

A Full, Fair And Feasible Solution To The Dilemma of Online Music Licensing¹

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I. Introduction

Practically no one is satisfied with the rules governing online use of copyrighted musical works and sound recordings. Rights holders believe that the rules are inadequate to protect their ability to sell recorded music. Information technology firms and consumer electronics makers are concerned that they will not be permitted to develop new media or new markets. Webcasters are being driven out of business by statutory license fees that exceed their gross revenues. Those who survive must operate with unprecedented program content restrictions. And consumers are alarmed that the rules will expose them to liability for enjoying music when, where and how they want.

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Despite the growing conflict between the music industry and each of these other groups, their interests are not necessarily incompatible. It is possible simultaneously to protect the integrity of copyrights, promote technological innovation, facilitate the growth of digital audio services, and meet consumer demand.

The problem is, however, that because of the Internet it will not be possible to prevent the widespread unauthorized distribution of recorded music in digital form. This, in turn, jeopardizes the music industry's \$40-plus billion dollars in annual worldwide revenue from the sale of recordings.

The industry has responded with legislative proposals, technological access restrictions and anti-copying measures, and infringement litigation. Nonetheless, digital music piracy is on the increase and CD sales are in decline. It appears that the only effect -- if not the intent -- of the industry's strategy has been to thwart development of a lawful market for the online use of music.

Simply put, the music industry soon may no longer be able to sustain its traditional sales-based revenue model. Neither law, nor technology, nor moral suasion will suffice.

An alternative to the sales-based revenue model is needed for online uses of music; an approach to rights management that will not depend on access restrictions or anti-copying technology for its success; one that is structured specifically to accommodate the changed circumstances imposed on the music industry by the emerging global digital network.

I suggest this:

- Congress should create an online transmission right for musical works and sound recordings. This new right would replace the now-existing reproduction, performance and distribution rights in these works for online purposes only.
- Licenses under the online transmission right would authorize all acts cognizable under the Copyright Law that may be involved in transmitting music to end users. Licenses would be granted without regard to the conduct of end users: It would no longer matter whether consumers only listened to online transmissions or also downloaded them.
- The online transmission right should be subject to a statutory license and administered by a single rights collective on behalf of all rights holders of musical works and sound recordings.
- Rights holders and service operators must cooperate in the development and deployment of a uniform rights management system for monitoring which works were transmitted and by whom. To this end, rights holders would identify the works in which they claim protection. They would also provide a technological means for marking individual works and tracking them when transmitted online. For their part, service operators wishing to qualify for the statutory license must ensure that they only transmit properly marked works and that they keep track of the works they transmit.
- The statutory license fee for each service would be based on its revenue or its operating expenses, whichever is greater. Adjustments could be made to

the fee to reflect differences among services in the prominence of their use of music as well as in the relative proportion of copyrighted and public domain works they transmit. Within this framework, the statutory license fee rate could be set by voluntary negotiations between the rights collective and service operator representatives. Failing voluntary agreement, the rate would be established by government-supervised arbitration following an evidentiary hearing.

- In addition, a flat monthly license fee would be charged for members of peer-to-peer file sharing networks and similar online communities wishing to avail themselves of the statutory license.
- Royalty distribution would be based on a full census of licensed transmissions. In this way, royalty payments would correspond precisely with online transmissions and they would be made only to those rights holders whose works were actually transmitted by licensed services. Disputes regarding royalty distribution could be settled either by voluntary agreement or by arbitration.

An online transmission right, collectively administered, and subject to a statutory license, is the best model for the administration of online rights in music and sound recordings. By these means, the ongoing public policy deadlock over the online use and protection of music could be broken and an online marketplace for music could flourish.

A fuller explanation of the need for an online transmission right, as well as the details of its implementation, follows.

II. The Music Industry's Sales-Based Revenue Model Will Soon No Longer Be Sustainable

Internet transmissions are instantaneous and worldwide in scope. This changes the dynamics of record piracy. Previously, large-scale piracy required an organizational infrastructure, production facilities, distribution channels and lots of money. It was cumbersome at best and vulnerable at every turn to the industry's anti-piracy campaigns. Also in the past, the copying and distribution of recordings by individual consumers, while troubling, never imperiled the industry.

Today, record piracy is cheap, quick and easy. Every Internet user, every member of a peer-to-peer file sharing network and every service operator in the world is a potential source for the unauthorized mass distribution of music. Many of these may be beyond the ready reach of lawful process. Accordingly, rights holders are preparing for future anti-piracy campaigns that will pit the industry directly against consumers regarding conduct occurring in the privacy of people's homes.

The industry's exposure is greatest for "legacy" recordings. Nearly all recorded music has already been distributed by the record labels in digital format through the sale of CDs. Anyone can turn these works into digital audio files and distribute them on the Internet in unprotected form. Whatever technological fixes the industry may devise for newly made recordings cannot protect works already in the public's hands.

