INTERIM PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT OFFICE
LIBRARY OF CONGRESS

In the Matter of	)	
	)	
RATE SETTING FOR	)	Docket No. 2000-9
DIGITAL PERFORMANCE RIGHT	)	CARP DTRA 1 & 2
IN SOUND RECORDINGS AND	)	
EPHEMERAL RECORDINGS	)	

REPORT OF THE COPYRIGHT ARBITRATION ROYALTY PANEL

February 20, 2002

Eric E. Van Loon
Chairperson

Jeffrey S. Gulin
Arbitrator

Curtis E. von Kann
Arbitrator

TABLE OF CONTENTS

APPENDICES

INTERIM PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT OFFICE
LIBRARY OF CONGRESS

In the Matter of	)	
RATE SETTING FOR DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS AND EPHEMERAL RECORDINGS	)	**Docket No. 2000-9 CARP DTRA 1 & 2**

REPORT OF THE COPYRIGHT ARBITRATION ROYALTY PANEL TO THE LIBRARIAN OF CONGRESS

Pursuant to 37 C.F.R. § 251.53, the undersigned members of the Copyright Arbitration Royalty Panel hereby submit the Panel's Report to the Librarian of Congress.

I. INTRODUCTION

A. SUBJECT OF THE PROCEEDING

This is a rate adjustment proceeding convened under 27 C.F.R. § 251 *et seq*., pursuant to which this Copyright Arbitration Royalty Panel ("CARP" or "the Panel") has been empanelled to set compulsory license fees for eligible[1] nonsubscription digital audio

[1] There is dispute as to whether transmissions by certain parties to this proceeding (alleged to be "interactive" services and thus not eligible for licenses under 17 U.S.C. 114(d)(2)) meet the definition of eligible nonsubscription transmissions. However, the Copyright Office has ruled that "the Panel's responsibility is to … set appropriate rates, and not to discern whether a particular service meets the eligibility requirements for using the license." 65 Fed. Reg. 77292, 77333 (Dec. 11, 2000). *See also* Docket No. 2000-9 DTRA 1 & 2, Order of July16, 2001, at 5-7,

transmissions of sound recordings as provided for in § 114 of the Digital Millennium Copyright Act ("DMCA"), as well as for the making of ephemeral copies to facilitate such transmissions, as provided for in § 112 of the DMCA. This CARP is setting fees for two license periods: (a) October 28, 1998 - December 31, 2000, and (b) January 1, 2001 - December 31, 2002.

The subject matter underlying this proceeding -- access to music – spans from ancient antiquity to state-of-the-art technology. Humankind's affinity for music extends from ancient campfires to today's capacity to transmit music across vast distances and hear it played with remarkable fidelity. The Panel is cognizant that the decision it renders today could significantly affect citizen access to music for years to come.

B. <u>PARTIES TO THE PROCEEDING</u>

The current[2] parties to this proceeding are: (i) the "Webcasters," namely, BET.com, Comedy Central, Echo Networks, Inc. ("Echo"), Listen.com, Live365.com, MTVi Group, LLC ("MTVi"), Myplay, Inc. ("MyPlay"), NetRadio Corp. ("NetRadio"), Radio Active Media Partners, Inc. ("RadioAMP"), RadioWave.com, Inc. ("RadioWave"), Spinner Networks Inc. ("Spinner.com"), and XACT Radio Network LLC ("XACT"); (ii) the FCC-licensed radio Broadcasters, namely, Susquehanna Radio

---

9 (hereinafter, orders of both the Copyright Office and the Panel <u>respecting this docket</u> shall be cited as "Order of" followed by the date of the order and page number).

[2] At the outset of the proceeding, Webcaster parties also included Coollink Broadcast Network, Everstream, Inc., Incanta, Inc., Launch Media, Inc., MusicMatch, Inc., Univision Online, and Westwind Media.com, Inc., which have since withdrawn or been dismissed from the proceeding. National Public Radio ("NPR") reached a private settlement with RIAA. Because RIAA, AFTRA, AFM, and AFIM propose the same rates and take similar positions on most issues, they are sometimes referred to collectively as "RIAA" or "Copyright Owners and Performers" for convenience. Similarly, Webcasters, Broadcasters, and the Business Establishment Services are sometimes referred to collectively as "the Services."

Corporation, Clear Channel Communications Inc., Entercom Communication Corporation, Infinity Broadcasting Corporation, and National Religious Broadcasters Music License Committee (collectively " the Broadcasters"); (iii) the Business Establishment Services, namely, DMX/AEI Music Inc. (also referred to as "Background Music Services"); (iv) American Federation of Television and Radio Artists ("AFTRA"); (v) American Federation of Musicians of the United States and Canada ("AFM"); (vi) Association For Independent Music ("AFIM"); and (vii) Recording Industry Association of America ("RIAA").

The Webcasters are internet services that each employ a technology known as "streaming,"[3] but comprise a range of different business models and music programming. *See e.g.,* Written Direct Testimony[4] of Zittrain at 2; Tr. 6917-33 (Mills); Tr. 4025-29 (Lyons); Tr. 4554-77 (Porteus); Tr. 7277-97 (Roy); Tr. 8151-90 (Jeffrey).

