THE SOUND RECORDING PERFORMANCE RIGHT AT A CROSSROADS: WILL MARKET RATES PREVAIL?

Jeffrey A. Eisenach†

Starting in the 1990s, Federal policy has moved in the direction of a market-oriented approach towards sound recording rights, beginning with Congress’ decision to create a sound recording performance copyright in 1995. In 1998, Congress provided that most statutory royalty rates, including the rates paid by webcasters like Pandora Radio, would be set using a market-based “willing buyer, willing seller” ("WBWS") standard. Since then, the WBWS standard has been applied in several rate setting proceedings, but complaints from webcasters that the rates were “too high” have led to Congressional intervention and, ultimately, to adoption of rates below market levels. Now, as a new rate setting cycle is about to get underway, webcasters have begun lobbying Congress to replace the WBWS standard with a new version of the so-called 801(b) standard, which promises copyright users a right of “non-disruption.” Adoption of the 801(b) standard – and the other changes favored by the webcasters – would result in rates below economically efficient levels, thereby distorting markets, slowing innovation and harming consumers. This paper examines the market for sound recording performance rights, concluding that Congress should resist webcasters’ pleas for regulatory favoritism and instead continue moving towards a market-oriented approach, starting with extending the sound performance right to terrestrial radio.

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I. INTRODUCTION

Until 1995, the principal protections afforded to holders of sound recording copyrights were rights of reproduction and distribution. Thus, copyright holders of sound recordings, such as record companies, could monetize the copying and distribution of their recordings, but could not charge for “performances,” such as when radio stations played copyrighted music. In the absence of such a property right, naturally, the sound recording owner’s income was limited to sales revenue of CDs and other such phonorecords.

Beginning with passage of the Digital Performance Right in Sound Recordings Act (“DPRA”) in 1995, Congress has moved gradually in the direction of creating performance rights and putting in place the conditions to allow such rights to be traded at market (that is, economically efficient) rates. The first sound recording performance right, for certain digital performances, was created by DPRA, which also created a compulsory license for nonexempt, noninteractive, digital subscription transmissions. In 1998, Congress expanded the compulsory license to additional digital performances in the Digital Millennium Copyright Act (“DMCA”). As a result, for some rights, particularly “interactive” services, buyers and sellers bargain freely over rates and conditions.

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2 Binder, supra note 1, at 11.
3 Id.
8 17 U.S.C. § 114(d)(1), (d)(2)(A)(i); In re Rate Setting for Digital Performance Right
However, “non-interactive” services (i.e., radio-like “streaming” services), may take advantage of a compulsory license: Buyers and sellers have the option of negotiating voluntary agreements (which is generally done on an industry-wide basis), but if they fail to do so, sellers are required to license rights at government-determined “statutory” rates.

In this context, the criteria for setting statutory rates are obviously important. For most non-interactive services, the DMCA established a “willing buyer/willing seller” (“WBWS”) standard, which is intended to set rates at “strictly fair market value.” In practice, as implemented by Copyright Arbitration Royalty Panels (“CARP”) and later by the Copyright Royalty Board (“CRB”), the WBWS standard has resulted in a market-oriented approach to setting rates.

In adopting the WBWS standard, Congress chose to reject the previous, less market-oriented standard used in the DPRA—a standard that utilized the four-part test under § 801(b) of the 1976 Copyright Act. Unlike the WBWS standard, the 801(b) standard requires regulators to take into account non-market based criteria in setting royalties for statutory licenses, including specifically to set rates so as to protect licensees against any “disruptive” effects that might be caused by paying royalties—no matter how market-oriented they may be.
Thus, the 801(b) standard arguably grants licensees a *de facto* right to perpetual profitability, allowing licensees to argue that they and their business models have a right to be protected from “disruption.” In the dynamic world of online content delivery—in which new and improved business models are constantly replacing old, obsolete ones—the creation of such a right has obvious negative consequences for innovation.

Fortunately, the 801(b) standard currently applies to only a handful of companies, which were “grandfathered” when the DMCA was adopted. Thus, royalties for all other sound recording performance rights are established either through direct market negotiations at the parties or, for compulsory licenses, under the market-oriented WBWS standard. Moreover, in recent years, Congress has shown substantial interest in bringing the one significant remaining area in which property rights are lacking—over-the-air performances by terrestrial broadcasters—under a market-oriented framework, by extending the sound recording performance right to such performances. In short, the recent history of the sound recording performance right has been clearly in the direction of a more market-oriented approach.

In mid-2012, however, legislation was introduced in both the House and Senate that would reverse the pro-market trend by replacing the WBWS standard with the less-market-oriented 801(b) standard for the compulsory licenses for sound recording performances. The Internet Radio Fairness Act (“IRFA”) (H.R. 6480 in the House; S. 3609 in the Senate)—which was supported by some webcasters, like Pandora—would have required copyright judges to

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16 Designation As a Preexisting Subscription Service, 71 Fed. Reg. 64,639, 64,641 (Nov. 3, 2006).


take into account whether market-based royalty rates might “disrupt” the business models of licensees. It goes without saying that the webcasters who supported the bill had expected the 801(b) approach to result in lower royalties than under the current market-based standard.

The IRFA did not stop, however, at imposing the anti-disruption standard on future royalty proceedings. It contained a series of additional measures, all designed to tilt the institutional playing field to the advantage of webcasters, including prohibiting the CRB from considering certain types of evidence and forcing it to ignore relevant precedents. As if to ensure that economics will play as small a role as possible in future CRB deliberations, the Act even removed the requirement that at least one of the three CRB judges have expertise in economics.

As this article will explain below, the arguments offered in support of the IRFA—that it was necessary to ensure a vibrant market for digital music, or that it would “level the playing field” by subjecting all digital music distributors to the same copyright regime—are unfounded. The market for digital music is growing by leaps and bounds and the rapid growth of online advertising and wireless broadband ensure that it will continue to do so. Webcasters are not paying “unreasonable” rates and are fully capable of paying market rates in the future. Moreover, imposing the 801(b) standard on webcaster royalty proceedings would not address the most serious imbalances in the current royalty regime, including the fact that over-the-air broadcasts by terrestrial broadcasters continue to be exempt altogether from the sound recording performance right.

Part II of this article presents a brief history of the sound recording performance right. Part III reviews the implementation of the WBWS and 801(b) standards by the CARP and the CRB, and explains why, in practice, the 801(b) standard is likely to result in below-market rates. Part IV explains why the rates established for non-interactive online music services under the WBWS standard are both efficient and “reasonable,” and details the harm to innovation, competition and consumers that would result from adoption of the 801(b) standard for all statutory royalty proceedings. Part V presents a brief summary

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22 See Internet Radio Fairness Act of 2012 § 3; see also 158 Cong. Rec. at S6628.
23 Internet Radio Fairness Act of 2012 § 2.
24 See infra Part IV.
and offers a few concluding thoughts. Specifically, it recommends that Congress return to the market-oriented path it started down in the 1990s, beginning with extending the sound performance right to terrestrial radio.

II. THE SOUND RECORDING PERFORMANCE RIGHTS: A BRIEF HISTORY

Under § 102 of the Copyright Act of 1976, there are two types of copyrights associated with recorded music. The first copyright protects the “musical work,” which consists of notes and lyrics written by the composer. This “musical work” copyright is typically held by a music publisher. The second type of copyright, “sound recording,” protects subsequent recordings of a given song by a particular artist. This “sound recording” copyright is typically held by the producer of the sound recording, most often a record label.

Prior to 1995, there was an important distinction between the rights in a musical work copyright and a sound recording copyright. The owner of a musical work copyright was granted a “performance right,” which entitled her to compensation whenever her copyrighted work was performed or broadcast publicly. The owner of a sound recording copyright, however, was not granted a

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26 Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084, 24,086 (May 1, 2007) (codified at 37 C.R.F. pt. 380) [hereinafter Webcaster II] (noting that § 102 of the Copyright Act “identifies various categories of works that are eligible for copyright protection . . . these include ‘musical works’ and ‘sound recordings’”).

27 Id.

28 See Kimberly L. Craft, The Webcasting Music Revolution Is Ready to Begin, As Soon As We Figure Out the Copyright Law: The Story of the Music Industry at War with Itself, 24 HASTINGS COMM. & ENT. L.J. 1, 4 (2001).

29 Webcaster II, supra note 26, at 24,086 (“The term . . . ‘sound recording’ results from ‘the fixation of a series of musical, spoken or other sounds. A song that is sung and recorded will constitute a sound recording by the entity that records the performance, and a musical work by the songwriter.’ ”); see also Brian Day, Note, The Super Brawl: The History and Future of the Sound Recording Performance Right, 16 MICH. TELECOMM. & TECH. L. REV. 179, 183 (2009) (“Sound recording copyrights, on the other hand, are normally owned by the artist or record label and protect the originality of the recording itself as distinct from the underlying written lyrics or melody.”).

30 Webcaster II, supra note 26, at 24,086.

31 Craft, supra note 28, at 4 (“If a performance of the musical work happens to be broadcast over the airwaves such as by a radio station, each play is also worth money, in the form of royalties, to the songwriter and publisher.”); see also Jeremy Delibero, Copyright Arbitration Royalty Panels and the Webcasting Controversy: The Antithesis of Good Alternative Dispute Resolution, 5 PEP. DISP. RESOL. L.J. 83, 85 (2005) (“Within the Copyright Act, copyright owners enjoy an exclusive right of public performance. The copyright owner may recover royalties anytime a third party publicly performs the work. A public perfor-
performance right.\textsuperscript{32} For example, when a radio station publicly broadcasts a song over the air, it pays a royalty to the holder of the musical work copyright, but not to the holder of the sound recording copyright.\textsuperscript{33} The principal protection afforded to owners of sound recording copyrights was a reproduction and distribution right, which granted compensation for the physical reproduction and sale of sound recordings (and prevented the unauthorized reproduction and distribution of recordings).\textsuperscript{34} This reproduction right was beneficial to sound recording copyright owners prior to the 1990s, when recorded songs were primarily disseminated to consumers via the sale of physical records or CDs.\textsuperscript{35} Broadcasters also argued that a performance right was unnecessary because radio airplay helped promote the sales of sound recordings.\textsuperscript{36}

A. The Digital Performance Rights Act

In the 1990s, the emergence of digital communications technologies and the growth of the Internet dramatically altered the music landscape.\textsuperscript{37} In addition to purchasing cassettes or CDs, or tuning into AM/FM radio, listeners could access music via digital satellite transmissions, Internet radio (\textquotedblleft webcasters\textquotedblright), or cable music services.\textsuperscript{38} As digitally broadcast music began to take root, record

\begin{thebibliography}{9}
\bibitem{32}Webcaster II, supra note 26, at 24,086 (\textquotedblleft The performance right is granted to all categories of copyrighted works with one exception: Sound recordings. Thus, while the owner of a musical work enjoys the performance right, the owner of a sound recording does not.\textquotedblright).
\bibitem{33}See Craft, supra note 28, at 6 (\textquotedblleft While radio broadcasters pay royalties to publishers and writers for use of the musical work, they have, however, never had to pay any sort of royalty or licensing fee to the actual record companies for use of the sound recording.\textquotedblright); see also Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd., 574 F.3d 748, 753 (D.C. Cir. 2009) (\textquotedblleft The copyright owners of musical works, but not those of sound recordings, have long enjoyed exclusive rights to public performances of their works.\textquotedblright).
\bibitem{35}Craft, supra note 28, at 5–6 (\textquotedblleft Traditionally, the record companies have made money by selling copies of the sound recording, in form of vinyl albums, and later cassette tapes and CDs. The record companies then pay the musical artist a percentage of these sales (i.e., the artist’s royalties).\textquotedblright).
\bibitem{36}Day, supra note 29, at 184.
\bibitem{37}Delibero, supra note 31, at 86–87.
\bibitem{38}Id.; see also Eldar Haber, Copyrights in the Stream: The Battle on Webcasting, 28 SANTA CLARA COMPUTER & HIGH TECH. L.J. 769, 773 (2012) (\textquotedblleft Webcasting is a digital transmission of creative work over a network that results in the playing of the work, without storing a permanent copy at the recipient’s end . . . Put simply, webcasting is listening to music or watching a video in ‘real time,’ instead of downloading a file and viewing or lis-
labels, backed by both the Copyright Office and the Patent and Trademark Office, argued that the prevailing copyright structure would not adequately compensate owners of sound recording copyrights. Congress was concerned that “certain types of subscription and interactive audio services might adversely affect sales of sound recordings and erode copyright owners’ ability to control and be paid for use of their work,” as well as about the potential for further erosion in the future from “pay-per-listen, audio-on-demand, or ‘dial-up’ services for a particular recording or artist” (the so-called “celestial jukebox”).

In response to these concerns, Congress enacted the Digital Performance Right in Sound Recordings Act in 1995.