Even encryption may not protect new works from uncompensated distribution. Technological anti-copying measures beget countermeasures, and news of a successful hack will be available immediately to anyone who cares to know it.

Reliance on a succession of technological measures has proven unavailing. There is no reason to believe that the result will be different next time, or ever.

The industry takes comfort in the observation that most consumers walk past the vendor selling CDs at the card table on the street to pay more in retail stores for licensed products. It is believed that good and honest consumers will continue to do the right thing in the online context; and that, in any event, they will continue to demand the highest quality merchandise.

It remains to be seen whether consumers will be able to hear the difference between licensed and unlicensed digital audio files. The extent to which they will care about small differences is itself a different matter. However, even the most vigilant consumer may not be able to distinguish between services that are authorized to offer downloads and those that are not. When criminal groups – domestic and foreign – migrate to the Internet, the pirate services they launch could have the same look and feel and same sophisticated functionality as those operated by the largest entertainment companies.

It is also possible that the music industry has misjudged its customers. The public regards music differently than it does other content. Music is portable. Music is ubiquitous. Music appears to be free. Everyone is a music consumer, whether they buy CDs, go dancing or to concerts, or only listen to the radio and watch television. People develop an ownership interest in the music they most like to hear. “They’re playing our song,” is a heartfelt refrain. The psychological effect on consumers of this sense of personal entitlement to other people’s property should not be overlooked.

Compounding these enforcement problems, the industry will not likely be able to rely on a technological solution such as audio players that only operate with files containing particular codes. Not all audio is music. Not all music is copyrighted. And not all rights holders want to limit online uses of their works. Moreover, because ownership of rights in music and in recordings may change hands often, a decision to limit online uses of particular works in response to today's market circumstances may become a decision binding on all subsequent owners of those rights for all time and under all circumstances.

In addition, "copyright friendly" audio players may raise "fair use" and free speech concerns depending on whether and how they impede individuals from communicating with each other. Obviously, if given the opportunity, consumers would choose devices that accept all works.

The music industry depends heavily on the sale of hit records. However, through the Internet, the market for distribution by sale of individual recordings can be ruined in a moment's time and without payment of any royalties to songwriters, music publishers, recording artists or record labels. By the time a rights holder discovers that its newly released recording is being distributed unlawfully online, notifies the service operator demanding "takedown", and obtains removal of the work from the service, the damage will have been done, the loss incurred. Under these circumstances, the industry's sales-based revenue model will soon no longer be sustainable.

Faced with these market conditions and uncertainties, the industry has struggled to extend its existing revenue model into the digital age. To this end, industry members have largely refused to voluntarily license works for online use by others. Instead, they have launched their own branded services to offer subscription-based

access to limited portions of their catalogs. These have not been well received by consumers. The industry also has turned to Congress and the courts for vindication.

This approach is understandable, especially in light of the uncertainty over how the online music marketplace will develop, what form the next technology breakthrough may take, and which licensing structure or structures will be most beneficial in the long-run. It is also uncertain what role anti-trust and competition laws may play. No one reasonably can fault such a mature industry for resisting transformation and preferring preservation of the relationships upon which its past successes have been based. However, circumstances have catapulted the music industry into the forefront where every business decision is subject to scrutiny and becomes part of the ongoing policy debate.

There is no sound reason why public policy should not support the opportunity of those who create and own copyrighted music and sound recordings to derive ample rewards from their contributions to culture and commerce. It is our obligation to secure their right to do so. By the same token, it is not reasonable for the music industry to expect public policy to support its desire to do business in a particular way.

The industry reports that its worldwide revenues from the sale of recorded music declined by approximately 15% for the eighteen-month period ending June 30, 2002. It attributes this decline, in substantial part, to those aspects of the global digital network and other new technologies that are beyond its control. Others question the contribution these factors may have made. In either event, the decline may well have been sharper had the industry not pursued its legislative agenda and campaign of enforcement litigation.

Nevertheless, whatever short-term benefits the industry might gain from its current approach, it will prove self-defeating in the long-run. The strategy will not meaningfully reduce the threat of unauthorized distribution of recorded music. Consumers continue downloading and copying music from online services; and unlicensed peer-to-peer file sharing networks are proliferating. And because its strategy is necessarily reactive, the industry will always lag behind its latest challenge.

On the other hand, the strategy has stymied American technology firms in their deployment of high-speed broadband connections for the consumer market. Consumers, it turns out, are reluctant to pay higher monthly access fees when rights holders will allow so little sought-after content to be made lawfully available. Similarly, consumer electronics makers, fearing liability, have been reluctant to market new devices and systems with next generation capabilities. And for it all, the industry's strategy has resulted in fewer licensed uses of fewer works and slowed the growth of royalties that those in the industry otherwise may have earned.

III. Congress Should Create An Online Transmission Right For Musical Works And Sound Recordings

The Internet and other digital media will maximize the opportunity for music to be used and for rights in music to be licensed. But technology may render certain traditional rights unenforceable and blur the distinction between others. New definitions of rights are needed to meet these newly arising circumstances.