The Broadcasters are commercial AM or FM radio stations that are licensed by the Federal Communications Commission ("FCC").

---

[3] The Webcasters' activity, sending music or other audio programming over the Internet to the listener's computer, is known as "streaming" because the webcaster "streams" packets of digitized transmissions in a time-dependent, location-dependent manner. *See* Griffin W.D.T. 4-8. To the listener, it seems like traditional radio, but unlike radio signals that are "broadcast," the streams are transmitted to individual recipients. The recipient's computer receives the streamed packets, reassembles them, and plays them back via common software programs known as "players." *See id*. Unlike "downloads," which may be permanently stored in the recipient's computer, the digits of streamed music are designed to be used once and then discarded. *See id.*

[4] Hereinafter, references to written direct testimony shall be cited as "W.D.T" preceded by the last name of the witness and followed by the page number. References to written rebuttal testimony shall be cited as "W.R.T" preceded by the last name of the witness and followed by the page number. References to the transcript record shall be cited as "Tr." followed by the page number and the last name of the witness. References to proposed findings of fact and conclusions of law shall be cited as "PFFCL" preceded by the name of the party that submitted same and followed by the paragraph number. References to reply proposed findings of fact and conclusions of law shall be cited as "RPFFCL" preceded by the party and followed by the paragraph number.

The Business Establishment Services, DMX/AEI Music,[5] deliver sound recordings to business establishments for the enjoyment of the establishments' customers. *See* Knittel W.D.T. 4

RIAA is a trade association representing record companies, including the five "majors" and numerous "independent" labels. Its SoundExchange division has been designated by RIAA member copyright owners (who account for about 90% of all sound recordings legitimately distributed in the United States) as the non-exclusive agent to collect and to distribute Section 112 and 114 royalties. *See* Rosen W.D.T. 4; Tr. 438-39 (Rosen).

AFTRA, the American Federation of Television and Radio Artists, is a national labor organization representing performers and newspersons. *See* Tr. 2830 (Himelfarb).

AFM, the American Federation of Musicians, is a labor organization representing professional musicians. *See* Bradley W.D.T. 1.

AFIM, the Association For Independent Music, is a trade association representing independent record companies, wholesalers, distributors and retailers. *See* Tr. 2830 (Himelfarb).

C. THE STATUTORY BACKGROUND

1. Music Copyright Law in General

Section 102 of the Copyright Act of 1976 identifies various categories of works that are eligible for copyright protection. *See* 17 U.S.C. § 102. These include "musical works" and "sound recordings." *Id*. at Section 102(2) and 102(7). The term "musical

[5] DMX/AEI Music is the successor company resulting from a merger between AEI Music Network, Inc. ("AEI") and DMX Music, Inc. ("DMX").

work" refers to the notes and lyrics of a song, while a "sound recording" results from "the fixation of a series of musical, spoken, or other sounds." *Id*. at Section 101. Thus, for example, the compact disc ("CD") entitled *Whitney Houston's Greatest Hits* contains Whitney Houston's rendition of *I Will Always Love You* and the CD entitled *Jolene* contains Dolly Parton's rendition of *I Will Always Love You.* Sherman W.D.T. 3-4. Each of the two renditions constitute distinct sound recordings and both the sound recordings and the single underlying musical work are "fixed" in the two CDs. *See id*. There are separate copyrights in each sound recording of *I Will Always Love You* and these copyrights are separate from the copyright in the underlying musical work. *See id*.

The copyright *owner* receives a bundle of exclusive rights including "performance" rights and "reproduction and distribution" rights. *See* 17 U.S.C. §106. Copyright owners of musical works are granted the exclusive right "to perform the copyrighted work publicly." *Id*. at 106(4). So, for example, the copyright owner has the exclusive right to authorize, or license, a radio broadcaster to publicly perform the musical work – to play a CD containing the copyrighted musical work such as *I Will Always Love You* over the radio. *See* Sherman W.D.T. 6-7. However, the Section 106(4) performance right does not extend to sound recordings. Accordingly, the broadcaster that publicly performs (broadcasts) *I Will Always Love You* must be licensed by the copyright owner[6] of the musical work, but need *not* be licensed by the copyright owner of the sound

[6] Songwriters who create musical works generally assign an interest in their copyrights to musical publishers who typically pay the songwriter an advance and a share of royalties that they collect for licensing the musical work. *See* Sherman W.D.T. 11-12. Songwriters and publishers typically bifurcate the administration of their rights. Performance rights in musical works are administered in the United States by three performing rights societies ("PROs") – the American Society of Composers, Authors and Publishers ("ASCAP"); Broadcast Music, Inc. ("BMI"); and SESAC, Inc. *See id* at 13. The PROs typically enter into licensing agreements on behalf of their member songwriters and publishers with thousands of businesses that perform musical works. The PROs

recording.[7] *See id.* Sections 106(1) and 106(3) grant copyright owners exclusive rights "to reproduce the copyrighted work in copies or phonorecords" and to "distribute copies or phonorecords of the copyrighted work to the public by sale …" 17 U.S.C. §106(1), (3). Musical works may be reproduced and distributed within the meaning of Sections 106(1), (3) in three principal ways: (a) mechanical reproductions -- the recording of a musical work on a CD, cassette, computer file or other phonorecord;[8] (b) synchronizations -- the recording of a musical work on a soundtrack of a motion picture or other audiovisual work;[9] and (c) print – the printing of a musical work on sheet music or in books. *See* Sherman W.D.T. 9.