The DPRA granted the owners of sound recordings a right to compensation for performances of copyrighted works broadcast “by means of a digital audio transmission,” often referred to as the “digital performance right.” “Terrestrial” broadcasters, like AM and FM radio stations, that simulcast transmissions over the Internet were exempt. Non-subscription services—that is, those services that are ad-supported—did not exist at the time.

While DPRA required digital music services to compensate copyright holders, it treated interactive services and non-interactive services very differently. Because interactive services provide the ability to listen to a given song “on demand,” thus obviating the need to purchase a physical copy of a sound
recording, they arguably pose a more potent threat to music sales than non-

interactive services (which are more akin to radio).\(^{46}\) Thus, Congress estab-
lished an exclusive copyright for interactive services, allowing rights holders to 
negotiate freely in the market for such rights.\(^ {47}\)

For non-interactive services (that is, radio services or “webcasters”), DPRA 
created a compulsory license granting users full access to record companies’ 
libraries of sound recordings.\(^ {48}\) Royalty rates could still be voluntarily negotiat-
ed by the parties, but if they failed to agree, rates were set through binding ar-
bitration by a Copyright Arbitration Royalty Panel convened by the Librarian 
of Congress, subject to his review and a right to appeal to the D.C. Circuit 
Court of Appeals.\(^ {49}\)

Notably, DPRA borrowed the substantive criteria for arbitrated royalty rates 
from a pre-existing four-part standard found in § 801(b)(1) of the Copyright 
Act of 1976.\(^ {50}\) Specifically, § 801(b)(1) requires that royalty rates achieve four 
objectives:

(A) To maximize the availability of creative works to the public;

(B) To afford the copyright owner a fair return for his 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 us-
er in the product made available to the public with respect to relative creative 
contribution, technological contribution, capital investment, cost, risk, and con-
tribution to the opening of new markets for creative expression and media for 
their communication; and

(D) To minimize any disruptive impact on the structure of the industries in-
volved and on generally prevailing industry practices.\(^ {51}\)

As discussed below, the first three criteria, standing alone, imply a standard 
that is similar to the market-based WBWS standard. However, the fourth crite-

\(^ {46}\) Id.; see also Day, supra note 29, at 185.

\(^ {47}\) Id.; see also Day, supra note 29, at 185.

\(^ {48}\) See Amy Duvall, Royalty Rate-Setting for Webcasters: A Royal(ty) Mess, 15 MICH. 
TELECOMMS. & TECH. L. REV. 267, 270 n.20 (2008) (“The statutory license is compulsory 
because the user of the copyrighted work need not get individual permission from the copy-
right holder; their permission is automatically given if the user complies with the require-
ments of the statute.”). The requirements of the statutory licenses included limitations on the 
number of songs by a single artist or from a single album that could be played per hour, as 
well as a prohibition on releasing an advance playlist of upcoming songs. Id. at 270 n.20, 
271.

\(^ {49}\) Webcaster I, supra note 10, at 45,242 (discussing the Librarians review powers under 
former § 802(f)-(g)); Duvall, supra note 48, at 271.


\(^ {51}\) Id.
rion, requiring “non-disruption,” reflects a departure from the principle of market-based rates in favor of protecting licensees from potentially “disruptive” changes in royalties.52 Today, only a handful of services remain subject to this anachronistic standard.

B. The Digital Millennium Copyright Act

The years immediately following passage of the DPRA saw the emergence of the Internet and the rapid growth of “streaming radio.”53 These new services were generally non-interactive and non-subscription, relying on advertising for revenue.54 Because advertising-supported services were not in existence at the time DPRA was passed, they were not covered by its compulsory license.55 In 1998, Congress addressed this oversight by expanding the scope of the compulsory license as part of the DMCA.56 The DMCA offered these new non-interactive services the benefit of a statutory license (rather than requiring these services to negotiate licenses with individual sound recording copyright owners).57

The DMCA divided non-interactive digital audio services into two groups.58 The first group consisted of FCC-licensed satellite digital audio services (“SDARS”) that existed prior to July 31, 1998 (i.e., satellite radio companies

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52 Id. § 801(b)(1)(d).
55 See Day, supra note 29, at 187; see also Jackson, supra note 45, at 457 (“At the time the [DPRA] was written, webcasting was a nascent technology. By 1998, webcasting had proliferated with hundreds of radio stations and webcasters streaming music on the Internet. As Congress prepared to pass the Digital Millennium Copyright Act, the RIAA successfully lobbied to insert language to the provisions of the DPRA to close the ‘loophole’ that prevented them from licensing non-subscription webcast performances.”); Craft, supra note 28, at 5, 12 (“The new technology, along with its various Internet applications, spread quickly. Suddenly, online-only webcasters were streaming digital music over the Internet – not merely on the envisioned subscription basis like satellite and cable companies, but also on a non-subscription basis by means of paid advertisements, like ordinary radio programming.”).
56 Webcaster II, supra note 26, at 24,086.
57 See Craft, supra note 28, at 5, 15 (“This license would ease the burden of having to locate and pay all of the individual record companies that held the sound recording copyrights to the various musical selections transmitted.”).
Sirius and XM) and three subscription services: DMX, Music Choice and Mu-
zek (called “Pre-Existing Subscription Services,” or “PSS”).59 Under the
DMCA, PSS and SDARS were grandfathered in under the 801(b)(1) standard,
under the theory that they had relied on the standard at the time.60

The second group consisted of “new” digital subscription services and ser-
VICES making “eligible non-subscription transmissions,” which included Internet-only radio webcasters like Pandora and simulcasts of over-the-air broad-
casts.61 For these services, in the absence of a voluntary agreement between
copyright holders and the webcasters, the DMCA directed that the rates for
statutory licenses and royalties should be set by the CARP to “represent the
rates and terms that would have been negotiated in the marketplace between a
willing buyer and a willing seller” (this is the WBWS standard).62

As discussed further below, Congress has intervened directly in the setting
of webcaster royalties twice since passage of the DMCA, both times by pass-

59 See SDARS I, supra note 15, at 4080 n.3 (“Section 114(j)(11) of the Copyright Act
defines the term ‘preexisting subscription service’ to mean ‘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.’”).
60 H.R. REP. NO. 105-796, at 89.
61 See Duvall, supra note 48, at 272 (“The Digital Millennium Copyright Act (DMCA)
addressed royalty payments for webcasters under Section 114. The DMCA adopted the
statutory license for two types of webcasting: ‘preexisting subscription services’ and ‘eligi-
ble non-subscription services.’ These two categories included terrestrial radio stations’
online rebroadcasts as well as pure webcasters, but excluded providers who allowed users to
download or select music of their choice.”).
62 See 17 U.S.C. § 114(f)(1) (pre-existing services); see also id. §114(f)(2) (eligible
non-subscription services and new subscription services). With respect to the WBWS stand-
card, Congress directed that several considerations be taken into account. Section
114(f)(2)(B) says:

In determining such rates and terms, the copyright arbitration royalty
panel shall base its decision on economic, competitive, and program-
ing 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 record copy-
right 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.

Id. § 114(f)(2)(B); see also H. COMM. ON THE JUDICIARY, 105TH CONG., SECTION-BY-
SECTION ANALYSIS OF H.R. 2281 AS PASSED BY THE UNITED STATES HOUSE OF
ing legislation favorable to webcasters. In 2002, it passed the Small Webcasters Settlement Act of 2002, which “encouraged” record labels to negotiate lower rates with small webcasters than had been set by the CARP in the Webcaster I proceeding. Then, in 2008 and 2009, Congress passed (and then extended) the Webcaster Settlement Act, which again “encouraged” rights holders to negotiate lower royalty rates, this time offering all webcasters a discount from the rates set by the CRB in its 2007 Webcaster II decision.

Notably, neither the DPRA nor the DMCA extended the sound performance rights to the most prolific users of sound recordings, terrestrial radio stations. In the late-2000s, however, Congress considered adopting legislation—the Performance Rights Act of 2007 (H.R. 4789 and S. 2500) and its successor, the Performance Rights Act of 2009 (H.R. 848 and S. 379)—which would have extended the sound recording right to terrestrial radio, established a compulsory license for terrestrial radio stations, and adopted a single “fair market value” standard for all terrestrial broadcasters, cable, satellite and Internet services. Specifically, as passed by both the House and Senate Judiciary Committees, § 2 of the Performance Rights Act instructed the CRB to establish statutory rates under the first three prongs of § 801(b)(1), but rejected § 801(b)(1)(D), the non-disruption standard. Based on CRB precedent, the first three prongs of §

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71 Id. at 14–15 (2010) (“The section further establishes rate standard parity among ter-
801(b)(1) establish a market-based standard that is similar, if not identical, to the WBWS standard. Thus, the Performance Rights Act would have created a level playing field for all users of sound performance rights with rates set either through voluntary negotiations or, where necessary, through a statutory license based on a market-based standard.

III. THE SOUND RECORDING PERFORMANCE RIGHT IN PRACTICE

Since passage of the DPRA and DMCA, sound recording performance copyright holders and licensees have engaged in multiple rounds of negotiations over digital performance royalties, sometimes arriving at voluntary agreements, but more commonly settling rates through litigated proceedings before the CARP and its successor, the CRB.72

Since 1998, there have been three full-blown copyright royalty proceedings for non-pre-existing digital music services under the WBWS standard (known as Webcaster I, Webcaster II, and Webcaster III); in addition, as noted above, there have been two direct statutory interventions, the Small Webcaster Settlement Act of 2002 and the Webcaster Settlement Acts of 2008 and 2009.73 As detailed in the first subsection below, the formal proceedings have involved extensive economic analysis, supported by literally dozens of industry and economic experts, with multiple layers of administrative and judicial review.74 While the results of these proceedings have in many regards favored webcasters, webcasters have succeeded on more than one occasion in lobbying Congress to intervene in the process in favor of still lower rates. Thus the terrestrial broadcasters, cable, satellite, and Internet services, by creating one rate standard for Copyright Royalty Judges (CRJs) to consider, regardless of the platform involved. The new standard will be the old 801(b) standard minus subpart (D).”.

72 In the meantime, of course, rights holders have also negotiated voluntary agreements with online interactive services, such as Spotify. Ben Sisario, Google Expected to Start a Competitor to Spotify, N.Y. TIMES, May 15, 2013, B9. As discussed below, these voluntarily negotiated rates have been used by the Copyright Royalty Board as the basis for setting compulsory license rates.


74 See infra Part III.A.
IRFA was merely the latest in a string of efforts by webcasters to have royalties set at below-market rates.

In addition to the three Webcaster proceedings, there have been two formal proceedings (PSS I and SDARS I) to set rates for PSS and SDARS, and a second (SDARS II) is underway.\textsuperscript{75} Rates in these proceedings have been set under the 801(b) standard and, as discussed in the second subsection below, demonstrate that the 801(b) standard has resulted in rates below market-based levels.

Table 1 presents a brief summary of the primary Webcaster and SDARS proceedings.\textsuperscript{76}


\textsuperscript{76} The following review addresses the central issues in these proceedings and for copyright policy going forward, namely the terms and level of royalty rates for the primary sound performance right at issue. Each proceeding has also addressed a variety of ancillary issues, such as the rates for “ephemeral” recordings (which are digital copies made for the purpose of facilitating online music distribution), minimum fees applicable to smaller webcasters, the division of certain proceeds between studios and artists, and so forth. See, e.g., Webcaster III, supra note 73, at 13,026; Webcaster II, supra note 26, at 24,084; Webcaster I, supra note 10, at 45,240. No effort is made here to present a complete or comprehensive treatment of these ancillary issues.
TABLE 1
SELECTED RATE PROCEEDINGS, 1998–2013

<table>
<thead>
<tr>
<th>Term</th>
<th>Governing Standard</th>
<th>Proceeding</th>
<th>Decision Date</th>
<th>Appeal Complete</th>
<th>Final Statutory Rate</th>
<th>Royalty Metric</th>
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<td>Non-Interactive Services</td>
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<tr>
<td>2011–2015</td>
<td>WBWS</td>
<td>Webcaster III</td>
<td>March 2011</td>
<td>n/a</td>
<td>0.19¢ (2011) rising to 0.23¢ (2015)</td>
<td>Per-performance</td>
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<td>Pre-existing Services (PSS and SDARS)</td>
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<tr>
<td>1996–2000</td>
<td>801(b)</td>
<td>PSS I</td>
<td>May 1998</td>
<td>May 1999</td>
<td>6.5% Percentage of gross revenue</td>
<td></td>
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<tr>
<td>2013–2017</td>
<td>801(b)</td>
<td>SDARS II</td>
<td>April 2013</td>
<td>n/a</td>
<td>SDARS: 9% (2013) rising to 11% (2017) \ PSS: 8% (2013) – 8.5% (2014–2017)</td>
<td>Percentage of gross revenue</td>
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A. Webcaster Rates and the Willing Buyer/Willing Seller Standard

As noted above, there have been three full-blown rate proceedings to establish rates for Internet-only webcasters and simulcasters since 1998. Each time, the adjudicating body—first a CARP, then the CRB—held extensive hearings, took testimony from numerous expert economic and industry witnesses, engaged in full briefing schedules, and issued a written decision explaining the basis for the resulting rates; each decision has been subject to appeal before the D.C. Circuit. Nevertheless, each decision has led to complaints by webcasters, who have lobbied Congress to intervene and set lower rates. Indeed, most webcasters today are paying royalty rates negotiated pursuant to the Webcaster Settlement Act of 2009, which are below the market-based rates established by the CRB in the Webcaster II proceeding. This subsection describes the process by which webcaster rates have been established since 1998.