Prior to the Internet, public performances, as such, only involved the public performance right in musical works. They did not involve the licensable

reproduction or distribution of music or any rights at all in sound recordings. Similarly, the making and distribution of recordings did not involve public performances.

Streaming media and the ability of end users to download and retain perfect digital copies permit, for the first time, the simultaneous exploitation of the performance and distribution rights in songs and in the recordings that embody them. In addition, the loading of music onto a server's hard drive and the incidental, transitory copies made in the course of transmissions to end users may count as the reproduction and distribution of both the songs and the recordings involved.

As a practical matter, it may not be possible to know whether end users only listen to online performances or also download them. Nevertheless, knowing specifically what end users are doing in each instance is key to licensing the performance and distribution rights separately -- as had been the practice prior to the Internet, and as continues to be with analog and other non-Internet uses.

Not knowing which rights are being exploited in a particular transmission has driven rights holders to increasingly great lengths to justify their online licensing practices. For example, music publishers find a licensable performance in every download and the distribution of copies in every performance. The performance rights organizations, such as ASCAP and BMI, which license public performances of the copyrighted musical works owned by their publisher members, assert that every transmission of a musical work constitutes a performance of that work, even if the music was transmitted only for downloading and was inaudible as it was being sent. They seek to charge license fees for these unheard "performances" even though their publisher clients also collect mechanical (reproduction and distribution) license fees for the same transmissions.

In addition, publishers seek to impose mechanical license fees even if no permanent downloads are involved and the only “copies” made are transitory and incidental to transmissions that are nothing more than performances. They are especially concerned that "on-demand" streaming may substitute for record sales and, therefore, eliminate the rationale for the publishers' mechanical license fee.

When Congress passed the Digital Millennium Copyright Act ("DMCA") in October 1998, its stated purpose was twofold: First, to ensure that rights holders would be protected as new technologies affected the ways in which their creative works were used; and second, to create fair and efficient licensing mechanisms that address the complex issues facing rights holders and rights users as a result of the rapid growth of digital audio services. See, H.R. Conf. Rep. No. 105-796, 105 Cong. 2d. Sess., at 79 (1998). Neither goal has been achieved. Congressional intent was thwarted by an on-rush of circumstances that no one foresaw.

Congressional action is again required. This time, however, Congress should take a different approach. It should consider aggregating the separate rights of music publishers and record labels in their respective works and creating hybrid online transmission rights for music and sound recordings. These new rights would subsume the parties' now-existing reproduction, performance and distribution rights. Licenses under the online transmission right would authorize every act cognizable under the Copyright Law that may be involved in transmitting musical works and sound recordings to end users.

Because the distribution and performance rights would no longer have independent existence, the online transmission right could be licensed without regard to the conduct of end users. It would not matter if they copied or only listened to transmissions. It would not matter if they shared. It would not be necessary to

know how many copies, if any, were made in the course of a transmission. Nor would it matter whether transmitted copies were temporary or permanent.

Moreover, unlike the distribution right, but like the performance right, the online transmission right could not be subverted by a single unlicensed service operator, Internet user, or peer-to-peer file sharing network. Whether or not particular transmissions were licensed would not affect the market for the online transmission right over all.

The experience of music performance rights organizations proves this point. ASCAP and BMI license radio stations for over-the-air broadcast performances of the musical works in their respective catalogs. The broadcast license fees they collect compose a major portion of their total annual revenue. However, even if the largest radio station or group was not licensed at a particular time, the rights organizations' ability to license the nation's thousands of other broadcasters would not be impaired. People would continue to tune to their local stations to hear their favorite songs over and over again; and the overwhelming majority of broadcasters would continue to operate lawfully by securing the public performance rights they need. Those who act outside the law can be sued for copyright infringement; and the courts should continue to require infringers to pay more in damages and other costs than they would have paid in license fees.

Finally, an online transmission right would not depend on the efficacy of exclusionary technology for its success. Far from needing to limit access to their works, rights holders would have an incentive to encourage the most extensive uses possible. This would free the industry from pursuit of unbreakable encryption, allowing it to focus instead on development of the monitoring techniques needed to implement its new configuration of rights.

An online transmission right would represent a major shift in leverage and economics within the music industry, and it almost goes without saying that rights holders who think they have a strong position vis-a-vis other rights holders may not be interested in negotiating alternate arrangements. Nevertheless, the policy issues involved are broader than the interests of the music industry alone. In this important area, policy should be guided by what is fair and what is feasible and what is in the best interest in the long-run for everyone involved.

IV. Online Transmissions Should Be Subject To A Statutory License

An online transmission right would enable transmissions of copyrighted music and sound recordings to be made available from a vast number of licensed sources, anytime, anywhere, to anyone with Internet access. It remains to be shown, however, specifically how this new right can form the basis of a viable marketplace for music.

As a starting point, the online transmission right should be subject to a statutory license.