2. The DPRA

In 1995, Congress enacted the Digital Performance Right in Sound Recordings Act ("DPRA"), which added a new Section 106(6) to the Copyright Act. That provision grants copyright owners of *sound recordings* the exclusive right "to *perform* the copyrighted work publicly by means of a digital audio transmission." *See* 17 U.S.C. § 106(6) (emphasis added). This grants record companies and artists a new right: the

---

generally grant "blanket licenses" that permit the licensee to perform any musical works within their repertories for a set license fee, as well as more limited licenses for specific purposes. *See id.* Publishers typically handle the licensing of reproduction and distribution rights in musical works through The Harry Fox Agency.

[7] Record companies normally handle the licensing of the copyright rights in their sound recordings. But, as previously mentioned, a division of RIAA known as SoundExchange acts on behalf of many record companies, including all of the majors, to license performance and reproduction rights that are subject to the statutory licenses in Section 112 and 114. *See* Sherman W.D.T. 14.

[8] The rights to authorize the recording and distribution of the phonorecord to the public are commonly referred to as "mechanical rights." *See id*.

[9] The rights to authorize these reproductions and distributions are commonly referred to as "sync rights." *See id.*

right to receive royalties when sound recordings are transmitted ("performed") over the internet. However, Congress limited this new Section 106(6) digital performance right through certain exemptions that it set forth in an amended Section 114 of the Copyright Act including, among others, exemptions for (a) nonsubscription broadcast transmissions; (b) retransmission of broadcast radio stations within 150 miles of their transmitters; and (c) transmissions to business establishments. *See* 17 U.S.C. § 114 (d)(1).

Congress also amended Section 114 to create a new compulsory license for certain subscription digital audio services, which transmit sound recordings to cable television and Direct Broadcast Satellite subscribers on a non-interactive basis. *See* 17 U.S.C. §114(d)(2). The compulsory license permits the services, upon compliance with certain statutory conditions, to make those transmissions without obtaining consent from, or having to negotiate license fees with, copyright owners of the recordings. *Id.* Congress established procedures to facilitate voluntary negotiation of rates and terms for the subscription services compulsory license. This included a provision authorizing copyright owners and services to designate common agents on a nonexclusive basis to negotiate licenses – as well as to pay, to collect, and to distribute royalties – and a provision granting antitrust immunity for such actions. *See* RIAA Exhibit 113 DP (setting forth Sections 114 and 801 of the Copyright Act as enacted in the DPRA); Sherman W.D.T. 23-24.

Absent agreement, the Copyright Office must convene a CARP to recommend royalty rates and terms for adoption by the Librarian of Congress. Congress directed the CARP to set a royalty rate for the subscription services' compulsory license that achieves the policy objectives in Section 801(b)(1) of the Copyright Act. *Id.*

Under the DPRA, copyright owners must allocate one-half of the compulsory licensing royalties that they receive from the subscription services compulsory license to recording artists. Forty-five percent of the royalties must be allocated to featured artists; 2½ percent of the royalties must be distributed by AFM to non-featured musicians; and 2½ percent of the royalties must be distributed by AFTRA to non-featured vocalists. *See* 17 U.S.C. § 114(g).

3. <u>The DMCA</u>

After passage of the DPRA, a dispute arose concerning the proper treatment of webcasters who stream sound recordings on a nonsubscription basis. The webcasters argued that they were exempt under the DPRA from the Section 106(6) digital performance right. The recording industry, on the other hand, took the position that the DPRA did not exempt webcasters and that webcasters were required to obtain the consent of copyright owners of the sound recordings that they transmit over the internet. *See* Sherman W.D.T. 24; Tr. 321 (Sherman).

Congress resolved that dispute in 1998 with the passage of the DMCA. It made clear in the DMCA that webcasting is subject to the Section 106(6) digital performance right and that webcasters who transmit sound recordings on an *interactive* basis, as defined in Section 114(j), must obtain the consent of, and negotiate fees with, individual owners of those recordings. However, webcasting would be eligible for compulsory licensing when done on a *non-interactive* basis. Accordingly, Congress created a new compulsory license in Sections 114(d)(2) & (f)(2) for "eligible nonsubscription transmissions," which include non-interactive transmissions of sound recordings by webcasters. 17 U.S.C. § 114(d)(2). To qualify for that compulsory license, the webcaster must comply with several conditions in addition to those that the DPRA applied to subscription services. As with the subscription services royalties, webcaster royalties are allocated on a 50-50 basis to copyright owners and to performers. *See generally* Sherman W.D.T. 24-28; RIAA Exhibit 114 DP at 79-91 (DMCA Conference Report); *Bonneville International Corp. et al v. Peters*, 153 F. Supp. 2d 763, 768-69 (E.D.Pa.2001), appeal pending.