80 See cases cited supra note 79.

81 See generally Notification of Agreements under the Webcaster Settlement Act of 2009, 74 Fed. Reg. 34,796 (July 17, 2009) [hereinafter 2009 Webcaster Settlement]; Notification of Agreements under the Webcaster Settlement Act of 2008, 74 Fed. Reg. 9293 (Mar. 3, 2009) [hereinafter 2008 Webcaster Settlement]. See David Oxenford, Pureplay Webcasters and SoundExchange Enter into Deal under Webcaster Settlement Act to Offer Internet Radio Royalty Rate Alternative for 2006-2015, BROADCAST L. BLOG (July 7, 2009), http://commcns.org/1ID7BbS (noting that the settlement by “SoundExchange and a group of webcasters that [the author] represented in the [CRB] proceeding . . . not only reaches back to set rates different, and substantially lower, than those that were arrived at by the CRB for the period from 2006–2010, but also resolves the rates for 2011-2015”); see also Manuel Roig-Franzia, Pandora’s Keeper, WASH. POST, Apr. 4, 2013, at C1 (“In 2007, a federal panel—the [CRB]—issued a ruling that would have raised the royalty rate paid by webcasters so high that it would have forced them out of business. Drama ensued . . . . What resulted was a deal: Pandora, other music streamers, performers and the recording industry agreed to a new set of rates.”); Sarah McBride, Royalty Plan Is Set for Online Radio, WALL ST. J., July 8, 2009, at B8; John Timmer, Pandora Lives! SoundExchange Cuts Deal on Webcasting Rates, ARS TECHNICA (July 7, 2009), http://commcns.org/1i8joa1.
1. Webcaster I

The *Webcaster I* proceeding began on November 27, 1998, after a six-month voluntary negotiation period between webcasters and the RIAA resulted in a number of agreements between individual webcasters and the record companies, but failed to produce an industry-wide agreement. In accordance with the DMCA, a CARP was convened to establish the rates and terms for a statutory license. Its report, recommending royalty rates for the period from October 28, 1998 through December 31, 2002, was released more than three years later, on February 20, 2002.

The CARP proceeding was extensive by any standard. It included a full cycle of direct and rebuttal testimony, with 49 economic and industry expert witnesses presenting direct testimony and 26 on rebuttal, as well as oral arguments and multiple rounds of briefs. The resulting record was “one of the most voluminous records in CARP history,” including a “written transcript of over 15,000 pages, many thousands of pages of exhibits, and over 1,000 pages of post-hearing submissions” by counsel.

In reaching its decision, the CARP grappled with and resolved a number of highly technical legal and economic questions, many of which were resolved in favor of webcasters. For example, under the statute, the CARP concluded that the WBWS standard was created to set rates and terms “that would have been negotiated” by a willing buyer and a willing seller in a “hypothetical marketplace” in which no compulsory licenses existed and rates were determined by negotiations between music services and copyright holders. While the parties agreed that the willing “buyers” in this context were non-interactive digital music services, they disagreed as to the identities of the hypothetical

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82 *See Webcaster I*, supra note 10, at 45,241.
83 *Id.* at 45,240.
84 *Id.* at 45,241 (discussing the CARP proceeding); Randall C. Picker, Copyright As Entry Policy: The Case of Digital Distribution, 47 ANTITRUST BULL. 423, 462 (2002) (discussing the February 20, 2002 report by the CARP).
86 *CARP Report*, supra note 8, at 18; *see also* ROBIN JEWELER, CRS REPORT FOR CONGRESS, COPYRIGHT LAW: STATUTORY ROYALTY RATES FOR WEBCASTERS 3 (last updated Nov. 18, 2003) (“In a lengthy opinion based upon thousands of pages of testimony and evidence, the CARP recommended a public performance fee of 0.14¢ per performance and an ephemeral license fee of 9% of performance fees due for Internet transmissions by qualifying webcasters and commercial broadcasters.”).
“sellers.”

The RIAA, representing the interests of the copyright holders (i.e., record companies), asserted that the seller in the hypothetical marketplace should consist of “a single collective of sound recording copyright owners (such as RIAA), offering a blanket license” for access to the sound record libraries of its members. In contrast, the music services argued that in a hypothetical marketplace where compulsory licenses did not exist, a single RIAA-like entity could not negotiate on record companies’ behalf. This is because the antitrust exemption granted to RIAA, which allowed it to bargain on behalf of the collective, was conditional on the compulsory nature of the licenses at issue. The Services—a collection of Webcasters, Broadcasters, and similar organizations—contended that a single RIAA-like entity in the hypothetical marketplace would wield market power sufficient to distort negotiations. Instead, the services proposed that the “sellers” in the WBWS market be comprised of a “non-trivial number” of smaller collectives, offering blanket licenses in competition with one another. Ultimately, the CARP rejected both proposals, concluding instead that the appropriate “sellers” in the hypothetical marketplace were neither a single collective nor a number of smaller collectives, but rather individual record companies, offering “blanket licenses for each record company’s repertory of sound recordings.” From the perspective of the webcasters, this was a highly favorable result, as it meant that rates were based on the assumption that all copyright owners were competing against one an-

88 CARP Report, supra note 8, at 21.
89 Id. at 21–22.
90 Id. at 23. The CARP Report said:

We recognize that the hypothetical marketplace we seek to replicate would operate more efficiently, with lower transactional costs, if a single collective designated by the services could negotiate with a single collective designated by the record companies. Even if such negotiations were non-exclusive, Congress clearly perceived antitrust concerns with such an arrangement. Congress authorized antitrust exemptions respecting such negotiations only within the context of compulsory licenses.

91 Id. at 22 (“The Services’ perception of the sellers, in the hypothetical marketplace envisaged by Congress, is starkly different. They assert that RIAA’s vision ‘would eviscerate the protections sought by the Justice Department and implemented by Congress to prevent the exercise of market power [by the RIAA or the record companies].’”). The CARP Report uses “Services” to refer to “Webcasters and the business Establishment Services.” Id. at 2 n.2.
92 Id. at 22.
93 Id. at 44.
other in the marketplace rather than being represented jointly by bargaining agents.94

In addition, the CARP concluded that the WBWS standard did not necessitate any ex post adjustments of the royalty rates it determined based on the “additional factors” enumerated in § 114(f)(2)(B), finding that these factors would already be “fully reflected in any agreements actually negotiated between webcasters and copyright owners in the relevant marketplace.”95

In the course of this extensive proceeding, RIAA and the music services presented competing proposals for determining royalty rates, each backed by expert testimony.96 RIAA proposed basing rates on the agreements negotiated between the RIAA and 26 separate webcasters during the voluntary bargaining period,97 noting that those agreements involved “the same buyer, the same seller, the same right, the same copyrighted works, the same time period, and the same medium as those in the marketplace that the CARP must replicate.”98 Webcasters, on the other hand, proposed rates derived from a theoretical model which attempted to estimate appropriate royalty rates for the sound recording right based on rates for musical work performance rights established between music publishers and over-the-air-radio broadcasters.99

The CARP ultimately decided that the webcasters’ theoretical model was unreliable, in part because of intrinsic differences between the musical work performance right and the sound recording performance right.100 Moreover, it concluded, “the quest to derive rates which would have been negotiated in the hypothetical willing buyer/willing seller marketplace is best based on a review of actual marketplace agreements, if they involve comparable rights and comparable circumstances.”101 Taking multiple factors into account, the CARP concluded that while 25 of the 26 agreements that had been negotiated by

94 Id. at 46 (explaining that “as it meant that rates were based on the assumption that all copyright owners were competing against one another in the marketplace rather than being represented jointly by bargaining agents”).
95 Id. at 35 (emphasis in original).
96 Id. at 38.
97 Id.
98 Id. (emphasis in original) (internal quotation marks omitted).
99 Id. at 28, 38 (“Accordingly, Webcasters calculated their proposed per-performance and per-hour sound recording performance fee by extrapolation from the aggregate fees paid to ASCAP, BMI, and SESAC by over-the-air radio stations holding blanket performance licenses.”).
100 Id. at 40 (“The Panel is uncomfortable with many of these assumptions and the cumulative effect casts significant doubt on the reliability of the ultimate conclusions. The Panel finds that this theoretical construct suffers serious deficiencies.”).
101 Id. at 43.
RIAA were “unreliable benchmarks,” the freely negotiated agreement with Yahoo! was “evidence of an entirely different character,” reflecting “a truly arms-length bargaining process on a level playing field between two major players of comparable skill, size, and economic power.” Thus, based largely on the Yahoo! agreement, the CARP set a statutory performance royalty rate of 0.14¢ per performance for Internet-only (“IO”) webcasters.

In adopting the per performance rate structure, the CARP rejected arguments that it should set rates as a percentage of licensees’ revenues. The CARP found that the per-performance structure was superior because (1) a per-performance metric is directly reflective of the right being licensed; (2) percentage-of-revenue models are difficult to implement because relevant webcaster revenues are complex; and, (3) many webcasters are small and do not generate much revenue, so that the adoption of a percent-of-revenue model could result in copyright owners receiving little or no compensation for the use of their material.

The CARP also grappled with the issue of whether webcasters promoted music sales, especially in the context of radio retransmissions (i.e., copyrighted material contained in Internet retransmissions of broadcast radio signals). The CARP could not determine whether webcasters created a net increase or net decrease in the sale of phonorecords, despite the “undisputed testimony that traditional over-the-air radio play has a tremendous promotional impact on phonorecord sales” and the absence of evidentiary support for concluding that the impact of Internet simulcasts was any less significant. The CARP set a lower Radio Retransmission (“RR”) rate of 0.07¢.

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102 Id. at 60.
103 Id.
104 Id. at 61; see also Duvall, supra note 48, at 273–74 (“To determine the rates that would have been negotiated in the marketplace under the per performance model, CARP reviewed actual royalty agreements to comply with its statutory obligations under the DMCA. It found that the RIAA/Yahoo! agreement provided an appropriate benchmark for the rate-setting because it was the only RIAA-negotiated agreement ‘to reflect a truly arms-length bargaining process on a level playing field between two major players of comparable skill, size, and economic power.’”).
105 Webcaster I, supra note 10, at 45,243.
106 Id. at 45,243.
107 See CARP Report, supra note 8, at 37. The CARP also recommended a minimum royalty fee of $500 per annum. Id. at 95.
108 Id. at 32–34.
109 Id. at 74–75. The CARP did not conclude that there was no promotion, the CARP limited said that the evidence was insufficient to persuade them either way. Id. at 33–34.
110 Recent Legislation, Copyright Law—Congress Responds to Copyright Arbitration
As provided for under the DPRA, the CARP’s findings were reviewed by the Register of Copyrights and the Librarian of Congress (“LOC”). In its Final Rule and Order, released on July 8, 2002, the LOC—after reviewing briefs filed by both sides—upheld the CARP’s determination regarding the definition of the participants in the relevant hypothetical marketplace. However, the LOC ruled that the CARP erred when the CARP set royalty rates that were higher for Internet-only webcasters than rates for radio retransmissions. While the LOC accepted that the RIAA’s agreements with webcasters served as a more reasonable benchmark than the webcasters’ proposed “theoretical model,” it lowered the IO webcasting rate from 0.14¢ per-performance to 0.07¢ per-performance (to match the royalty rate for RR entities). Thus, the LOC cut the per-performance rate set by the CARP for pureplay webcasters, which was based on the actual rate agreed to by RIAA and Yahoo!, by 50%.

The LOC’s decision also contained important language concerning the distinction between the 801(b) and WBWS standards. The two standards, it concluded, were not the same. Rather, the 801(b) standard is “policy-driven, whereas the standard for setting rates for non-subscription services set forth in § 114(f)(2)(B) is strictly fair market value—willing buyer/willing seller,” therefore, the two rates cannot be equal as a matter of law.