In principle, voluntary market-driven licensing arrangements are to be preferred over statutory or compulsory licenses. In practice, statutory licensing or its equivalent has been standard in the music industry for decades. Of the now-existing rights in musical works and sound recordings that the online transmission right would replace, only the record labels' right to sell recordings is not already subject to statutory licensing or to court ordered mandatory licensing under anti-trust consent decrees. Given the experience to date, experimentation with a free market for online rights in music may well result in continued market failure.

There are hundreds of thousands of copyrighted musical works and sound recordings and tens of thousands of rights holders. Moreover, each of several rights holders may have an interest in any particular song or recording. Therefore, a minimum of two licenses from separate rights holders would be required for each recording of each song transmitted online. It would be impractical and unduly burdensome to require every service operator to identify, locate and negotiate with every music publisher and record label whose works the operator wishes to transmit.

The exploitation of online rights in music constitutes a new and evolving use for which licensing experience is lacking. Many rights holders already have adopted a wait and see attitude and refused to grant others online rights in their works. There is also much uncertainty over pricing. Because of this, service operators who are able to secure the rights they need have been required to pay license fees to multiple parties calculated on inconsistent bases.

A statutory license would guarantee that each qualifying service operator would receive a license for all rights in all copyrighted works it transmits. Such a “one-stop-shop” for all online music licensing needs would also reduce the transactional costs associated with rights acquisition. This savings could be shared with consumers. Moreover, a statutory license would contain fees established on an industry-wide basis through government administered arbitration proceedings. This would act as a check on excessive license fees and so-called "double dipping." It also would standardize license fee calculation and reporting and payment procedures and further decrease the administrative cost of compliance.

Rights holders would also benefit from such an arrangement. As a condition for the statutory license, service operators should be required to cooperate with rights

holders in marking works with identifying codes and tracking marked works when they are transmitted. This information will be needed to calculate statutory license fees; and it will be key to ensuring that royalties for licensed transmissions are distributed only to those rights holders who are entitled to receive them.

And finally, consumers would benefit because they would be assured full, immediate and uninterrupted access to the musical entertainment they most want.

Statutory licensing is warranted, but only a limited form of it is necessary. A parallel free market could also operate in which individual rights holders and service operators could enter into voluntary, non-exclusive license agreements on whatever terms they find acceptable.

V. The Statutory License Should Be Administered On A Collective Basis

Collective administration is the most efficient and effective way to implement the statutory license. Of the rights that the online transmission right would replace, only the record labels' right to sell recordings is not already administered -- for the most part, successfully -- by a rights collective.

Each of the existing collectives serves a narrow constituency in a divided industry. ASCAP and BMI, operating under federal court supervision, license music performance rights for their respective songwriter and music publisher members. The Harry Fox Agency acts as a clearinghouse on behalf of music publishers for compulsory mechanical licenses. And Sound Exchange, established by the Recording Industry Association of America and recently given recognition by the Librarian of Congress, administers digital performance rights in sound recordings under the DMCA statutory license for the benefit of record labels.

A separate collective should be established for the online transmission right. The collective would act on behalf of all music and sound recording rights holders to administer the new statutory license. It would seek to maximize compliance by advising service operators how to fulfill their obligations under the law and, when appropriate, initiate infringement litigation for unauthorized transmissions. It would represent rights holders in industry-wide negotiations to set and adjust license fees. If voluntary agreement on fees were not possible, the collective would present the rights holders' case in rate proceedings before the Copyright Arbitration Royalty Panel or some designated successor tribunal. In addition, the collective would analyze transmission data and distribute royalties to those rights holders whose works were transmitted pursuant to the statutory license.

Collective administration would reduce the cost to rights holders of administering online rights in music. It would allow uniform standards to be employed for marking works and tracking them when transmitted. And it would ensure that all rights holders, large and small, would benefit from online transmissions of their works.

There are, however, long-standing divisions within the music industry, particularly between music publishers and record labels regarding ownership, valuation and administration of the different rights each group owns. For example, the record labels blame music publishers, in large part, for blocking passage of a performance right in sound recordings in the United States until 1995. Music publishers, in turn, accuse record labels of substantial under-reporting and under-payment of mechanical license fees owed for songs the labels record. There is also an ongoing dispute between publishers and labels regarding the value of "timed-out"

downloads that automatically terminate the ability of end users to access music files after a pre-determined number of uses or period of time.

All of this may complicate efforts at collective administration. Nevertheless, in the digital age, and under the online transmission right, music publishers and record labels will become increasingly interdependent and will need to work cooperatively together for their mutual success.

In any event, under a statutory license, collectively administered, any marketplace disruption that may result from lingering or latent antagonism within the music industry would likely be limited to the royalty distribution phase of the rights administration process. This would have no effect on service operators, however. Those operators who qualify for the statutory license still would be guaranteed access to all covered works, and fees still would be determined through arbitration.

Nevertheless, in order to further protect the interests of individual rights holders, service operators and the public at large, and in recognition of the inherent volatility of the mix, the collective should operate in all respects on a transparent basis and be subject to judicial supervision and Congressional oversight.