Congress adopted the DPRA voluntary negotiation and CARP procedures for the DMCA webcaster performance license. *See* 117 U.S.C. § 114(e),(f). However, it changed the statutory standard by which a CARP must set rates and terms for the webcaster compulsory license. Congress provided that the CARP must adopt rates and terms for the webcaster performance license 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).

Congress also recognized that webcasters who avail themselves of the Section 114 license may need to make one or more temporary or "ephemeral" copies of a sound recording in order to facilitate the transmission of that recording. Accordingly, Congress created a new compulsory license in Section 112(e) for such copies and extended that compulsory license to services that transmit sound recordings to certain business establishments under the Section 114(d)(1)(C)(iv) exemption created by the DPRA. *See generally* Sherman W.D.T. 24-28; RIAA Exhibit 114 DP at 89-91 (DMCA Conference Report).

Again, Congress adopted the DPRA voluntary negotiation and CARP procedures for the Section 112 ephemeral license. 17 U.S.C. 112(e)(2),(3). And Congress again directed the CARP to set rates and terms for this license that meet the willing buyer/willing seller standard applicable to the Section 114 webcaster performance license. 17 U.S.C. § 112(e)(4).

II. THE PROCEEDINGS

A. PRE-HEARING PROCEEDINGS

Pursuant to Section 114(f)(4)(B)(i), on September 20, 1999, the Copyright Office directed eligible nonsubscription services, that wish to rely upon the Section 114 compulsory license, to file appropriate notices with the Copyright Office by October 15, 1999 or, if they had not yet launched, prior to their first transmission. *See* 64 Fed. Reg. 50758 (September 20, 1999). As of early 2001, initial notices were filed for nearly 2,300 web sites, of which 1557 were filed by AM/FM broadcast radio stations. *See* RIAA Exhibit 126 DP; Marks W.D.T. 4.

Pursuant to the six-month voluntary negotiation provision of the DMCA, on November 27, 1998, the Librarian initiated a voluntary negotiation period covering the timeframe October 28, 1998 through December 31, 2000. *See* 63 Fed. Reg. 65555 (November 27, 1998). On January 13, 2000, the Librarian initiated a second six-month period for the parties to negotiate voluntary rates and terms covering January 1, 2001 through December 31, 2002. *See* 65 Fed. Reg. 2194 (January 13, 2000). RIAA, designated by virtually all of its members and several non-member record labels as their nonexclusive, common negotiating agent (*see* Tr. 321-22 (Sherman); Sherman W.D.T. 23-24), reached agreements with 26 webcasters during and subsequent to these two formal negotiation periods. However, apparently because an industry-wide agreement had not been reached, RIAA petitioned the Copyright Office on July 23, 1999 to commence the CARP process for the period October 28, 1998 through December 31, 2000. On August 28, 2000 RIAA filed a second petition covering the period January 1, 2001 through December 31, 2002.

In response to RIAA's petitions, the Copyright Office directed interested parties to file notice of their intent to participate in the 1998-2000 CARP proceeding and the 2001-02 proceeding. *See* 64 Fed. Reg. 52107 (Sept. 27, 1999); 65 Fed. Reg. 55302 (Sept. 13, 2000); 65 Fed. Reg. 77393 (Dec. 11, 2000). RIAA, AFIM, AFM, AFTRA, about 43 webcasters, and 82 broadcasters filed notices of intent to participate. NPR filed notices to participate on its own behalf and on behalf of non-commercial public radio stations qualified for funding from the Corporation for Public Broadcasting. AEI and DMX (prior to their merger) also filed separate notices of intent to participate.

B. THE DIRECT CASES

On April 11, 2001, RIAA filed its direct case. AFM, AFTRA and AFIM also submitted direct cases and supported RIAA's proposed rates. Twenty-five Webcasters and Broadcasters submitted direct cases. NPR submitted a separate direct case and a separate rate proposal covering public radio stations. AEI and DMX submitted direct cases and a Section 112 rate proposal for organizations that transmit sound recordings to business establishments.

The Panel conducted 31 days of hearings on the direct cases, commencing July 30, 2001 and ending September 14, 2001. A total of 49 witnesses testified.

RIAA presented the following witnesses during the direct case hearings: Cary Sherman, Executive Vice President and General Counsel, RIAA; Hilary Rosen, President and Chief Executive Officer, RIAA; Linda McLaughlin, Vice President, National

Economic Research Associates, Inc. ("NERA"); David Altschul, Vice Chairman and General Counsel of Warner Bros. Records; Paul Katz, Senior Vice President of Business Affairs for Zomba Music Publishing and Zomba Recording Corporation; Charles Ciongoli, Senior Vice President of Finance, Universal Music Group; James Griffin, Chief Executive Officer, Cherry Lane Digital, LLC; Ron Wilcox, Senior Vice President, Business Affairs and Administration, Sony Music, U.S. and Executive Vice President, Business Affairs and New Technology, Sony Music Entertainment Inc.; Paul Vidich, Executive Vice President, Strategic Planning and Business Development, Warner Music Group.; LaVerne Evans, Senior Vice President and General Counsel, Legal and Business Affairs, BMG Entertainment; Anthony Pipitone, President, Warner Special Products, Inc.; Lawrence Kenswil, President, Universal eLabs, Universal Music Group; Dr. Thomas Nagle, Chairman, Strategic Pricing Group, Inc.; Jay Samit, Senior Vice President, New Media, EMI Recorded Music; Steven Wildman, Professor of Economics and Telecommunications studies at Michigan State University; Robert Yerman, Director of Intellectual Property Practice for LECG, LLC; and Steven Marks, Senior Vice President, Business and Legal Affairs, RIAA.