The LOC’s ruling was upheld on appeal by the D.C. Circuit Court in *Beethoven.com LLC*. However, even before the appeal was decided, Congress—heeding complaints from small webcasters that the rates (even after being cut in half by the LOC) were too high—stepped in by passing the Small Webcasters Settlement Act of 2002, which “gave noncommercial and small commercial webcasters additional time to negotiate,” and expressed to copyright owners “the strong encouragement of Congress to reach an accommodation with the small webcasters on an expedited basis.” Shortly thereafter, the
small webcasters reached a compromise agreement with RIAA setting royalty rates that were capped as a percentage of small webcasters’ revenues or expenses rather than calculated on a per-performance basis.123

2. Webcaster II

The next statutory license proceeding for webcaster royalty rates, covering the period 2006–2010, established rates through another formal rate proceeding, this one lasting more than two years, from February 2005 until May 2007,124 this time under the purview of the CRB, the successor to the CARP panel.125 The Webcaster II proceeding again involved direct and rebuttal testimony from dozens of expert witnesses, including formal hearings, hundreds of motions and pleadings, and over 13,000 pages of transcripts.126

As in Webcaster I, the CRB evaluated several proposed benchmarks for royalty rates proposed by copyright owners and webcasters, again embracing an approach based on rates for comparable rights that had been negotiated freely in the marketplace.127 Specifically, the CRB embraced a model proposed by SoundExchange’s economic expert, Dr. Michael Pelcovits. Termed the “Interactive Webcasting Market Benchmark,”128 the model utilized the royalty rates negotiated individually between copyright owners and interactive music services (adjusted for differences in interactivity) as a basis for royalties for non-
interactive services under compulsory licenses.\textsuperscript{129} Based largely on the interactive services benchmark, the CRB set per-performance rates at 0.08¢ for 2006, rising gradually to 0.19¢ in 2010,\textsuperscript{130} as shown in Table 2. Thus, under Webcaster II, the statutory rate was scheduled to reach the 0.14¢ per performance rate—the very rate recommended by the CARP for Internet-only transmissions—in 2008.\textsuperscript{131}

\begin{table}[h]
\centering
\caption{Statutory Royalty Rates for Commercial Webcasters Under Webcaster II}
\begin{tabular}{ll}
\hline
Year & Per-Performance Royalty \\
\hline
2006 & 0.08¢ \\
2007 & 0.11¢ \\
2008 & 0.14¢ \\
2009 & 0.18¢ \\
2010 & 0.19¢ \\
\hline
\end{tabular}
\end{table}

The CRB’s decision was appealed to the D.C. Circuit Court of Appeals, in Intercollegiate Broadcast System v. Copyright Royalty Board.\textsuperscript{133} The Court upheld the CRB’s determination of royalty rates for commercial webcasters, including specifically its decision to base royalties on the market-based interactive services benchmark.\textsuperscript{134} The Court also rejected the webcasters’ assertions that the rates set by the CRB were “crushing and disproportionate.”\textsuperscript{135}

\textsuperscript{129} See Duvall, supra note 48, at 279. The CRB also concurred in the Webcaster I determination that the preferred metric for calculating statutory royalties is a per-performance model, as opposed to royalties based on a percentage-of-revenue. Webcaster II, supra note 26, at 24,090.

\textsuperscript{130} See Webcaster II, supra note 26, at 24,096.

\textsuperscript{131} Compare Webcaster I, supra note 10, at 45,243 (rejecting the “proposed rates ($0.14 per performance for Internet-only transmission and $0.07 per performance for radio retransmissions) for the section 114 license and substitut[ing] [the Librarian’s] own determination ([$0.0007] per performance for both types of transmissions]”), with Webcaster II, supra note 26, at 24,096 (setting rates at $0.0014 for 2008).

\textsuperscript{132} Adapted from information in Webcaster II. See Webcaster II, supra note 26, at 24,096.

\textsuperscript{133} See Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd., 574 F.3d 748, 752 (D.C. Cir. 2009).

\textsuperscript{134} Id. at 758.

\textsuperscript{135} Id. at 760. The Court did, however, vacate the $500 minimum fee for both commer-
court found that the WBWS standard does not require to the CRB to set rates that allow all firms in the market to earn a profit:

Finally, it was not error for the Judges to reject the small commercial webcasters’ pleas that paying per performance would wreck their inefficient business models. The Judges made clear they could not “guarantee a profitable business to every market entrant.” The Judges are not required to preserve the business of every participant in a market. They are required to set 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.” 17 U.S.C. § 114(f)(2)(B). If small commercial webcasters cannot pay the same rate as other willing buyers and still earn a profit, then the Judges are not required to accommodate them.136

Thus, the court ruled, while webcasters are guaranteed access to sound recording performance rights under a compulsory license, Congress did not extend to them a right to perpetual profitability.137

3. The Webcaster Settlement Act and the 2009 Compromise

As with Webcaster I, many webcasters reacted negatively to the Webcaster II decision.138 Pandora and others claimed that the CRB’s royalty rates would push webcasters to the verge of collapse,139 with Pandora asserting that the CRB rates would force it to pay almost 70% of its revenues in performance royalties.140

As in 2002, Congress reacted sympathetically to webcasters’ complaints,141 this time by passing the Webcaster Settlement Act of 2008 and later the Webcaster Settlement Act of 2009 (together, the “WSAs”).142 Modeled on the Small Webcaster Settlement Act of 2002, the WSAs expressed to copyright

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136 Id. at 761 (internal citations omitted).
137 See id.
138 Duvall, supra note 48, at 283.
139 See Day, supra note 29, at 190–91 (“The reaction to the CRB rates was immediate and dramatic. Small and large webcasters alike predicted the CRB rates would result in the ‘end of Internet Radio.’ For instance, Pandora Internet Radio . . . maintained that it was ‘on the verge of collapse’ as a result of the new rates.”).
140 See Day, supra note 29 (citing a prepared statement by Pandora Media, Inc.).
141 See Elahe Izadi, Pandora, Growing Up Washington Style, Nat’l J. (July 9, 2012), http://commcns.org/1gNQ6le.
owners “the strong encouragement of Congress to reach an accommodation with the webcasters on an expedited basis,” and provided a window of time in which to do so. Not surprisingly, rights holders entered into negotiations with webcasters over lower rates, reaching eight separate agreements (containing a total of twelve royalty schedules) with different segments of the webcasting market—for example, non-commercial webcasters, non-commercial educational webcasters, and pureplay webcasters—in late 2008 and early 2009.

The new rates, which were available to qualified webcasters on an opt-in basis, overrode the market-based Webcaster II rates established by the CRB for webcasters that elected the alternate rates, and generally covered the ten-year period from 2006–2015. Table 3 shows the alternate schedule of rates for Pureplay webcasters, which are substantially lower than the rates determined by the CRB in Webcaster II. For example, the royalty rate per-performance under Webcaster II in 2010 would have been 0.19¢, while the WSA Pureplay rate is only 0.097¢. And, the 0.14¢ originally recommended by the CARP in Webcaster I to take effect in 1998, and delayed under Webcaster II until 2008, was pushed back another seven years, until 2015.

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145 See 2008 Webcaster Settlement, supra note 81, at 9294 (listing agreements between SoundExchange and various webcasters).
146 See 2009 Webcaster Settlement, supra note 81, at 34,798.
147 Webcaster II, supra note 26, at 24,096 (setting the per-play rate applicable to Commercial Webcasters at 0.19¢ for 2010); 2009 Webcaster Settlement, supra note 81, at 34,799 (setting the per-play rate applicable to Commercial Webcasters at 0.097¢ for 2010).
148 Webcaster I, supra note 10, at 45,273 (setting the per-play rate for all internet transmissions by Webcasters and Commercial Broadcasters at $0.0007 per performance); Webcaster II, supra note 26, at 24,096 (setting the per play rate applicable to Commercial Webcasters at $0.0014 for 2008); 2009 Webcaster Settlement, supra note 81, at 34,799 (setting the per-play rate applicable to Commercial Webcasters at $0.0014 for 2015).
**TABLE 3**

**ROYALTY RATES FOR PUREPLAY WEBCASTERS**

**UNDER THE 2009 WEBCASTER SETTLEMENT ACT COMPROMISE**

<table>
<thead>
<tr>
<th>Year</th>
<th>Per-Performance Royalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0.08¢</td>
</tr>
<tr>
<td>2007</td>
<td>0.084¢</td>
</tr>
<tr>
<td>2008</td>
<td>0.088¢</td>
</tr>
<tr>
<td>2009</td>
<td>0.093¢</td>
</tr>
<tr>
<td>2010</td>
<td>0.097¢</td>
</tr>
<tr>
<td>2011</td>
<td>0.102¢</td>
</tr>
<tr>
<td>2012</td>
<td>0.11¢</td>
</tr>
<tr>
<td>2013</td>
<td>0.12¢</td>
</tr>
<tr>
<td>2014</td>
<td>0.13¢</td>
</tr>
<tr>
<td>2015</td>
<td>0.14¢</td>
</tr>
</tbody>
</table>

Importantly, Congress directed the LOC to make it clear that the Webcaster Settlement Act rates were not to be interpreted as “market based.” To highlight that fact, Congress unequivocally stated in § 114(f)(5)(C) that the new rates were to be considered the result of unique circumstances and, specifically, were not precedential with respect to the WBWS standard:

> 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 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.

Thus, the rates currently being paid by webcasters like Pandora are not market based, but rather the result of a compromise that set rates below those es-

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149 *2009 Webcaster Settlement, supra* note 81, at 34,799.

150 *See id.* at 34,801 (noting that the Rates and Terms shall be considered a compromise motivated by the unique circumstances, and the Rates and Terms cannot be represented as market rates in any proceeding).

tablished by the CRB under the WBWS standard. The compromise extends the term of the agreement through 2015. Lastly, the compromise requires large pureplay webcasters to pay the greater of 25% of revenues or the agreed upon per play rates.

4. Webcaster III

While rates for 2011–2015 were established for most webcasters by the various Webcaster Settlement Act compromises, the CRB was still required to hold a new royalty rate proceeding to set statutory rates and terms for the 2011–2015 period that such rates would apply to webcasters that were not in existence at the time of the Webcaster Settlement Act or chose not to opt-in to one of the WSA rate schedules. Despite the fact that most webcasters did not participate in the proceeding, the Webcaster III proceeding involved extensive direct and reply testimony from numerous experts from all sides, full briefing schedules, and so forth.

Applying the WBWS standard, the CRB once again (as in Webcaster II) set rates by reference to a benchmark based on the rates negotiated between rights holders and interactive digital services, which are not subject to the compulsory copyright and thus are prima facie market-based. The CRB released its rate determinations on March 9, 2011, with rates again established on a per-performance basis, as shown in Table 4.

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152 See 2009 Webcaster Settlement, supra note 81, at 34,796–99 (describing statutory rates which webcasters may elect to pay).
153 Id. at 34,799.
154 Id.
155 See generally Webcaster III, supra note 73. The Webcaster III proceeding began on January 9, 2009, and thus overlapped negotiations then underway under the Webcaster Settlement Act. Those negotiated resulted in voluntary agreements among many of the parties for which rates would have otherwise been determined under Webcaster III.
156 Id. at 13,031 (noting that royalty adjustments were made based on the non-interactive nature of the licenses under consideration).
157 Id. at 13,047–48.
TABLE 4\textsuperscript{158}

\textbf{STATUTORY ROYALTY RATES FOR
COMMERCIAL WEBCASTERS UNDER \textit{WEBCASTER III}}

<table>
<thead>
<tr>
<th>Year</th>
<th>Per-Performance Royalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>0.19¢</td>
</tr>
<tr>
<td>2012</td>
<td>0.21¢</td>
</tr>
<tr>
<td>2013</td>
<td>0.21¢</td>
</tr>
<tr>
<td>2014</td>
<td>0.23¢</td>
</tr>
<tr>
<td>2015</td>
<td>0.23¢</td>
</tr>
</tbody>
</table>

Figure 1 below illustrates the disparity between the royalty rates determined by the CARP and CRB under the WBWS standard in the \textit{Webcaster I}, \textit{Webcaster II} and \textit{Webcaster III} proceedings and the royalty rates actually paid by pureplay webcasters. The blue line in Figure 1 represents the original royalty rates set by the CARP and the CRB, which applied the WBWS standard after extensive proceedings in which economic evidence was used to estimate a market-based rate. The red line represents the final royalty rates actually charged to webcasters after their appeals to the Librarian of Congress for \textit{Webcaster I} and to Congress after \textit{Webcaster II}.\textsuperscript{159}

\textsuperscript{158} Derived from information in \textit{Webcaster III}. See id. at 13,048.

\textsuperscript{159} Note that rates negotiated by small webcasters under the Small Webcaster Settlement Act, which were expressed as a share of revenues rather than on a per-performance basis, are not shown.
As Figure 1 shows, some pureplay webcasters (including Pandora) have secured per-performance royalty rates well below the market-based rates mandated by Congress under the DMCA.