VI. Digital Rights Management Requires Cooperation Among Rights Holders, Service Operators And Technology Firms

Rights management for music in the digital age begins and ends with the ability to monitor online transmissions. Knowing which works have been transmitted and by whom underlies licensing, enforcement, contract administration and royalty distribution.

Initially, it is necessary to determine who is transmitting covered works in order to know who needs a license. If a license is refused, identification of works transmitted without authorization is necessary for enforcement litigation. Once licensed, transmission data will be needed to calculate fees due. And knowing specifically which works were transmitted by each licensed service is necessary in order to know who among the rights holders is entitled to receive royalty payments.

The foundation of digital rights management is the creation of a database identifying all works that are subject to the statutory license. Neither all music nor all sound recordings are copyrighted. For example, U.S. recordings first made prior to February 15, 1972, are not subject to copyright protection. In addition, works that once were copyrighted may no longer be protected either because of the passage of time or failure of the works' rights holders to comply with technical requirements of the law. Works that are not protected by copyright would not be covered by the statutory license.

Service operators need to know which works are protected so they will know if and when they need to comply. Those who are licensed need a way to confirm that they are not paying license fees specifically for transmission of works in the public domain.

For the most part, service operators, acting on their own, will be unable to distinguish between copyrighted and public domain works. Yet, in order to avoid infringement, operators must obtain authorization before they transmit any copyrighted works. On the other hand, rights holders know precisely which of their works are protected and which are not. Under these circumstances, rights

holders should shoulder the burden of identifying the works in which they claim protection.

Rights holders must agree on a universal numbering system by which a unique identifying code would be assigned to each musical work and to each sound recording. By cross-referencing these codes with other information in the collective's database, it would be possible to determine each work's title, and to identify its writer, publisher, recording artist and record label. The reverse also is true. By knowing a work's title and the performing artist who recorded it, one could derive the relevant unique identifying code numbers.

Much of the data needed for this identification system already has been compiled. Some of it is held in databases operated by the existing rights collectives. Some is in the rights holders' own databases. Some of it is publicly available. Most of it is treated as trade secrets. Yet, all of this data must be aggregated into a single database to be made accessible through the Internet to all service operators; without it, the systematic and comprehensive monitoring of online transmissions will not be possible.

Whether or not a work is listed in the collective's database, its transmission by service operators who otherwise qualify for the statutory license should be deemed to be authorized and, therefore, not infringing. However, if a work is not listed in the database, then its transmission under the statutory license should not be subject to payment of any license fee. In any event, if a work were not listed, the rights collective would be unable to verify if or when that work has ever been transmitted; and, accordingly, the collective would have no basis to distribute royalties to rights holders of such a work for transmissions occurring during any period the work was not listed.

Rights holders who list their works in the collective's database will benefit from the statutory license to a greater degree than will those who choose not to identify the works in which they claim protection. This bias in favor of rights holders who actively participate in a uniform system of rights management flows from the nature of the global digital network itself and is not a mere formality thrown as a roadblock to protection.

Digital rights management also requires a means for physically marking audio files with codes identifying the works they contain and a means for tracking online transmissions of marked works. For this, the cooperation of service operators is essential.

The process of marking digital audio files requires access either to the files themselves or to the recordings from which they were made. Until recently no one considered it necessary to encode recordings with the data needed to track their transmission in a global digital network. Therefore, existing recordings are not marked and cannot be tracked systematically when transmitted. Even once the industry begins marking newly made recordings, the problem with previously distributed unmarked works will remain.

The solution lies with service operators. They select the works to be made available for transmission and operate or control the servers from which these transmissions originate. This places service operators in the best position to ensure that only properly marked works are transmitted.

Therefore, as a condition of the statutory license, service operators must share responsibility for ensuring that the works they transmit are properly marked. If the copy of a work that an operator wishes to transmit is not already identified, the

operator must obtain the relevant information from the rights collective's database and embed it in the file prior to transmitting it. In addition, operators must neither alter nor remove previously embedded identification codes. Transmission of works with altered codes, or works from which embedded codes have been removed, or transmission of works that are not properly marked but for which the identification codes are available from the rights collective's database, should subject the service operator to a suit for copyright infringement.

It would only be necessary for service operators to mark particular digital audio files one time. Once recorded, a work's identity is fixed: Its title, and the names of the songwriters and performing artists cannot change. Only the identity of the rights holders could be subject to change, for example, through the sale of a music publishing catalog, or the purchase of one record label by another. In the event of any such transfer of rights, the collective would modify the database to reflect the new ownership interests and, subsequently, would pay royalties to the new rights holders. However, the primary identifying code for each work involved would not have changed and there would not be any additional obligations imposed on service operators. In this way, operators could build libraries of compliant digital music files for their ongoing use under the statutory license.