The following witnesses testified on behalf of AFTRA during the direct case hearings: Greg Hessinger, National Executive Director of AFTRA: Jennifer Warnes, recording artist; and AFM presented testimony from Harold Bradley, recording artist; Kevin Dorsey, background vocalist and arranger. AFIM presented testimony from Gary Himelfarb, Founder, RAS Records.

Webcasters and Broadcasters presented the following witnesses during the direct case hearings: Professor William Fisher, Harvard Law School; Joe Lyons, Director of

New Business Development, Comedy Central; Michael Wise, Chief Financial Officer, NetRadio; David Pakman, President of Business Development and Public Policy, My Play; Brad Porteus, Vice President of MTVi Radio and General Manager of Internet Radio Operations for MTVi.; Rob Reid, Chairman, Listen.com; Quincy McCoy, Vice President of Radio and Music Programming, MTVi SonicNet; Fred McIntyre, Executive Director, Business Development, AOL Music, Spinner.com; Dan Halyburton, Senior VP, General Manager, Group Operations, Susquehanna Radio Corporation; Professor Michael Mazis, Kogod School of Business, American University; Michael Fine, Consultant; James P. Donahoe, Senior Vice President, Clear Channel Broadcasting; Professor Jonathan Zittrain, Harvard Law School; Paul Kempton, Founder and Senior Partner, Media Matrix Partnership; Adam Jaffe, Professor of Economics, Brandeis University and Chair of the Department of Economics and the Chair of the University Intellectual Property Policy Committee; Scott Mills, COO and Executive Vice President, BET Interactive LLC; David Juris, President and CEO, XACT Radio; Tuhin Roy, Executive Vice President of Strategic Development, Echo Networks, Inc.; Charles Moore, Vice President of Business Development, RadioActive Media Partners; Stephen Fisher, Executive Vice President and Chief Financial Officer, Entercom Communications Corp.; Dan Mason, President, Infinity Radio; Nathan Pearson, President and CEO, Radiowave.com; John Jeffrey, Executive Vice President of Corporate Strategy and General Counsel, Live365 Inc.; and Joe Davis, Senior Vice President for Operations, Salem Communications.

Webcasters and Broadcasters submitted, but subsequently withdrew written direct testimony from the following witnesses: David Bean, Vice President of Programming, Music Match, Inc.; Robert Ohlweiler, Senior Vice President of Business Development, Music Match, Inc.; Diego Ruiz, Vice President and General Manager, Univision Online, Inc.; Clifton Gardiner, President of Westwind Division, Radio One Networks, Inc.; Michael Peterson, Senior Vice President, Coollink Broadcast Network; Steven McHale, Co-Founder, President and Chief Executive Officer, Everstream, Inc.; Eric Snell, Chief Financial Officer, Incanta, Inc.; Robert D. Roback, President, Co-Founder, and Director, Launch Media, Inc.; and David Goldberg, Chief Executive Officer, Launch Media, Inc. *See* June 25, 2001 Order (Music Choice, Incanta and Everstream); Aug. 3, 2001 Order (Music Match); Aug. 29, 2001 Order (Univision Online and Westwind); Sept. 14 Order (Coollink); Tr. 13242-43 (Launch). Webcasters also had submitted written testimony from Alanis Morisette, a recording artist. By agreement of the parties, the Panel received that written testimony into evidence without Ms. Morisette presenting oral testimony at the direct case hearings. *See* Tr. 9862.

The following witnesses testified on behalf of the Business Establishment Services: Barry Knittel, President of AEI Music Markets Worldwide, and Doug Talley, Chief Technical Officer, AEI/DMX. DMX had submitted written testimony from Lon Troxel, its President and Chief Executive Officer, but that testimony was withdrawn. *See* Tr. 6571.

The following witnesses testified on behalf of NPR during the direct case hearings: Kenneth Stern, Executive Vice President, NPR, and Dr. Jane Murdoch, Vice President of Charles River Associates.

C. THE REBUTTAL CASES

The parties filed written rebuttal cases on October 4, 2001. The Panel conducted ten days of rebuttal hearings, commencing October 15, 2001 and ending October 25, 2001. A total of 26 witnesses testified.

The following rebuttal witnesses testified on behalf of RIAA during the rebuttal hearings: Barrie Kessler, Executive Director, Internal Operations and Data Management, Sound Exchange; Michael Williams, Executive Vice President of Finance and Operations, RIAA; James McDermott, Senior Vice President, New Technology and Electronic Music Distribution, Sony Music, U.S.; Lawrence Kenswil, President, Universal eLabs, Universal Music Group; Dr. Thomas Nagle, Chairman, Strategic Pricing Group, Inc.; Professor Richard Seltzer, Howard University; Dr. George Schink, Director LECG, LLC; Steven Marks, Senior Vice President, Business and Legal Affairs, RIAA; and Professor Steven Wildman, Michigan State University. RIAA had submitted written rebuttal testimony from Deane Marcus, Senior Vice President, Strategic Planning & Business Development, Warner Music Group; Carmine Coppola, Vice President and Chief Financial Officer, Sony Music International; and Prescott Price, Senior Vice President, Finance, EMI Group. By agreement of the parties, the Panel received that written testimony into evidence without those witnesses testifying at the rebuttal hearings. RIAA also submitted written testimony from Mark Ansorge, Vice President and Associate Counsel, Warner Music Group, Inc., but that testimony was subsequently withdrawn. *See* Tr. 13234.