C. Section 801(b) and the “Non-Disruption” Standard

Unlike the WBWS standard, the 801(b) standard now being advocated by webcasters is explicitly not market-based—that it, it is not designed to replicate the rates that would be achieved in a competitive market. \textsuperscript{160} Rather, the

\textsuperscript{160} See Written Direct Statement of Music Choice at 13–15, In re Determination of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services, No. 2011-1 CRB PSS/Satellite II (Copyright Royalty Bd., Nov. 29, 2011) [hereinafter Direct Statement of Music Choice], available at http://commcns.org/1D7m6s (arguing simultaneously that current rates will result in petitioner Music Choice’s demise and that there are no similar market benchmarks on which to base royalty rate).
fourth pillar of the 801(b) standard reflects Congress’ desire that rates be set so as to “minimize” any “disruptive” impact on the parties; that is, if market-based rates are determined to be disruptive for licensees, they must be lowered. From a policy perspective, the “non-disruption” standard may result in locking in place inefficient or obsolete business models, or even encouraging inefficient investments by firms which know that, under the 801(b) standard, rates will be set so as to prevent “disruption” to their business models. For licensees and their investors, such a guarantee is obviously quite valuable.

This subsection briefly reviews the application of the 801(b) standard since its adoption in the 1976 Copyright Act, focusing on proceedings involving royalty rates for SDARS services, SDARS I (completed in 2008) and SDARS II. In SDARS I, the non-disruption criterion played an important role, leading directly to rates lower than would have been reached under the WBWS standard. And, while the SDARS II proceeding is not yet complete, the expert economic testimony presented there demonstrates that, at least in the eyes of copyright users, the non-disruption criterion amounts to a guaranteed return on investment for licensees, now and into the future. Before addressing the two SDARS proceedings, it is useful to review briefly the three prior proceedings in which the 801(b) standard was applied.

1. Early Interpretations of the 801(b) Standard

Prior to the creation of the Copyright Royalty Board, the 801(b) standard was applied twice by the Copyright Royalty Tribunal (“CRT”) in 1981, and once by CARP in 1997. The two CRT proceedings involved the statutory licenses for jukeboxes and for the mechanical license, that is, the right to use a musical composition when making a copy of a sound recording. As the CRB

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161 See 17 U.S.C. § 801(b)(1)(D) (requiring one function of the Copyright Royalty Judges while making royalty determinations is to minimize any disruptive impact on the structure of the industries involved in rate setting).

162 See SDARS I, supra note 13, at 4097 (describing considerations of the analysis of the “minimizing disruption” factor).

163 See Direct Statement of Music Choice, supra note 160, at 44–45 (arguing that royalties have been so disruptive as to cause the failure of competing firms, thus compelling the Board to set a lower rate).


later noted, in the 1980 Jukebox License Proceeding,\textsuperscript{166} neither the CRT nor the D.C. Circuit, which reviewed the decision on appeal, substantively dealt with the 801(b) standard as such.\textsuperscript{167} The CRT’s decision in the 1981 Mechanical License Proceeding, however, did address the standard, focusing on the statutory requirement that rates be “reasonable,” and suggesting that the individual 801(b) standards could be satisfied by rates lying within a zone of reasonableness.\textsuperscript{168} In its subsequent review, the D.C. Circuit agreed.\textsuperscript{169}

In 1997, a CARP took up the issue of royalties for PSS under the recently passed Digital Performance Right in Sounds Recordings Act.\textsuperscript{170} When the CARP’s decision came down heavily on the side of the PSS, it was reviewed and revised by the Librarian of Congress, and rates ultimately were set at 6.5\% of revenues.\textsuperscript{171} However, neither the Librarian’s decision nor the subsequent D.C. Court of Appeals decision to reject an appeal by the Recording Industry Association of America dwelt on the proper interpretation of § 801(b).\textsuperscript{172}

\begin{flushleft}
\textsuperscript{166} See 1980 Adjustment of the Royalty Rate, supra note 165, at 888–89 (reaching a decision in light of the 801(b) standard but observing that such criteria was not contemplated for exclusive application to the determination of the jukebox rate).

\textsuperscript{167} See SDARS I, supra note 15, at 4082 (noting that “[w]hile the Tribunal’s decision was somewhat lengthy, its consideration and application of the standard and the Section 801(b)(1) factors was not”).

\textsuperscript{168} See Adjustment of Royalty Payable under Compulsory License for Making and Distributing Phonorecords, supra note 165, at 10,479; see also Recording Indus. Ass’n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 11 (D.C. Cir. 1981).

\textsuperscript{169} Recording Indus. Ass’n of Am. v. Copyright Royalty Tribunal, 662 F.2d at 11, 18; see SDARS I, supra note 15, at 4083 (noting that “[t]o the extent that the statutory objectives determine a range of reasonable royalty rates that would serve all these objectives adequately but to differing degrees, the Tribunal is free to choose among those rates, and courts are without authority to set aside the particular rate chosen by the Tribunal if it lies within a ‘zone of reasonableness’”).

\textsuperscript{170} See SDARS I, supra note 15, at 4083 (noting that “[u]nlike prior statutory licenses where the Congress fixed the initial rates within the statute, the rates for the new digital performance right license were left to resolution by a CARP. The Librarian convened a CARP in 1997 for PSS and SDARS. The SDARS settled with copyright owners and withdrew from the proceeding, and the CARP rendered a determination only with respect to the PSS. The Librarian reviewed the CARP’s determination and rejected it with respect to the rate as well as to certain terms, and the U.S. Court of Appeals for the District of Columbia Circuit reviewed the Librarian’s decision.”).

\textsuperscript{171} Recording Indus. Ass’n of Am. v. Librarian of Cong., 176 F.3d 528, 531 (D.C. Cir. 1999).

\textsuperscript{172} See id. at 532–33 (finding that the Librarian’s interpretation of § 802(b) was reasonable and declining to impose its own interpretation).
2. SDARS I

In January 2006, the CRB initiated a rate proceeding to establish statutory royalties for PSS and SDARS for 2007 and 2008 through 2012.173 The PSS services negotiated voluntary agreements, which were ratified by the CRB in late 2007,174 but the SDARS services (at that time, Sirius and XM) did not, and the CRB issued statutory rates for SDARS services in January 2008.175 The decision, known as SDARS I, left no doubt that the 801(b) standard, as interpreted by the CRB and reviewed by the DC Circuit, is likely to result in rates lower than the market-based rates set under the WBWS standard.176

Like the Webcaster proceedings, SDARS I was a full-blown rate proceeding, featuring dozens of economic and industry experts, direct and rebuttal testimony and so on.177 The CRB began its analysis by seeking to establish a benchmark based on voluntarily negotiated rates for comparable services, and ultimately chose again—as in the Webcaster II and Webcaster III proceedings—to rely on a model based on the market rates negotiated for interactive subscription services.178 Based largely on an analysis by Dr. Janusz Ordover, the CRB determined that a royalty rate equal to 13% of subscriber revenue constituted a “reasonable estimate of a marketplace derived benchmark.”179

The next step in the CRB’s analysis was to establish a “zone of reasonableness” within which the final rates—based on the § 801(b) criteria—would have to lie.180 The Board determined that the 13% benchmark “marks the upper boundary of a zone of reasonableness for potential marketplace benchmarks,” that a lower boundary was established by the 2.35% of revenues paid by SDARS for musical works licenses, but that “based strictly on marketplace evidence, a rate close to the upper boundary is more strongly supported than

175 See id.
176 See id.
177 See SDARS I, supra note 15, at 4081 (stating that in addition to the written direct statements and written rebuttal statements, the judges heard 26 days of testimony, which filled over 7,700 pages of transcript, and over 230 exhibits were admitted).
178 See id. at 4083.
179 See id. at 4083, 4085–88 (explaining that the CRB continues to prefer a per-performance metric to one based on a percentage of revenues, because several factors made it impractical to utilize a per-performance metric in this case).
180 See id. at 4083.
one close to the lower boundary.” 181 Hence, prior to explicit consideration of
the four 801(b) criteria, the judges had in mind a rate closer to 13% than to
2.35%. 182

The next step in the Board’s analysis was to determine “whether these poli-
cy objectives weigh in favor of divergence from the results indicated by the
marketplace benchmark evidence.” 183 Looking at the first two criteria, which
require, respectively, “maximizing the availability of creative works to the
public” and providing a “fair return” to both copyright holders and users, the
Board determined that no adjustments from market rates were necessary and,
indeed, that the criteria do not as a general matter imply rates different from
those set in the market. 184

The Board reached a different conclusion, however, with respect to the latter
two criteria, § 801(b)(1)(C) (which requires an assessment of the “relative
roles” of the copyright owner and user with respect to creative contribution,
technological contribution, capital investment, cost, risk and contribution to the
opening of new markets) and § 801(b)(1)(D), the non-disruption standard.185

With respect to the “relative roles” criteria, the CRB found that the need for
SDARS to make “new expenditures related to their satellite technology…may
weigh in favor of a discount from the market rate.” 186 However, it determined
that this issue was “intimately intertwined” with the non-disruption standard,
and decided to “treat the potential disruptive effect of postponing investment in
new satellite technology” as part of its consideration of the non-disruption
standard. 187

In applying the non-disruption standard, the Board concluded that a devia-
tion from market rates was justified on two grounds—profitability and invest-
ment.188 First, it concluded, raising rates to the market-based level would “in-
crease costs and raise the necessary critical mass of subscribers sufficient to
generate revenues that yield EBITDA profitability.” 189 Thus:

In order not to significantly delay the attainment and amounts of EBITDA
profitability and positive free cash flow, some rate within the zone of reasona-

181 Id. at 4094.
182 Id.
183 Id.
184 See id. at 4094, 4094–96.
185 See id. at 4096.
186 Id. at 4097.
187 Id.
188 Id.
189 See id.
bleness that is less than 13% is warranted.\textsuperscript{190}

Second, with respect to investment, it decided that royalty rates should be set so as not to place “any undue constraint on the SDARS’ ability to successfully undertake satellite investments planned for the license period.”\textsuperscript{191} Based on these factors, the Board found it “appropriate to adopt a rate from the zone of reasonableness for potential marketplace benchmarks that is lower than the upper boundary most strongly indicated by marketplace data.”\textsuperscript{192} Accordingly, it set an initial rate of 6% of revenues, rising to 8% over the six-year (2007–2012) term of the license—roughly 50% below the 13% benchmark it had initially concluded reflected a “reasonable estimate of a marketplace derived benchmark.”\textsuperscript{193}

3. SDARS II

Perhaps the best way to understand the impact of the 801(b) non-disruption standard is to examine how it is invoked in an actual proceeding, such as the one that the CRB had engaged in to determine rates for PSS and SDARS for the five-year term beginning in January 2013.\textsuperscript{194} In that proceeding, experts for copyright users repeatedly invoked the 801(b) standard as the basis for claiming that rates should be set below marketplace levels in order to guarantee their clients a rate of return on both past and future investments, arguing that the standard not only permits but could require the CRB to deviate from market-based rates in order to advance “social values”\textsuperscript{195} such as “distributive justice.”\textsuperscript{196}

For example, an expert who submitted a statement on the behalf of Sirius

\textsuperscript{190} Id.
\textsuperscript{191} Id. SoundExchange appealed the CRB’s ruling to the D.C. Circuit Court of Appeals arguing that the royalty rates set by the CRB were too low, where The Court upheld the CRB’s ruling, stating that the CRB did not act unreasonably in setting rates. The Court did not, however, make a determination on whether the rates themselves were too high or too low. See generally SoundExchange, Inc. v. Librarian of Cong., 571 F.3d 1220 (D.C. Cir. 2009).
\textsuperscript{192} SDARS I, supra note 15, at 4097.
\textsuperscript{193} Id. at 4093.
\textsuperscript{195} Written Rebuttal Testimony of Roger G. Noll on Behalf of Sirius XM Radio Inc. at 50, In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, No. 2011-1 CRB PSS/Satellite II (Copyright Royalty Bd., July 2, 2012), available at http://commens.org/1hHhNEO.
\textsuperscript{196} Id. at 6.
XM asserted that the CRB is required to “ensure that all participants would still have voluntarily engaged in the market transactions needed to make satellite services available had they been aware of the rates when they made the decisions to enter into those transactions,”197 which is equivalent to requiring that rates be set so as to guarantee investors profits on their initial investments, apparently in perpetuity.198 Another expert testified that, under § 801(b), rates that do not permit copyright users to recover the start-up costs of entering the industry199 and ensure that they can “recover the financial cost of [future] investments” would be “disruptive,” because users must have incentives to continue investing in their businesses.200 To summarize, while it is theoretically possible for the 801(b) standard to result in the same rates as under the WBWS standard,201 there is no question that the two standards are—as one supporter of the IRFA recently agreed—”starkly different.”202 Nor is it surprising that, as one knowledgeable observer recently noted, “[T]he change from the willing buyer/willing seller standard to the 801(b) standard is widely anticipated to significantly lower the royalty rates that online radio services pay.”203 As discussed further below, other elements of the IRFA were also designed to ensure copyright users continue to pay below market rates in the future.

