowing the PROs and other entities to become music rights organizations ("MROs"), which would be authorized to license both performance and mechanical rights.

Mechanical Licensing and Section 115

Study participants highlighted the serious shortcomings of the 106-year old compulsory license for "mechanical" reproductions of musical works (*e.g.*, CDs, vinyl records and downloads) in section 115. On the copyright owner side, parties complained that the mandatory nature of the license does not permit them to control their works or seek higher royalties. On the licensee side, parties criticized section 115's requirement of song-by-song licensing, a daunting task in a world where online providers seek licenses for millions of works. In light of these concerns, the Office offers the following recommendations:

- Permit collective licensing of mechanical rights but with an opt-out right for interactive streaming and download uses. The Office is sympathetic to music publishers' arguments for elimination of the compulsory license in section 115 in favor of free market negotiations. But in light of the diffuse ownership of musical works, it seems clear that some sort of collective system would be necessary even in section 115's absence. The Office thus believes that, rather than eliminating section 115 altogether, section 115 should instead become the basis of a more flexible collective licensing system that will presumptively cover all mechanical uses except to the extent individual music publishers choose to opt out. At least initially, the mechanical opt-out right would extend to interactive streaming rights and downloading activities—uses where sound recording owners operate in the free market (but not physical goods, which have somewhat distinct licensing practices). As envisioned by the Office, the collective system would include MROs (as noted, with the ability to represent both performance and mechanical rights), a GMRO (that would collect for works or shares not

represented by an MRO or covered by a direct deal), and individual publishers that choose to opt out. Licensees could thus achieve end-to-end coverage through the combination of MROs, the GMRO, and direct licensors.

- Establish blanket licensing for digital uses under section 115. To further facilitate the rights clearance process and eliminate user concerns about liability to unknown rightsowners, the Office believes that mechanical licensing, like performance licensing, should be offered on a blanket basis by those that administer it. This would mean that a licensee would need only to file a single notice with an MRO to obtain a repertoire-wide performance and mechanical license from that licensing entity. The move to a blanket system would allow marketplace entrants to launch their services—and begin paying royalties—more quickly.

- CRB ratesetting on an "as-needed" basis. The Office believes that the CRB should continue to set rates under the section 115 license, though with an important modification: as is now the case with performance rights, rather than establish rates across the board every five years, the CRB would set rates for particular uses only on an as-needed basis when an MRO and licensee were unsuccessful in reaching agreement. Other interested parties (such as other MROs and other users) could choose to join the relevant proceeding, in which case those parties would be bound by the CRB-determined rate.

- Ensure copyright owners possess audit rights. Publishers have long complained about the lack of an audit right under section 115. In that regard, section 115 is an outlier—such audit rights have been recognized under other statutory licenses. The Office believes that the mechanical licensing system should be amended to provide for an express audit right, with the particular logistics to be implemented through regulation.

- Maintain audiovisual uses in the free market. Record companies proposed extending compulsory blanket licensing to certain consumer audiovisual products—such as music videos, album cover videos, and lyric videos—uses that have traditionally required a synchronization license negotiated in the free market. The Office is sympathetic to the labels' concerns, but cannot at this time recommend that consumer synch uses be incorporated into a government-supervised licensing regime. The Office does not perceive a market failure that justifies creation of a new compulsory license, and the market appears to be responding to licensing needs for consumer audiovisual products.

Section 112 and 114 Licenses

One of the few things that seems to be working reasonably well in our licensing system is the statutory license regime under sections 112 and 114, which permits qualifying digital services to engage in noninteractive streaming activities at a CRB-determined (or

otherwise agreed) rate. Although the differing ratesetting standards for these licenses—as well as some of the rates established under those standards—have been a source of controversy, from the record in this study, the licensing framework itself is generally well regarded. Notwithstanding the comparatively positive reviews of the section 112 and 114 licenses, there are a few relatively minor improvements that the Office believes should be considered:

- Consider ratesetting distinction between custom and noncustom radio. In 2009, the Second Circuit ruled that personalized radio services are eligible for the section 112 and 114 licenses. Although the Office has some reservations about that interpretation, there appears to be no overwhelming call to remove custom radio from the statutory regime. Nonetheless, within that regime, it may be appropriate to distinguish between custom and noncustom radio, as the substitutional effect of personalized radio on potentially competing interactive streaming services may be greater than that of services offering a completely noncustomized experience. While the issue could be addressed legislatively, this does not appear to be necessary, as the CRB has the discretion to set different rate tiers today when the record supports such an outcome.