AFTRA and AFM submitted written rebuttal testimony from Greg Hessinger, National Executive Director of AFTRA.

The following witnesses testified during rebuttal on behalf of the Webcasters and Broadcasters: Cindy Charles, MTVi; Charles Moore, Vice President of Business Development, RadioActive Media Partners, Inc.; Ronald Gertz, President and CEO, Music Reports, Inc.; Michael Fine, Consultant; Professor William Fisher, Harvard Law School; Professor Michael Mazis, Kogod School of Business, American University; David Fagin, recording artist; Professor Jonathan Zittrain, Harvard Law School; and Professor Adam Jaffe, Brandeis University.

NPR submitted written rebuttal testimony from Dr. Jane Murdoch, Vice-President, Charles River Associates. By agreement of the parties, the Panel received that written testimony into evidence without Dr. Murdoch's testifying at the rebuttal hearings. *See* Tr. 12393.

Shortly before the conclusion of the direct case evidentiary hearings, the Panel invited each of the 26 webcasters who had entered into voluntary agreements with RIAA to testify during the rebuttal hearings. Seven of the 26 RIAA licensees subsequently testified during the rebuttal hearings: Bruce Bechtold, President and CEO, Cybertainment; David Mandelbrot, Vice President and General Manager, Entertainment Division, Yahoo!, Inc.; Wolfgang Spegg, President and CEO, musicmusicmusic; Scott Purcell, Founder and CEO, OnAir Streaming Networks, Inc.; John Heilbronn, President, Cablemusic Networks, Inc.; Matthew Hackett, Founder and CEO, Kickradio.com; Jim Junkala, President and COO, Multicast Technologies; and Randy Freedman, Counsel, Multicast Technologies.

Lists of exhibits offered during the direct case and the rebuttal case hearings are attached hereto as Appendix C and Appendix D, respectively.

Hearings in this proceeding were interrupted twice by tragic external events. On the morning of September 11, 2001, the Library of Congress building in which the hearing was being conducted was evacuated abruptly by Capital Police; fortunately, the hearing was able to be resumed the following morning. Subsequently, on October 17, 2001, the rebuttal hearing was again interrupted due to fear of anthrax contamination, and the proceedings had to be relocated for eight days. The Panel wishes to express its appreciation and admiration for, and commend the thoughtfulness of, counsel for the parties and the legal staff of U.S. Copyright Office, whose conduct reflected the highest degree of consideration and professionalism throughout these difficult periods.

D. THE SUSPENSION OF PROCEEDINGS

On November 8, 2001, the parties jointly moved the Copyright Office to suspend the CARP proceedings for the period November 9, 2001 through December 2, 2001. The purpose of the suspension was to permit the parties to engage in settlement negotiations. By Order dated November 9, 2001, the Copyright Office granted the motion and set February 20, 2002 as the deadline for the submission of the final CARP Report. The negotiations resulted in a confidential settlement agreement between NPR (National Public Radio) and RIAA. The parties also reached an accord respecting all non-rate terms, excepting one contested issue relating to the designation of an agent to receive and distribute royalties in the circumstance where a copyright owner has not made a designation. Pursuant to joint request of the parties, on December 20, 2001, the Panel issued an order to reopen the record for the limited purpose of admitting into evidence the agreed-upon terms.

E. POST-HEARING SUBMISSIONS AND ARGUMENTS

Following resumption of the proceedings, the parties submitted Proposed Findings of Fact and Conclusions of Law, Replies thereto, and various other memoranda, pursuant to schedules established by the Panel. On December 20, 2001 and January 11, 2002, the Panel heard two days of oral arguments presented by counsel for the parties.

F. THE ENORMITY OF THE RECORD

This proceeding has spawned one of the most voluminous records in CARP history. It includes a written transcript approaching 15,000 pages, many thousands of pages of exhibits, and over 1000 pages of post-hearing submissions by extraordinarily able counsel. In these pages, the parties have raised literally hundreds of contentions relating to statutory construction, economic theory, technology, particulars of their respective industries, and a host of other subjects. Addressing all of these individual contentions, and the evidence supporting or contradicting each, would generate a final report of hundreds, perhaps thousands of pages. Such an endeavor is not required, nor is it practicable within the time constraints imposed under 37 C.F.R. § 251.53(a).

Accordingly, in this Report the Panel attempts to articulate only the principal grounds upon which our determinations are based. Of course, in arriving at these determinations, the Panel has carefully considered all of the parties' evidence and arguments. To the extent this Report comports with a particular proposed finding of a party, we accept that proposed finding. To the extent it does not, we reject that proposed finding.