198 See id.
200 Id.
202 See John Villasenor, Digital Broadcast Music Royalties: The Case for a Level Playing Field, 19 ISSUES TECH. INNOVATION 1, 9 (2012) (stating that the desire to lower the “high royalty burdens” paid by webcasters is the primary rationale offered by IRFA’s proponents for its enactment).
IV. THE NON-DISRUPTION STANDARD: THE PROPOSED INTERNET RADIO FAIRNESS ACT AND THE MARKET FOR ONLINE MUSIC

The Internet Radio Fairness Act (H.R. 6480 and S. 3609)\(^{204}\) would have fundamentally altered both the standards and the process by which statutory royalties were established for non-interactive webcasters like Pandora.\(^{205}\) As described in the first subsection below, the clear purpose, and the virtually certain effect, would have been to tip the playing field against copyright owners in favor of the webcasters, resulting in lower royalty rates for covered webcasters – which of course is why the webcasters support it.\(^{206}\) As explained below, there is no evidence that high royalty rates are stifling the growth of online music in general or, in particular, the growth of Pandora, or that such services would be unable to pay market based rates in the future.

IRFA not only sought to lower royalty rates, but also to “level the playing field” by subjecting Pandora and other webcasters to the same rate standard that now applies to PSS and SDARS services.\(^{207}\) The biggest problem with this argument is that non-interactive webcasters’ biggest competitors are not PSS or SDARS, but rather interactive services (like Spotify), which obtain sound recording performance rights without the benefit of a compulsory license of any sort.\(^{208}\) Thus, what Pandora is seeking through the IRFA is to increase the competitive advantage it already holds over interactive services by obtaining an even more attractive compulsory license.\(^{209}\) Meanwhile, the IRFA would have done nothing to address the other obvious imbalance in the sound recording performance right, which is the continuing exemption enjoyed by the over-the-air transmissions of terrestrial broadcasters.\(^{210}\)

The first subsection below reviews the IRFA’s main provisions and explains

\(^{204}\) See H.R. REP. NO. 6480 (2012).

\(^{205}\) Villasenor, supra note 202, at 11.

\(^{206}\) Id.


\(^{209}\) Savitz, supra note 208.

\(^{210}\) Villasenor, supra note 202, at 13.
the effects that they would have had on the rate-setting process and its results. The second subsection shows why the rates currently being paid by webcasters are not unreasonable, and why the IRFA is not necessary to preserve a vibrant and growing market for online music. The third subsection explains why the uneconomic rates that the IRFA would have produced, along with the perverse incentives inherent in the non-disruption standard, would reduce incentives for content creation, slow innovation, and harm consumers.

A. The IRFA Would Dramatically Tilt the Rate Setting Process in Favor of Webcasters

If one set out to write statutory language designed to favor webcasters over copyright owners in rate setting proceedings, the result would look a lot like the IRFA. While a complete exegesis is beyond the scope of this study, a partial listing of its more significant provisions provides a sense of the proposal’s scope and ambition. Among other things, the IRFA would have: (a) imposed a heavily-modified version of the § 801(b) criteria for royalty rates, with the modifications further favoring webcasters; 211 (b) intervened directly in the rate setting process, by extending the webcaster-friendly Webcaster Settlement Act rates (for small pureplay webcasters) for an extra year; 212 (c) shifted the burden of proof to copyright holders to show that proposed rates do not exceed an amorphous new standard; 213 (d) prohibited copyright royalty judges from considering certain types of evidence likely to favor copyright holders; 214 (e) reversed the CRB’s (economically-grounded) decision to favor “performance” royalties over “percentage of revenue” royalties; 215 (f) prohibited the

211 See Internet Radio Fairness Act of 2012 §3(a)(1)(B) (“In establishing rates and terms under this paragraph, the Copyright Royalty Judges shall apply the objectives set forth in section 801(b)(1).”).
212 Id. § 3(b)(4) (“The rates and terms of any settlements made pursuant to the amendments made by the Webcaster Settlement Act of 2009 (Public Law 111-36; 123 Stat. 1926) that were to expire before December 31, 2015, shall be extended through December 31, 2015, according to the rates and terms applicable to 2014.”).
213 Id. § 3(a)(2)(A)(ii) (“In any proceeding under this subsection, the burden of proof shall be on the copyright owners of sound recordings to establish that the fees and terms that they seek satisfy the requirements of this subsection, and do not exceed the fees to which most copyright owners and users would agree under competitive market circumstances.”).
214 Id. § 3(a)(2)(A)(iv) (“To the extent the Copyright Royalty Judges consider marketplace benchmarks to be relevant, the Copyright Royalty Judges shall limit those benchmarks to benchmarks reflecting the rates and terms that have been agreed under competitive market circumstances by most copyright users.”).
215 Id. (stating that the CRJs “shall not disfavor percentage of revenue-based fees”).
CRB from relying on some (but not other) prior decisions as precedents;\(^\text{216}\) (g) reversed the Webcaster Settlement Act’s guarantee that rates negotiated under the Act would not have precedential value for rate setting purposes;\(^\text{217}\) (h) created a special class of antitrust liability for joint activities by copyright owners, but not copyright users;\(^\text{218}\) (i) injected politics into the process by requiring copyright judges to be confirmed by the Senate rather than appointed by the Librarian of Congress;\(^\text{219}\) (j) eliminated the requirement that at least one of the copyright judges be an expert in copyright, and one an expert in economics;\(^\text{220}\) and, (k) subjected CRB rate decisions to de novo review, requiring the D.C. Circuit essentially to re-hear every rate case.\(^\text{221}\)

Among the many changes proposed by the IRFA, the most profound include the provisions that alter the substantive standards for rate setting,\(^\text{222}\) specify what evidence the CRB can consider,\(^\text{223}\) and change the makeup of the CRB itself.\(^\text{224}\)

First, in addition to replacing the WBWS standard with the 801(b) standard, the IRFA would have added four additional criteria which must be considered in setting rates: (1) “the public’s interest in both the creation of new sound recordings of musical works and in fostering online and other digital performances of sound recordings”\(^\text{225}\); (2) “the income necessary to provide a reasonable return on all relevant investments, including investments in prior periods for which returns have not been earned”;\(^\text{226}\) (3) “the value of any promotional benefit or other non-monetary benefit conferred on the copyright owner by the performance”;\(^\text{227}\) and (4) “the contributions made by the digital audio transmission service to the content and value of its programming.”\(^\text{228}\) Each of these criteria is favorable to webcasters, none more so than the requirement that the

\(^{216}\) Id. (stipulating that the CRJs “shall not take into account either the rates and terms provided in licenses for interactive services or the determinations rendered by the Copyright Royalty Judges prior to the enactment of the Internet Radio Fairness Act of 2012.”).

\(^{217}\) Id. § 3(b).

\(^{218}\) Id. § 5(a)(1)(A)–(B).

\(^{219}\) Id. § 2(1)(A).

\(^{220}\) Id. § 2(2)(A).

\(^{221}\) Id. § 6(d).

\(^{222}\) Id. § 3(a)(2)(A)(i)(II).

\(^{223}\) Id. § 6(a)(1)–(2).

\(^{224}\) Id. § 2(2)(A).

\(^{225}\) Id. § 3(a)(2)(A)(iv).

\(^{226}\) Id.

\(^{227}\) Id.

\(^{228}\) Id.
rates be set so as to ensure copyright users earn profits on past investments.\footnote{Id.}

Further, the IRFA would have shifted the burden of proof in rate setting proceedings to copyright owners, who would be required to establish that the fees in any statutory license do not exceed those to which “most copyright owners and users would agree to under competitive market circumstances,” defined as conditions in which none of the participants have market power.\footnote{Id. § 3(a)(2)(A)(iv), 3(a)(3)(B) (stating the burden of proof and defining “market circumstances”).} As a practical matter, it is likely that the only agreements that would meet this standard would be ones negotiated by the smallest independent record labels—that is, the ones willing to accept the lowest royalty rates.

Second, in applying the new criteria, the IRFA would have directed the CRB to ignore some evidence, but demands that other evidence be considered.\footnote{Id. §§ 3(a)(3)(B), 6(a)(1)–(2).} Judges are prohibited from taking into account the rates and terms in licenses for interactive services (which have provided the benchmark for the market-based rates in \textit{Webcaster II} and \textit{Webcaster III}) or in the CRB’s previous determinations, but permitted to consider the rates set by the Copyright Royalty Tribunal in the early 1980s and the CARP/LOC 1998 \textit{Webcaster I} decision.\footnote{Id. §§ 3(a)(2)(B), 6(a)(2).} In the meantime, rates negotiated under the Webcaster Settlement Act are, contrary to the Webcaster Settlement Act itself, now accorded precedential value.\footnote{Id. § 3(a)(3)(b)(3)–(4).} In short, evidence favorable to webcasters is required to be admitted, while evidence favorable to copyright owners is \textit{a priori} inadmissible.

Third, the IRFA would have changed the makeup of the CRB itself. Judges would have no longer been appointed by the Librarian of Congress, but instead by the President with the advice and consent of the Senate,\footnote{Id. § 2(2)(B)(i).} thus ensuring that the filling of every vacancy would become a vehicle for a political contest between the interested parties. Of equal concern is that the qualifications of the judges themselves would have been changed, removing the current requirement that one of the three judges have a significant knowledge of economics and another have significant knowledge of copyright law.\footnote{Id. § 2(2)(B)(i).} In the future, judges would be required simply to have ten years of experience in arbitration or litigation—that is, to be process experts rather than substantive ones.\footnote{Id. § 2(2)(A).}
At the end of the day, there is no question that, as Villasenor claims: the “obvious consequence” of imposing the 801(b) standard “would be lower rates for webcasters.”237 As discussed below, however, forcing copyright owners to effectively subsidize webcasters through artificially low royalties is neither necessary to promote the growth of online music nor desirable from the perspective of innovation or consumer welfare.

B. The IRFA Is Not Necessary to Ensure a Vibrant Market for Online Music

The market for online music is intensely vibrant and growing rapidly.238 Tens of thousands of new listeners are signing up to services like Pandora and Spotify every week, and existing listeners are using the services more and more intensely every year.239 Online advertising revenues are growing 30% per year,240 new firms are entering the market, and existing firms are garnering billion dollar market valuations.241 As Villasenor puts it, “The future of music distribution is clearly digital.”242

Against this reality, the IRFA proponents argue that webcasters need the below-market rates and guaranteed profits the legislation would provide in order to “grow and evolve.”243 Moreover, they argue, the current system is broken because the “onerous” WBWS standard can result in webcasters paying a

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237 See Villasenor, supra note 202, at 13.
238 Ryan Faughnder, iHeartRadio, Spotify Lead User Growth as Apple Unveils Streaming, L.A. TIMES (June 11, 2013), http://commcns.org/1hDk7NJ.
239 Id.
240 See infra Figure 4.
241 Ingrid Lunden, Digital Ads Will Be 22% of All U.S. Ad Spend in 2013, Mobile Ads 3.7%; Total Global Ad Spend in 2013 $503B, TECHCRUNCH.COM (Sept. 30, 2013), http://commcns.org/1jN9BmX (“In the U.S. . . . digital [advertising] in 2013 will account for 21.8% of all ad spend ($109.7 billion), up from 19% the year before.”). For example, in Los Angeles, California—“the vanguard of the ad evolution”—new boutique online advertising firms are steadily setting up shop, with some quickly reaching hundreds of millions in billings. Meg James, DIGITAL DISRUPTION; Ads in a Digital Age; Westside Firms Such as Omelet, Ignited and Blitz are Pushing Clients Beyond TV and Print and Onto the Internet, Smartphones and Tablets, L.A. TIMES, July 8, 2012, at B1. Research suggests that the “online advertising industry trades with an average price-earnings ratio of 28.2x compared to the S&P 500’s 16.2x price-earnings ratio [and its] stocks may be as much as 74% more expensive than the average U.S. stock.” Finding Value in the Growing Online Advertising Industry, MARKETWATCH (Apr. 3, 2013), http://commcns.org/MJJSzM.
242 See Villasenor, supra note 202, at 17.
higher percentage of their revenues in royalties than other firms, including in particular Sirius XM. 244 Neither argument withstands even cursory scrutiny.

First, the current copyright regime is not preventing the online music industry from “growing and evolving” at a rapid pace. Online radio is a two-sided market, involving both listeners (who, depending on the business model, may also be subscribers) and advertisers. 245 Both sides of the market are growing explosively. 246 For example, Figure 2, below, shows the proportion of Americans who have listened to online radio in the past 30 days from 2002 through 2012. Growth throughout the period has been rapid but has accelerated in recent years, with listenership rising by nearly 44.44% in just the last two years. 247

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244 See Villasenor, supra note 202, at 1–2; see Black, supra note 243.