The solution to tracking online transmissions also lies with service operators. Operators generate and maintain log files to document activity on their services. At a minimum, they should be required to capture the information that would identify which music they transmitted and when. The relevant data from these log files must be made accessible to the rights collective for purposes of confirming license fee reports and payments and to support a royalty distribution system. Transmission of a covered work that is not disclosed by an operator's log files

should subject that operator to liability for copyright infringement even if the service otherwise qualifies for the statutory license.

Digital rights management places a heavy burden on service operators, particularly smaller ones. Therefore, every effort should be made to minimize the cost of compliance. The works database must be readily accessible through the Internet, easily searched and fully supported. Ideally, the rights collective itself would make compliant digital audio files of all works available through the Internet for use by licensed operators.

As a group, service operators constitute a new community of music users. Individually, their experience with rights licensing varies widely. Some have, or have had licenses for uses of music in other media. Many have no prior experience at all with music rights licensing, and know little about the complex relationships that characterize the music industry. Under these circumstances, the music industry has the opportunity to foster mutually supportive relationships where none existed previously. It should seek to do so as quickly as possible.

Digital rights management cannot succeed without the assistance of the information technology and consumer electronics industries. It is fair that they should assume a full measure of responsibility in this regard. After all, they will benefit greatly from growth of the online music marketplace. Moreover, the sooner the digital music copyright dilemma is resolved, the sooner they will be able to profit from selling consumers products and services with the most appealing capabilities.

The technology industries should collaborate with rights holders and service operators to develop standards for the management tools needed to optimize

implementation of the online transmission right. Software must be developed to facilitate the works' matching, marking and logging processes. Certainly, tools to track the online use of works will be easier to create, use and maintain than are those tools needed to exclude people from accessing, copying and further distributing desired works.

Whatever tools may be needed by service operators to comply with the requirements of the statutory license should be made available to them free of charge by the rights collective; and the terms and conditions of license agreements for use of these and the other management tools needed to implement the online transmission right should be negotiated by the rights collective and the owners of the intellectual property rights in the tools involved.

VII. Qualifications For The Statutory License Should Be Limited To Those That Are Needed To Support Digital Rights Management

Eligibility for the statutory license should be conditioned only on those requirements and limitations needed to support digital rights management. Therefore, in order to qualify, operators may only transmit properly marked works and must track and log those transmissions, as discussed above. Beyond that, they must comply with financial reporting requirements and pay the applicable license fees in a timely manner.

Subject to these eligibility criteria, the statutory license for the online transmission right would be available to all service operators regardless of the business model they employ, the nature or density of their music use, or the content of their programming.

By contrast, under current law, the DMCA limits availability of the statutory license for sound recordings only to webcasters who offer eligible non-subscription transmissions that are also non-interactive in nature. Many services will not qualify.

As yet, it is not clear what degree of user influence or interaction will render a service "interactive" and therefore not eligible for the DMCA statutory license. Moreover, under the DMCA, eligibility as a non-subscription service does not depend only on whether the service is limited to subscribers, but also, in part, on the purpose for which the service is operated. Those that are operated for the purpose of providing audio entertainment programming are eligible, whereas those that are primarily oriented to the promotion of a particular company are not. The DMCA statutory license is not available to ordinary commercial web sites or other online services for which music is merely background entertainment. These do not qualify as non-subscription services even if they are available to all end users without distinction and for free. See, H.R. Conf. Rep. 105-796, 105 Cong. 2d. Sess., at 87 (1998). Those services that do not qualify for the DMCA statutory license are relegated to free market negotiations with rights holders who may refuse to grant online rights in the works they own.

The DMCA also imposes several program content restrictions on otherwise qualifying webcasters. For example, the DMCA limits the number of songs by the same artist or from the same recording that can be transmitted in any running three hour period. It prohibits transmitting programs shorter than five hours long if the program is available on demand by end users and always accessed at its beginning; and prohibits transmitting longer programs if made available for more than two

weeks. It also prohibits transmitting continuous or looped programs that are less than three hours long.

Moreover, the DMCA limits the ability of service operators to build a listener base through advertising. It prohibits advance announcement of programs that are shorter than one hour if they are transmitted more than a few times every couple of weeks and contain recordings in a predetermined order. And it prohibits publishing program schedules or making prior announcements of what is going to be played in any program of any length.

These extraordinary and exceedingly complicated limitations are unique to the DMCA webcasting statutory license. It is difficult to imagine how they could be won in free market negotiations. They are the statutory equivalent of technological anti-copying measures and just as unlikely to succeed. Under the online transmission right, none would be necessary, and none would be required.

VIII. Statutory License Fees Should Be Based On A Percentage Of Revenue Derived From Operation of Licensed Services

The diverse rights in musical works and sound recordings that are granted under current law are administered by different parties. Therefore, service operators who are able to obtain authorization for online uses are required to pay several separate license fees calculated on inconsistent bases.