III. THE STATUTORY CRITERIA FOR SETTING RATES AND TERMS

A. SECTION 114(f)(2)

1. The Statutory Language

The criteria for setting rates and terms for the Section 114 webcaster performance license are enunciated under 17 U.S.C. § 114(f)(2)(B), which provides in pertinent part:

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

The statute further directs the Panel to set "a minimum fee for each type of service" and grants the Panel discretion to consider the rates and terms for "comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements" negotiated under the voluntary negotiation provisions of the statute. 17 U.S.C. § 114(f)(2)(B).

2. The Relationship of the Statutory Factors to the "Willing Buyer/Willing Seller" Standard

The meaning of the "willing buyer/willing seller" standard was the subject of considerable testimony and argument. Indeed, prior to the hearing, dispute arose regarding the appropriate relationship between the statutory factors identified in § 114 (f)(2)(B)(i) and (ii), and the willing buyer/willing seller standard enunciated in the statute. In response to the written direct testimony of Services' witness William Fisher, RIAA filed a motion for declaratory ruling seeking clarification of the statutory standard. In an order issued on July 16, 2001, the Librarian ruled as follows:

> The statutory standard set forth in section 114(f)(2)(B) requires the Panel to determine the rates that a willing seller and a willing buyer would agree upon through voluntary negotiations in the marketplace. The Panel must use the "willing seller/willing buyer" standard to set rates for all non-interactive, nonsubscription transmissions made under the section 114 license, including those within 150 miles of the broadcaster's transmitter.
>
> In making its determination, the arbitrators should consider the two factors listed in section 114(f)(2)(B)(i) and (ii), but they should not limit their deliberations to these factors alone. Neither factor defines the standard for setting the rates. <u>See</u>, H.R. Rep. No. 105-796, 105th Cong., 2d Sess. 86 (1998) ("The test applicable to establishing rates and terms is what a willing buyer and willing seller would have arrived at in marketplace negotiations. In making that determination, the copyright arbitration royalty panel shall consider economic, competitive and programming information presented by the parties including, but not limited to, the factors set forth in clauses (i) and (ii)."). To the extent that a party's testimony is relevant to the analysis of what a willing buyer/willing seller would accept in the marketplace, it should be considered.

Order of July 16, 2001 at 5.

For further guidance in setting royalty rates that reflect the "willing buyer/willing seller" standard, the Librarian referred the Panel to his decision in the satellite rate adjustment proceeding. *See id*. In construing parallel language of 17 U.S.C. §119(c)(3)(D), the Librarian declared that "economic, competitive and programming information" must be considered by the Panel "if it were relevant to determining fair market value" but the weight to be accorded each factor depended upon its relative significance to a determination of fair market value. 62 FR 55742, 55746-47 (October 28, 1997).

Accordingly, the willing buyer/willing seller standard is the *only* standard to be applied. The two factors enumerated in the statute do *not* constitute additional standards or policy considerations. Nor are these factors to be used *after* determining the willing buyer/willing seller rate as bases to adjust that determination upward or downward. The statutory factors are merely factors to be considered, along with any other relevant factors, in *determining* rates under the willing buyer/willing seller standard.

3. The Nature of "The Marketplace"

The parties agree that the directive to set rates and terms that "would have been negotiated" in the marketplace between a willing buyer and a willing seller reflects Congressional intent for the Panel to attempt to replicate rates and terms that "would have been negotiated" in a *hypothetical* marketplace. *See e.g.*, RIAA PFFCL ¶¶ 77-82, Webcasters PFFCL ¶¶ 17-26. The parties further agree that the "buyers" in this hypothetical marketplace are the Services (and other similar services) and that this marketplace is one in which no compulsory license exists. *See id. See also* Noncommercial Education Broadcasting Rate Adjustment Proceeding 63 FR 49823, 49835 (September 18, 1998) ("It is difficult to understand how a license negotiated under the constraints of a compulsory license, where the licensor has no choice but to license, could truly reflect fair market value.") But they bitterly dispute the identities of the "sellers" in this hypothetical marketplace.

RIAA asserts that a single collective of sound recording copyright owners (such as RIAA), offering a blanket license for sale, must be the appropriate seller in the hypothetical marketplace we seek to replicate. *See* RIAA PFFCL ¶ 94. Consequently, RIAA argues that the 26 voluntary agreements it recently negotiated with various webcaster licensees, pursuant to Section 114(f)(2)(A), would serve as perfect benchmarks. *See* RIAA PFFCL (Introduction at 1).

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]." Webcasters PFFCL ¶ 26. By contrast, the Services seem to envision a theoretical world of perfect competition. Accordingly, they press the notion of a theoretical "competitive market" where the sellers consist of a "non-trivial number" of collectives (essentially, multiple RIAAs) in competition with each other, with each offering a blanket license consisting of all copyrighted sound recordings.[10] Tr. 11667-69 (Fisher); Tr. 6431, 6659, 6603-05, 12704 (Jaffe). *See also* Webcasters PFFCL ¶¶ 20-26.