245 Two-sided markets “coordinate the demands of distinct groups of customers who need each other in some way. . . . [F]or example . . . magazines provide a way for advertisers to find an audience . . . .” David S. Evans, The Antitrust Economics of Multi-Sided Platform Markets, 20 YALE J. ON REG. 325, 325 (2003).

246 “Weekly online radio reaches an estimated audience of 76 million in 2012; this 30% increase is the largest year over year spike in weekly usage we have seen since we began measuring the platform in 1998.” ARBITRON/EDISON RESEARCH, THE INFINITE DIAL 2012: NAVIGATING DIGITAL PLATFORMS 8 (2012) [hereinafter THE INFINITE DIAL 2012], available at http://commcns.org/1ksNW6C. “[T]he online advertising industry is rapidly growing . . . [as advertisers are] looking for a better return on investment [and] increasingly moving . . . to highly targeted online ads.” Finding Value in the Growing Online Advertising Industry, supra note 241.

247 The percentage of American online radio listenership grew from 27% to 39% between 2010 and 2012, an increase of slightly more than 44%. THE INFINITE DIAL 2012, supra note 246, at 8.
As Figure 2 shows, an estimated 103 million Americans, or 39% of the entire U.S. population aged 12 and older, now tune into some form of online radio each month.\textsuperscript{249} Similarly, the amount of time that listeners spend engaged with online radio has also increased dramatically. As shown in Figure 3, in 2012, listeners reported spending an average of 9 hours and 46 minutes per week listening to online radio, up from 6 hours and 13 minutes in 2008 (an increase of over 57\%).\textsuperscript{250}

\textsuperscript{248} Adapted from information provided by Edison Research/Arbitron. See id.  
\textsuperscript{249} Id.  
\textsuperscript{250} Id.
Not surprisingly, the rapid growth in listenership is leading equally to rapid growth in advertising revenues. Overall, online advertising is the fastest growing category of advertising worldwide, growing at 7.2% over the past year. As shown in Figure 4 below, online radio advertising is growing even faster: According to SNL Kagan, online radio advertising revenues will approach $400 million in 2012, and are projected to grow at a compound annual rate between 12 and 14% over the next decade.

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251 Figure 3 is based upon information in Edison Research/Arbitron’s report. Id.
252 Finding Value in the Growing Online Advertising Industry, supra note 241.
253 See NIELSEN, QUARTER 2 2012: GLOBAL ADVIEW PULSE LITE 8 (2012), available at http://commcns.org/ldtlnD8 (reporting that “Online ad spend (specifically display advertising) contributed to the [advertising] growth momentum around the globe, with a +7.2 percent increase recorded globally”).
254 See SNL KAGAN, MOBILE AD NETWORKS BY REVENUE, UNITED STATES 98 (2011) (on file with author).
The rapid growth of the industry has translated into financial success for existing firms and the entry of new ones.\footnote{Derived from information in SNL Kagan’s report, \textit{MOBILE AD NETWORKS BY REVENUE}. See \textit{id}. Figure 4 includes online/mobile ad revenues from Internet Music and Radio Pureplays—for example, AccuRadio, AOL Radio, Goom Radio, Last.fm, Live 365, MOG, Pandora, Slacker, Stitcher, Turntable.fm, and Yahoo! Music. \textit{id}.} Pandora, which is by its own account the “leader in internet radio in the United States,” with a dominant market share of 69%, has been the biggest beneficiary.\footnote{See \textit{Finding Value in the Growing Online Advertising Industry}, supra note 241.} As shown in Figure 5

\footnote{See \textit{Pandora Media, Inc., Annual Report (Form 10-K)}, at 41 (Mar. 12, 2012) [hereinafter \textit{Pandora 2012 Form 10-K}]. Pandora states, in its 10-K, that: Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. In January 2012, we had over 125 million registered users, which we define as the total number of accounts that have been created for our service at period end, and we added two new registered users every second on average. For the fiscal year ended January 31, 2012, we streamed 8.2 billion hours of radio and as of Jan-}
below, Pandora’s annual listener hours have more than quadrupled in the last two years, from 1.8 billion to 8.2 billion.\textsuperscript{258} Revenues over the same period have grown even faster, from $55.2 million in 2010 to $274.3 million in 2012.\textsuperscript{259}

\begin{figure}
\centering
\includegraphics[width=0.5\textwidth]{pandora_listener_hours.png}
\caption{PANDORA ANNUAL LISTENER HOURS (BILLIONS), 2010–2012}
\end{figure}

Much of the rapid growth that has occurred in the past few years is associated with the rapid adoption of smartphones and the accompanying increase in mobile consumption of digital media.\textsuperscript{261} For example, as shown in Figure 6

\textsuperscript{258} Id. at 40.
\textsuperscript{259} Id. at 43.
\textsuperscript{260} Figure 5 is based upon information in Pandora’s Form 10-K, filed in 2012. Id. at 40.
\textsuperscript{261} Pandora says that mobile devices are “an emerging phenomenon” and that the “number of listener hours on mobile devices has surpassed listener hours on traditional computers, and [it] expect[s] that this trend will continue.” Id. at 14.
below, Pandora reports that as of 2012, nearly two thirds of all listening hours are accounted for by mobile devices.\textsuperscript{262} Notably, SNL Kagan reports that in 2011, Pandora was the fifth largest U.S. mobile ad network by revenue, ranking behind only Google, Apple, Facebook and Twitter, and was growing at 476\% annually, far faster than any of the other top 25 firms.\textsuperscript{263}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{pandora_listening_hours.png}
\caption{Percentage of Total Pandora Listening Hours Accounted for by Mobile}
\end{figure}

As a result of its rapid growth, and of market expectations that it would continue to prosper in the future, Pandora successfully “went public” in 2011, garnering large payoffs for its early investors.\textsuperscript{265} The firm now trades on the New York Stock Exchange.

\begin{itemize}
  \item \textsuperscript{262} Pandora reports that it’s “mobile listenership has experienced significant growth” and “constitute[s] approximately . . . 65\% of [it’s] total listener hours for fiscal year[.] . . . 2012.” \textit{Id.}
  \item \textsuperscript{263} See SNL KAGAN, supra note 254, at 98.
  \item \textsuperscript{264} Figure 6 is adapted from information in Pandora’s 2012 Form 10-K. \textit{Pandora 2012 Form 10-K}, supra note 257, at 14.
  \item \textsuperscript{265} In June 2011, Pandora’s stock “rose 8.9 percent [by virtue of] its debut on the New York Stock exchange,” selling “14.7 million shares . . . [and] raising $234.9 million in its
York Stock Exchange under the symbol “P.” As of March 2, 2014, Pandora had an Enterprise Value of $7.04 billion.

Pandora’s defenders argue, however, that the company has not yet achieved profitability, and that “extremely high royalty burdens” are to blame, with content costs accounting for 69% of revenues. The situation would be even worse, they warn, if Pandora and the other webcasters currently covered by the Webcaster Settlement Act agreement were forced to pay the (higher) rates determined by the CRB in Webcaster III. There are several problems with these arguments. First, the fact that Pandora has not yet achieved profitability is hardly a surprise. Other successful online firms, including Facebook, Google, Vonage and many others, have taken years to achieve profitability: some have yet to do so. There is a good reason for this: Internet markets are characteristically


267 Villasenor, supra note 202, at 11.

268 For example, Pandora’s revenue is derived primarily from advertising: listener hours drive advertisement opportunities (inventory), attracting advertisers depends largely on a sufficient inventory, and revenue depends on the extent the inventory can be sold. Pandora 2012 Form 10-K, supra note 257, at 42. So although Pandora’s “total revenue has grown from $55.2 million in fiscal 2010 to $274.3 million in fiscal 2012, [at the same time, [its] total cost and expenses have grown from $70.6 million in fiscal 2010 to $285.3 million in fiscal 2012, principally as a result of the growth in content acquisition expenses.” Pandora 2012 Form 10-K, supra note 257, at 43.

270 Online firms such as Facebook, Google, and Vonage all face highly competitive markets that demand quick and constant innovation. Facebook Inc., Annual Report (Form 10-K), at 10 (Feb. 1, 2013) [hereinafter Facebook 2013 Form 10-K]; Google Inc., Annual Report (Form 10-K), at 8 (Jan. 23, 2013) [hereinafter Google 2013 Form 10-K]; Vonage Holdings Corp., Annual Report (Form 10-K), at 8 (Jan. 31, 2013) [hereinafter Vonage 2013 Form 10-K]. They must build a customer base, develop their presence, and market their brand, all of which take time. See Facebook 2013 Form 10-K, supra note 271, at 13, 17; Google 2013 Form 10-K, supra note 271, at 3, 9–10, 12; Vonage 2013 Form 10-K, supra note 271, at 5, 8–9. Due to the technological nature of an online market, these online firms generally must invest significant resources into staffing, equipment, infrastructure, research and development, data management, and user privacy security—all on a continuing basis. See Facebook 2013 Form 10-K, supra note 271, at 8–11, 15–24; Google 2013 Form 10-K, supra note 271, at 3, 7–12, 14, 16–19.

272 For example, Vonage has “incurred cumulative losses since [its] inception and may not achieve consistent profitability in the future. [Although it] achieved net income of [over
acterized by network effects, meaning that firms compete (in what is sometimes referred to as a “land grab strategy”) to achieve critical scale. While it is thus typical for firms like Pandora to invest in customer acquisition for an initial period before becoming profitable, there is no economic or public policy rationale for forcing their suppliers to subsidize such strategies.

Second, while Pandora’s content acquisition costs have indeed grown rapidly, they have not grown as rapidly as its revenues or, for that matter, as its overhead. As shown in Figure 7 below, Pandora’s content acquisition costs have grown by 351% over the past two years. Yet, its revenues have increased even faster, by nearly 400%, while its administrative and overhead expenses have grown even faster, by 457% over the past two years.


273 As the D.C. Circuit noted, “In markets characterized by network effects, one product or standard tends towards dominance, because ‘the utility that a user derives from consumption of the good increases with the number of other agents consuming the good.’” United States v. Microsoft Corp., 253 F.3d 34, 49 (D.C. Cir. 2001). Continuing, the court said, “For example, ‘[a]n individual consumer’s demand to use (and hence her benefit from) the telephone network . . . increases with the number of other users on the network whom she can call or from whom she can receive calls.” Id. Furthermore, the D.C. Circuit observed, “Once a product or standard achieves wide acceptance, it becomes more or less entrenched. Competition in such industries is ‘for the field’ rather than ‘within the field.’” Id.

274 JEFFREY H. ROHLFS, BANDWAGON EFFECTS IN HIGH-TECHNOLOGY INDUSTRIES 9, 14 (2003); see also Pandora Media, Inc., Registration Statement (Form S-1), at 17 (Feb. 11, 2011) (“Since our inception in 2000, we have incurred significant net operating losses and as of October 31, 2010, we had an accumulated deficit of $83.9 million. A key element of our strategy is to aggressively increase the number of listeners and listener hours to increase our market penetration.”).

275 See Pandora 2012 Form 10-K, supra note 257, at 47.

276 Id.
Third, while Pandora makes much of the fact that content acquisition accounts for a large proportion of its revenues,\(^\text{278}\) in fact its content costs as a proportion of revenues are comparable to other, similar firms.\(^\text{279}\) For example, while Netflix offers video rather than audio, and its revenues come more from subscriptions than from advertising, its basic business model—offering on-demand audio-video content over the Internet while minimizing its own infrastructure costs\(^\text{280}\)—is very similar to Pandora’s.\(^\text{281}\)

As shown in Figure 8 below, the proportion of revenues accounted for by content costs for Netflix and Pandora have been nearly identical over the last

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277 Figure 7 uses information in Pandora’s 2012 Form 10-K. Id.
278 Id. at 43.
279 For example, in the years 2010 and 2011, Pandora’s content acquisition expenses accounted for 60% and 50% of its revenues, respectively. Id. at 47. For the same years, Netflix reported its cost of revenues (the bulk of which was content acquisition expenses) as 62.6% and 61.9% of its revenues, respectively. See Netflix, Inc., Annual Report (Form 10-K), at 23–24 (Jan. 31, 2013).
281 *In a Dysfunctional Industry, Pandora Seeks an Algorithm for Profitability*, FORBES (Aug. 15, 2013 4:01 PM), http://commcns.org/1ksQOjF.
three years (2009–2011). Indeed, for each of the last two years, Netflix has paid a higher proportion of its revenues for content acquisition than has Pandora.