- Allow fine-tuning of technical aspects of the license through the exercise of regulatory authority. Internet services have criticized a number of the detailed limitations that section 114 imposes on compulsory licensees. These include the so-called "sound recording performance complement," a restriction that limits the frequency with which songs from the same album or by the same artist may be played by the service, as well as a prohibition against announcing upcoming selections. But for the fact that they appear in the statute itself, such details would seem to be more appropriately the province of regulation. As suggested more generally below, Congress may wish to commit nuances like these to administrative oversight by the Copyright Office.

- Consider permitting SoundExchange to process record producer payments. Record producers—who make valuable creative contributions to sound recordings—are not among the parties entitled by statute to direct payment by SoundExchange. In some cases, an artist may provide a letter of direction requesting SoundExchange to pay the producer's share of income from the artist royalties collected by SoundExchange, which SoundExchange will honor. It has been suggested that this informal practice be recognized through a statutory amendment. Though it would be beneficial to hear more from artists on this issue, the Office agrees that in many instances producers are integral creators and that the proposal therefore merits consideration.

- Allow SoundExchange to terminate noncompliant licensees. Unlike section 115, sections 112 and 114 do not include a right to terminate a licensee that fails to account for and pay royalties. The Office does not see a justification for

continued licensing of a user that is not meeting its obligations, and agrees that the section 112 and 114 statutory licenses should be amended to include a termination provision akin to that in section 115.

Public Broadcaster Statutory License

- Create a unified statutory licensing scheme for public broadcasters. Public broadcasters must engage in a multitude of negotiations and ratesetting proceedings in different fora to clear rights for their over-the-air and online activities. Especially in light of the relatively low royalty rates paid by public broadcasters, Office suggests that the ratesetting processes applicable to public broadcasters be consolidated within a unified license structure under section 118 under the auspices of the CRB, where they would likely be much more efficiently resolved.

D. Licensing Efficiency and Transparency

The Office believes that accurate, comprehensive, and accessible data, and increased transparency, are essential to a better functioning music licensing system. Authoritative data would benefit all participants in the marketplace for sound recordings and musical works, and facilitate a more efficient system. In addition, it is essential to make reliable usage and payment information available to rightsholders. To achieve these twin goals, the Office offers the following recommendations:

- Establish incentives through the statutory licensing scheme for existing market players to create an authoritative public database. The Copyright Office believes that any solution to the music data problem should not be built by the government but should instead leverage existing industry resources. Accordingly, the Office recommends that the government establish incentives through the statutory licensing regime to encourage private actors to coordinate their efforts and contribute to a publicly accessible and authoritative database, including by encouraging the adoption and dissemination of universal data standards. To facilitate this process, the Copyright Office should provide regulatory oversight regarding standards and goals.

- Establish transparency in direct deals. Throughout the study, a paramount concern of songwriters and recording artists has been transparency in the reporting and payment of writer and artist shares of royalties, especially in the context of direct deals negotiated by publishers and labels outside of the PROs and SoundExchange, which may involve substantial advances or equity arrangements. These concerns should be addressed as part of any updated licensing framework, especially one that allows publishers to opt out of the statutory licensing system and pursue direct negotiations. In the case of direct deals for rights covered by an MRO or SoundExchange, the Office recommends

allowing songwriters and artists to elect to receive their shares of royalties from the licensee through their chosen licensing entity.

E. An Updated Music Licensing System

To implement the principles and recommendations laid out above, the Copyright Office is proposing an updated framework for the licensing of musical works. The basic components of this proposal are as follows:

- MROs. Under the Office's proposal, except to the extent they chose to opt out of the blanket statutory system, publishers and songwriters would license their public performance and mechanical rights through MROs.
    - An MRO could be any entity representing the musical works of publishers and songwriters with a market share in the mechanical and/or performance market above a certain minimum threshold, for example, 5%. Existing rights organizations, such as ASCAP, BMI, HFA and others, could thus qualify as MROs.
    - Each MRO would enjoy an antitrust exemption to negotiate performance and mechanical licenses collectively on behalf of its members—as would licensee groups negotiating with the MROs—with the CRB available to establish a rate in case of a dispute. But MROs could not coordinate with one another and would be subject to at least routine antitrust oversight.
    - Each MRO would be required to supply a complete list of the publishers, works, percentage shares and rights it represented, as well as the MRO's licensing contact information, to the GMRO, and would be obligated to keep that information current. MROs would not have to share all of their data for purposes of the public database. For example, there would be no need for an MRO to provide contact information for its members (other than those that opted out) since the MRO would be responsible for distributing royalties under the licenses it issued.
    - MROs would also be responsible for notifying the GMRO of any members that had exercised opt-out rights by providing the relevant opt-out information, including where a direct license might be sought, so potential licensees would know where to go for license authority.
- GMRO. Even though most licensing activity would be carried out by the MROs and directly licensing publishers, the hub of the new licensing structure would be the "general" MRO or GMRO. The GMRO would have certain important responsibilities:
    - First, the GMRO would be responsible for maintaining a publicly accessible database of musical works represented by each MRO, which

would incorporate data supplied by the MROs and other authoritative sources. The GMRO would actively gather missing data, reconcile conflicting data, and correct flawed data, and would also provide a process to handle competing ownership claims. In addition to musical work data, the GMRO would also incorporate sound recording data—presumably from SoundExchange—into the public database, and be responsible for developing additional data that matched sound recordings with musical works to facilitate more efficient licensing.

- Second, the GMRO would also serve as the default licensing and collection agent for musical works (or shares of works) that licensees were unable to associate with an MRO or opt-out publisher. Services with usage-based payment obligations would transmit records of use for unmatched works, along with associated payments and an administrative fee, to the GMRO. The GMRO would then attempt to identify the MRO or individual copyright owners and, if successful, pay the royalties out. If unsuccessful, the GMRO would add the usage record to a public unclaimed royalties list and hold the funds for some period of time—*e.g.*, three years—to see if a claimant came forward. As is the case with SoundExchange, after that period, the GMRO could use any remaining unclaimed funds to help offset the costs of its operations.

- GMRO funding and resources. The Copyright Office believes that both copyright owners and users should provide support for the GMRO, as both groups will benefit from its activities. Under the Office's proposal, every MRO, as well as SoundExchange, would be required to contribute key elements of data to create and maintain a centralized music database. MROs would be responsible for allocating and distributing the vast majority of royalties. In exchange for these contributions on the part of copyright owners, the Office believes that most direct financial support for the GMRO should come from fees charged to users of the section 112, 114 and 115 licenses. Thus, although licensees would be paying royalties to MROs and individual publishers directly—and SoundExchange as well—they would have a separate obligation to pay a licensing surcharge to the GMRO. The surcharge to be paid by statutory licensees could be determined by the CRB based on the GMRO's costs (and without consideration of royalty rates) through a separate administrative process. The surcharge would be offset by administrative fees and other sources of income for the GMRO, including any "black box" funds unclaimed by copyright owners.

- Copyright Royalty Board improvements. Under the Copyright Office's proposal, ratesetting by the CRB would shift from a five-year cycle to a system under which the CRB would step in only as necessary when an MRO or SoundExchange and a licensee could not agree on a rate. The new model would

create opportunities for combined ratesetting proceedings for noninteractive services (*e.g.*, internet, terrestrial, and satellite radio) encompassing both sound recordings and musical works. The Office recommends other procedural adjustments to the CRB as well—including adjustments to the statutorily prescribed litigation process and its settlement procedures. It would also be worthwhile to remove unnecessary procedural details in the statute that are better left to regulation by the CRB.

- Regulatory implementation. The Copyright Office recommends that if Congress acts to restructure the music licensing system, it would be most productive for the legislation to set out the essential elements of the updated system but leave the details to be implemented through regulation by the Copyright Office and, in ratesetting matters, the CRB. Such a construct would likely be more realistic to enact than a highly detailed statutory prescription—especially in the case of music licensing, where the particulars can be overwhelming.

- Further evaluation. Should Congress choose to embark upon a series of changes to the licensing system as described above, the Office recommends that the new system be evaluated by the Copyright Office after it has been in operation for a period of several years. Assuming the new licensing framework includes an opt-out mechanism, the efficacy of that process would be of particular interest. Congress could choose to narrow or expand opt-out rights as appropriate.