For example, a pay-per-play-per-listener license fee model has been adopted for the sound recording performance right component of the DMCA webcasting statutory license. The fee, as of this writing, is seven cents per hundred listeners per recording per transmission. In addition, service operators must pay a

mechanical license fee to music publishers for server copies needed to facilitate transmissions of the publishers' songs. This fee is 8.8% of the total amount otherwise due for the sound recording performance right. They must also pay ASCAP and BMI public performance fees for musical works. The ASCAP fee is 1.6% of reportable revenue plus an additional fixed charge each time a user visits the licensed service. The BMI fee is 1.75% of reportable revenue.

Moreover, with respect to each work they transmit, service operators must provide the title of the song; classification of the song by musical genre; name of the recording artist; title of the album; name of the music publisher and of the record label; whether the work is instrumental or vocal; the number of times each work was transmitted; the date and duration of each transmission; and whether end users only listened to these transmissions or also made their own copies of them. It is unrealistic to expect service operators, particularly smaller ones, to know most of this information and unfair to require them to provide it in order to maintain their licensed status.

By contrast, under the online transmission right, only a single license fee payment would be due for any reporting period. Because the online transmission right would substitute for the parties' reproduction, performance and distribution rights, this single payment would cover all rights in all musical works and sound recordings that may be implicated by transmissions under the statutory license. Moreover, the only music use information that service operators would be required to provide is the server log file data showing when each work was transmitted and the publicly available unique identification number for each work.

The fee for an online transmission right would be established either through voluntary negotiations between the rights collective and service operator

representatives or by recourse to government supervised arbitration. Regardless of how it is accomplished, this process requires determination of a license fee structure, a rate and the base against which the rate is to be applied.

With respect to structure, the percentage of revenue approach is preferable to the pay-per-play model, especially from a public policy perspective.

The pay-per-play approach is obvious, straightforward and easy to implement. It also resonates with a rough fairness borne of the notion that one ought only use as much of a thing as one can afford. Nevertheless, it would deprive rights holders of the opportunity to share proportionately in the growing dollar-value of the bounty created by online transmissions of their works. It is also regressive. It discriminates against smaller service operators and will result in a marketplace in which only highly subsidized services and those that derive substantial revenue from advertising or the sale of goods will be able to transmit much music at all.

The revenue based approach avoids these shortcomings. In addition, it can accommodate significant differences in business models and music use among licensed services. It also results in a fair fee for all operators; one that is proportionate to the economic benefit each operator derives from transmissions of covered works.

For example, some services will be music intensive, offering transmissions of numerous works in various formats that are accessed by nearly all users. Others will make more limited uses of music. And, for some services, music use will be occasional and incidental to the primary purpose for which the service is in operation. These differences in the prominence of music use among services can be reflected in the license fee each service pays. This can be done by adjusting the

revenue base against which the fee is calculated by the relative number of users who access any music at any time during their visit. Thus, a service with \$100,000 in reportable revenue and users who all always access music every time they visit would pay twice the license fee of a service with the same revenue but whose users only access music every other time they visit.

In addition, not all works a service transmits will be protected by copyright; and for some that are protected, the service operator will have obtained authorization directly from the rights holders involved. This difference also can be reflected in the license fee each service pays. This can be done by adjusting the revenue base by the relative number of transmissions of works for which authorization is needed under the statutory license. Thus, a service with \$100,000 in revenue that only transmits protected works that are not directly licensed by their rights holders would pay twice the fee of a service with the same revenue that transmits an equal number of protected and public domain works.

These adjustments are not mutually exclusive; rather, where appropriate, they can be cumulative; and they would only be invoked at the discretion of the service operator involved.

The session tracking data needed to determine whether end users access music during their visits can be derived from the log files that each operator already would be required to maintain under the statutory license. The data needed to calculate the relative number of transmissions of copyrighted and public domain works also could be derived from server log files. The latter of these calculations would require the ability to identify and log transmissions of all works, not merely those that are protected. Therefore, the system by which the rights collective will

assign unique identifying numbers to protected works should be extended to include the identification of public domain works as well.

The rights collective will need to distinguish between copyrighted and public domain works in any event. Each year the copyrights in numerous protected works expire, allowing those works to fall into the public domain. The rights collective will need to manage this change in the status of individual works so that operators are not charged fees for transmissions of works that are no longer protected and so that rights holders are not paid royalties beyond the time when they are entitled to receive them.

With respect to the base against which the statutory license fee is calculated, and subject to the adjustments discussed above, the starting point should be the greater of service revenue or annual operating expenses.

There are several possible sources of service revenue. These include, for example, sponsor or advertising revenue, subscriber fees, payments made by program suppliers and other content providers, payments made by end users for their online purchase of goods, and payments associated with syndicated selling programs. As new online business models arise, new sources of service revenue will follow. Nevertheless, all service revenue, and not merely that which is directly generated by transmissions of covered music, should be subject to the statutory license fee.