![FIGURE 8](content_costs.png)

**FIGURE 8**

**CONTENT COSTS AS A PERCENTAGE OF REVENUES**

**PANDORA VS. NETFLIX, 2009–2011**

It is noteworthy that, like some of Pandora’s competitors in the audio market, Netflix does not benefit from a compulsory license, but instead relies on

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282 See Peoples, supra note 280.

283 More broadly, it is commonplace for digital music distributors of all stripes to pay 60% or more of their revenues for content. See Steve Knopper, *The New Economics of the Music Industry*, *Rolling Stone* (Oct. 5, 2011), http://commcns.org/1kQaE5s.

284 Adapted from information in the Form 10-K filings of Pandora and Netflix. See *Pandora 2012 Form 10-K*, supra note 257; Netflix, Inc., Annual Report (Form 10-K) (Feb. 10, 2012). Pandora reports “content acquisition costs” in its annual 10-K filings. According to Pandora’s 2012 10-K, “Content acquisition expenses principally consist of royalties paid for streaming music or other content to our listeners. Royalties are calculated using negotiated rates documented in master royalty agreements and are based on both percentage of revenue and listener metrics.” See *Pandora 2012 Form 10-K*, supra note 257, at 56. Netflix reports “cost of subscription” data in its annual 10-K filings. According to the company’s 2012 10-K, “Cost of subscription revenues consists of expenses related to the acquisition and licensing of content, as well as content delivery costs.” See Netflix, Inc., Annual Report (Form 10-K), at 28 (2012 filing).
negotiating contracts with content owners on a voluntary basis. And while the firm has had some stumbles over the past year, its market capitalization in late 2012 stood at over $4.4 billion. As of November 2012, the firm was fighting off a takeover bid by investor Carl Icahn, who believes it is undervalued, notwithstanding the fact that it pays over 50% of its revenues for content.

Fourth, and finally, Pandora’s claims of impending doom with respect to content costs are belied by the fact that other firms are rapidly entering the market to compete with it. As it reports in its most recent 10-K, “the audio entertainment marketplace continues to rapidly evolve, providing our listeners with a growing number of alternatives and new media platforms.” Among its competitors: Last.fm, iHeartRadio, and Slacker Personal Radio. Recent entrants including Rdio, “a rival streaming service created by the founders of Skype,” and Spotify, which has four million subscribers worldwide paying $10 per month for the right to access music online and was recently valued at $3 billion. As of late 2012, reports indicated that Apple was also preparing to enter the market for online radio.

The flood of new participants in the online music business is important for two reasons. First, these firms (and their investors) obviously do not share Pandora’s gloomy forecasts regarding their ability to earn a fair return on investment. Second, and at least equally important, many of these firms—including, for example, Spotify—are not eligible for the compulsory license at all, and thus have no choice but to negotiate copyright agreements in the marketplace. According to reports, Apple may choose to enter the online radio

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287 See Pandora 2012 Form 10-K, supra note 257, at 56.

288 Bryan M. Wolfe, Comparing iTunes to Pandora, Spotify, and Other Streaming Music Services, APPADVICE (June 11, 2013), http://commcns.org/1cxZMEr.

289 See Andy Fixmer & Adam Satariano, Apple’s Online Radio Service to Challenge Pandora in 2013, BLOOMBERG (Oct. 26, 2012), http://commcns.org/1i8pxTr.


292 See Fixmer & Satariano, supra note 289.

market through negotiated contracts, eschewing the compulsory license altogether.294

The fact that other firms see opportunities to profit in the online music marketplace suggests to some that Pandora needs to take a closer look at its business model.295 As noted above, online music is a two-sided market, with some (and sometimes more or, even, all) of the revenues coming from advertisers. Yet, if a firm like Pandora is engaged in a land grab strategy designed to maximize its market share in the short run in order to capture economies of scale, too much advertising risks driving consumers to competitors.296 A number of analysts have noted that Pandora has failed to monetize fully its large and growing audience.297 As one well-respected journalist put it, “Throughout the music industry there is a wide belief that Pandora could solve its financial problems—the company, which went public a year ago, has never turned an annual profit—by simply selling more ads.”298

To summarize, Pandora’s argument that royalties need to be reduced in order to preserve a healthy market for online music is simply not consistent with the facts. The market is vibrant and growing, and expected to continue to grow and evolve in the future. Pandora has been a major beneficiary of that growth, and while it would prefer to pay less for inputs into its production process, there is no public policy basis for forcing content creators to subsidize it or other webcasters by setting royalties at below-market rates.

294 See Fixmer & Satariano, supra note 289.
295 Paul Resnikoff, Why Pandora Will Be Dead by 2018, DIGITAL MUSIC NEWS (June 10, 2013), http://commcns.org/1hDq8tK.
297 Kyle Bylin, Can Pandora Find a Business Model That Works, SIDEWINDER.FM (May 10, 2013), http://commcns.org/1fDcvFN.
298 See Ben Sisario, Proposed Bill Could Change Royalty Rates for Internet Radio, N.Y. TIMES, Sept. 24, 2012, at B2; see also Richard Greenfield, Congress Should Be Working to Raise Royalty Rates on Pandora, Not Lower Them, BTIG RES. (Sept. 24, 2012), http://commcns.org/1l0CgTW (“[T]he reason why companies such as Pandora pay such high royalty rates as a percentage of revenues is because they severely limit audio advertising to protect the user experience and keep people on the platform. If Pandora ran several minutes of audio ads per hour (the way terrestrial radio does) vs. just a few 15 sec. spots, the % of revenues paid out as royalties would be dramatically lower and would be more in line with satellite radio or cable TV. Interestingly, Spotify’s radio product runs substantially more advertising per hour than Pandora.”).
C. The IRFA Would Exacerbate Market Distortions, Reduce Incentives to Create Content, Slow Innovation, and Harm Consumers

The IRFA is advanced by its proponents on grounds that it would create a level playing field for users of sound recording rights, increase revenues to artists and record labels, and even promote innovation. 299 Each of these claims is incorrect. In fact, on each count, the opposite is true.

First, while it is accurate that the sound recording performance right currently does not use the same rate standard for all users and in all markets, 300 it is inaccurate to argue that the IRFA could improve the situation. Currently, interactive services are subject to the sound recording performance right (but have no compulsory license); PSS and SDARS are subject to the 801(b) standard; webcasters, simulcasters and new subscription services are subject to WBWS; and terrestrial broadcasters are exempt altogether. 301 AM/FM radio stations pay royalties when they “simulcast” sound recording performances over the Internet, but pay nothing to “broadcast” them over the airwaves. 302 The goal of creating a more level playing field is a desirable one, but the IRFA would hardly achieve that purpose. By lowering rates to non-market levels for non-interactive users like Pandora, it would widen the gap between firms like Pandora and interactive webcasters, like Spotify, who arguably are their closest competitors. At the same time, it would do nothing to rectify the imbalance between terrestrial broadcasters and all other users, as the former would continue to be exempt. 303 From an economic perspective, the IRFA would not ame-

300 Public Performance Rights for Sound Recordings Fact Sheet, FUTURE MUSIC (Jan. 28, 2011) http://commcns.org/1gNT8MI.
301 17 U.S.C. § 114(d)(1)(A); see David Oxenford, Copyright Royalty Board Approves Settlement for Sound Recording Royalty Rates for “New Subscription Services” - Any Hints As to What A Broadcast Performance Royalty Would Be?, BROADCAST L. BLOG (Mar. 25, 2010), http://commcns.org/1hHnEtN; see also David Oxenford, Copyright Royalty Board Releases New Rates for Sirius XM and Cable Radio - They are Going Up, Full Reasoning of the Decision to Come?, BROADCAST L. BLOG (Dec. 17, 2012), http://commcns.org/1g5KSWH.
303 158 Cong. Rec. at S6628 (statement of Sen. Wyden) (“[The IRFA] would . . . treat Internet Radio, for purposes of establishing royalty rates, in the same way that satellite and cable radio are treated.”).
lorate, and might have exacerbated, the economic distortions associated with the current system.

It is informative, in this regard, that the IRFA’s proponents are unable to proffer a policy-based rationale, let alone an economically plausible one, for leaving the terrestrial exemption in place. For example, the only rationale Villasenor offers for not extending the sound recording performance right to over-the-air terrestrial broadcasters is a political one: “legislation including a provision ending the terrestrial broadcasters exemption would be likely to fail.”304

Second, the argument that artists and record labels would be better off under artificially low rates fundamentally ignores the economics of two-sided markets, in which firms like Pandora act as intermediaries between consumers, advertisers and content providers. In such markets, market rates strike the correct balance between the quantities provided on each side of the market. The efficient outcome, in other words, is the one that occurs when all market participants face market prices. As the CRB has said, “We agree with Dr. Ordover that ‘voluntary transactions between buyers and sellers as mediated by the market are the most effective way to implement efficient allocations of societal resources.’”305 Indeed, even some of the IRFA’s proponents appear to recognize the flaw in this argument, acknowledging that “while rates that are too high can be punitive, so can rates that are too low, as they shortchange the content creators on which the entire music broadcasting industry depends.”306 It is crucial to remember, in this regard, that a significant proportion of performance rights royalties flow through to the performers.307 Thus, the cross-subsidies granted to webcasters under the IRFA would come not just from the record labels, but from the artists themselves.

Finally, the argument that the IRFA, by imposing a non-disruption criterion on the rate setting process for a vibrant, rapidly changing digital music distribution industry, would enhance innovation,308 is as misguided upon close examination as it seems upon first blush. While it is true that “[o]ne obvious consequence of broadly applying § 801(b) would be lower royalty rates for

304 See Villasenor, supra note 202, at 13.
305 See SDARS I, supra note 15, at 4094.
306 See Villasenor, supra note 202, at 15.
307 See 17 U.S.C. § 114(g)(2)(B)-(D) (mandating that 50% of statutory performance royalties for sound recordings go to the artists); see also Public Performance Rights for Sound Recordings, supra note 300.
308 See Villasenor, supra note 202, at 1, 2 (“It also furnishes a strong disincentive to potential new market entrants and to the introduction of innovative new business models for delivering digital music.”).
webcasters," it does not follow that lower rates would cause webcasters to be more innovative. To the contrary, imposing a non-disruption standard would protect \emph{incumbent} webcasters from competition and innovation by demanding that rates be set so as to provide a guaranteed profit on both previous and new investments. This is the stuff of public utility regulation, not the dynamic Internet, and it would retard innovation, not advance it. As Dr. Janusz Ordover put it in his expert testimony in the ongoing SDARS II proceeding: "[T]he fourth policy factor . . . should never be used to shield the service at issue from the full rigors of vigorous marketplace competition. Doing so is likely to harm consumers and also impede (or deter) entry and expansion of rival services."

To summarize, the primary purpose of the IRFA, and one of its certain effects, was to produce below-market royalty rates for one class of online music distributors, providing its beneficiaries with a \emph{de facto} cross subsidy. Further, the IRFA would have locked in the resulting profits by guaranteeing webcasters a return on both existing and future investments. The asserted public policy justifications for these proposed market interventions are without merit; indeed, the IRFA would have distorted markets, retarded innovation, and, ultimately, deprived consumers of the benefits associated with competition and free markets.

V. SUMMARY AND POLICY RECOMMENDATIONS

The current sound recording performance right is imperfect, most notably because of the distortions associated with the fact that it does not apply to terrestrial broadcasters. Over the course of nearly 20 years, however, Congress

\footnote{Id. at 2.}

\footnote{Again, even the IRFA’s supporters acknowledge this problem. See id. at 15 ("[I]f due to technological obsolescence, poor management, or other factors, a legacy company had poorer EBITDA prospects than a new market entrant, would the fourth 801(b) factor be employed as a protectionist measure to prop up the legacy company.").}

\footnote{Testimony of Janusz Ordover at 5–6, \emph{In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, No. 2011-1 CRB PSS/Satellite II} (Copyright Royalty Bd., July 2, 2012), \textit{available at} \url{http://commcnr.org/OU8m8}. To the extent lower rates increased potential profits for non-interactive webcasters, they might attract entry. However, such entry would be of the "copycat" variety, spawned by the desire to take advantage of the arbitrage opportunity created by below-market rates.}

\footnote{For a more comprehensive treatment of the arguments in favor of the sound performance rights for terrestrial broadcasters, see Sunny Noh, \emph{Better Late than Never: The Legal Theoretical Reasons Supporting the Performance Rights Act of 2009}, \textit{6 Buff. Intell. Prop. L.J.} 6, 83 (2009).}
has moved gradually in the direction of expanding the sound recording right and, in so doing, increasing the role of market forces in allocating the economic resources used to produce, distribute and consume musical entertainment. As long as government remains enmeshed in the process of setting rates, there will be calls from interested parties for Congress to intervene on their behalf. Such calls should be seen, however, for what they are, and resisted. There is no public policy case in favor of the IRFA, only a political one.