The nature of streaming media makes it difficult to separate a service into music and non-music areas. This, in turn, makes it difficult to separate service revenue into that which is earned because of music and that which is not. For example, an end user who launches an audio stream from one area of a service in which no revenue is generated can continue to listen to that music while browsing another

area of the same service which contains advertisements and in which goods are offered for sale. The music may or may not still be playing at the moment the end user notices the advertisement or decides to make an online purchase of goods. If the only revenue subject to fee were that earned from the area in which the music stream was launched, the service operator either would pay no license fee at all, or pay only some designated minimum fee. Arguably, however, this result would not reflect the value derived from the use of music on this service. If the use of music did not benefit the service, it would be given up.

In addition, account also must be taken of those services that are able to operate without revenue. Unlike the broadcast, cable and satellite industries, where start-up and operating costs are enormous, the cost of entry into the online marketplace is relatively low. Because of this, online services need not necessarily make money in order to be viable for their operators. For example, many services are used to promote the offline, core business of the service operator and may never be an independent source of revenue unto themselves. Other services may be operated by organizations to provide information to end users that is not related to any business venture. And still others will be operated by individuals as a hobby and without any money making motive.

For all services of this sort a surrogate measure for revenue is needed. Annual operating expenses is a measure of the value placed on a service by its operator and can be used as a fair surrogate for revenue for the purpose of statutory license fee calculation. This approach was introduced by ASCAP in the 1997 version of its license agreement for webcasters; and even though ASCAP later abandoned it in favor of the regressive pay-per-user-visit approach, annual operating expenses

again became an element of license fee calculations under the Small Webcasters Settlement Act of 2002.

A determination must also be made as to the rate that will be applied against the base to calculate the statutory license fee for each service. For this, relevant, current economic data will be needed. It will be the responsibility of the rights collective and service operator representatives to adduce such data during license fee negotiations or before an arbitration panel, should a rate setting proceeding be necessary. Accordingly, a decision as to rate must wait the day.

Finally, the statutory license fee must contain rates for members of peer-to-peer file sharing networks as well as other online communities that provide the means for their members to transmit covered works. For this, a flat monthly fee per member may be appropriate. Music use reports would still be required.

IX. Royalty Payments Should Correspond Precisely With Fees Collected For Licensed Transmissions

Internet transmissions are digital and occur in a networked environment. It is possible, therefore, to identify all covered works that are transmitted online. Cooperation between service operators and rights holders coupled with the marking, tracking and logging requirements of the statutory license will provide the data on which such a census could be based. Only through a census can payment of royalties correspond precisely with licensed transmissions of individual works. This would ensure that Internet royalties are paid only to those rights holders who are entitled to receive them.

By contrast, sample surveys, such as those relied on by ASCAP and BMI, credit only a fraction of licensed uses. Royalties generated from transmissions that fall

within the sample are paid to the owners of the works in question; but royalties for transmissions of works that do not fall within the sample are not paid to the owners of those works; instead, they are paid to rights holders of other works that do fall within the sample. Thus, a royalty distribution system grounded in sampling necessarily results in rights holders not receiving royalties for all licensed uses of their works and may result in some rights holders never receiving royalties for any licensed uses of their works.

Similarly, if entitlement to royalties were directly determined by a census of online transmissions it would not be necessary to rely on indirect measures, such as point-of-sale data from record stores, to determine a work's value in this new medium.

Census-based royalty distribution under the online transmission right would be a two-phase process. In the first phase, the fees paid by each licensed service would be divided into two funds: one for musical works rights holders and one for sound recording rights holders. This division could result from voluntary negotiations between these two groups conducted under the auspices of the rights collective. However, if music publishers and record labels are unable to agree upon an allocation of royalties, an arbitration panel would be available to make that royalty distribution determination. This procedure is the same as that employed under other statutory licenses to divide a single, undifferentiated royalty fund among competing copyright claimant groups.

In making this determination, consideration should be given to the fact that sound recordings made prior to early 1972 are not protected by copyright. On the other hand, the musical works embodied in these public domain recordings may themselves still be subject to copyright protection. In addition, the Internet is especially well suited to live performance. These would involve the online

transmission right in the songs that were performed but would not involve any rights in sound recordings.

The second phase of royalty distribution requires the further division of each of the two royalty funds among the individual rights holders within the musical works and sound recordings claimant groups. Distribution of royalties to individual rights holders for transmissions of their works by licensed services could be made on a pro rata basis, service-by-service. Thus, a rights holder whose works account for 10% of all instances of properly logged transmissions of covered works by a particular licensed service would receive a royalty equal to 10% of the statutory license fees paid by that service for the reporting period in which the rights holders works were transmitted. This approach would ensure that all rights holders, large and small, receive a share of royalties that is proportionate to the money actually paid as license fees for online uses of their creative works. It would also reduce the likelihood that royalty distribution disputes would arise and would limit the nature and scope of those that did.

X. Conclusion

The online transmission right, collectively administered, and subject to a statutory license, is the best model for music rights administration in the digital age; it is a full, fair and feasible solution to the dilemma of online music licensing. If implemented, it will allow an online music marketplace to flourish.

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