The Panel rejects the Services' view. We recognize that an antitrust exemption was required to enable RIAA to act as a non-exclusive, common agent in negotiating agreements under the statutory license at issue here. In the absence of a compulsory license, even if the designation of the single common agent were non-exclusive, extraordinary market power would be concentrated in that single entity. However, in the hypothetical marketplace, where no compulsory license would exist, RIAA would *not* enjoy such an exemption and services would necessarily negotiate directly with the *record companies*. Indeed, numerous internet services, which were not eligible for

[10] In support of this theory, the Services cite *ASCAP v. Showtime/The Movie Channel, Inc.,* 912 F.2d 563 (2d Cir. 1990).

statutory licenses, and at least one that was eligible [redacted], did reach agreements with individual record companies.[11] *See e.g.,* RIAA PFFCL ¶¶ 167-69, Appendix A. *See also* [redacted]xx.

Moreover, we see no Copyright Office or Copyright Royalty Tribunal precedent for the Services' "competitive market" construct in the compulsory license context. Perhaps upon a showing that the record companies themselves, or even the majors, could exert oligopolistic power, we would be tempted to import the *ASCAP v. Showtime* (*see* n.10 *supra)* concept of multiple licensing collectives, each selling the same product. However, no record evidence supports this proposition.[12] Finally, it is difficult to imagine the practicality of competing licensing collectives each offering full blanket licenses, and the Services could offer no example of such circumstances existing in the real world. *See* Tr. 6612 (Jaffe).

Neither, however, can the Panel fully adopt the RIAA stance. 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 designations were non-exclusive, Congress clearly perceived antitrust concerns with such an arrangement. Congress authorized antitrust exemptions respecting such negotiations *only* within the context of the compulsory licenses. *See* 17 U.S.C. § 114(e). *See also* Webcasters PFFCL ¶ 21, n.7, 8. Consequently, the record companies could *not* designate

[11] Of course, the existence of a single negotiated agreement between one DMCA compliant service and one record company does not establish that non-exclusivity alone would provide adequate protection from RIAA market power. *See* discussion of "non-exclusivity" *infra*.

[12] Indeed, contrary record evidence was adduced. *See* Tr. 8978-83 (Murdoch) (sound recording marketplace is a competitive marketplace).

a single negotiation agent for non-statutory licenses, whether non-exclusive or not. RIAA's reliance upon the DPRA Senate Report (see RIAA RPFFCL ¶ 19, n.30) is misplaced. The Report does state that non-exclusivity "should help" prevent RIAA from demanding supra-competitive rates but, again, only in the context of the compulsory license where RIAA can not withhold use of the copyrighted works. *Id.* Accordingly, in the hypothetical marketplace, where no compulsory license would exist to provide true protection, we do not perceive the hypothetical seller to be RIAA. The appropriate sellers would be the individual record companies.

Thus, the Panel perceives the Section 114(f)(2) hypothetical marketplace as one where the buyers are DMCA-eligible (also referred to as "DMCA-compliant") services, the sellers are record companies, and the product being sold consists of blanket licenses for each record company's repertory of sound recordings.

4. <u>The Appropriate Willing Buyer/Willing Seller Rate</u>

As noted, the statute directs us to "establish rates and terms that *most clearly* represent the rates and terms that would have been negotiated in the marketplace." 17 U.S.C. § 114(f)(2)(B) (emphasis added). In the hypothetical marketplace we attempt to replicate, there would be significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors. Moreover, these parties would be negotiating rates for newly created property rights with no established pricing history.

One would, therefore, expect negotiations between diverse buyers and sellers to generate not a uniform rate, but a range of negotiated rates reflecting the particular circumstance of each negotiation. *See, e.g.*, Tr. 2618-20 (Nagle). Congress surely understood this when formulating the willing buyer/willing seller standard. Accordingly, the Panel construes the statutory reference to rates that "most clearly represent the rates…that would have been negotiated in the marketplace" as the rates to which, absent special circumstances, most willing buyers and willing sellers would agree.

B. SECTION 112(e)

The criteria for setting rates and terms for the Section 112 ephemeral licenses are enunciated under 17 U.S.C. § 112(e)(4), which provides in pertinent part:

> The copyright arbitration royalty panel shall establish rates that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller. In determining such rates and terms, the copyright arbitration royalty panel shall base its decision on economic, competitive, and programming information presented by the parties, including –
>
> (A) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise interferes with or enhances the copyright owner's traditional streams of revenue; and
>
> (B) the relative roles of the copyright owner and the transmitting organization 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.

As does Section 114, this section further directs the Panel to set "a minimum fee for each type of service." 17 U.S.C.§112(e)(4). Although Section 112 does not explicitly grant the Panel discretion to consider the rates and terms for comparable types of services, it does explicitly grant discretion to "consider the rates and terms under voluntary license agreements" negotiated under the provisions of the statute. 17 U.S.C. § 112(e)(4).

Accordingly, while the language of the two sections varies in minor respects, the Panel interprets the criteria for setting rates and terms as essentially identical. *See* Order of July 16, 2001 at 5.

IV. RATE PROPOSALS OF THE PARTIES FOR WEBCASTING SERVICES

A. RIAA RATE PROPOSALS

The RIAA approach is simple and straightforward. It offers as a benchmark the agreements reached between the RIAA and 26 separate webcasters which, RIAA alleges, represent a broad range of webcaster business models and comparable circumstances. *See* RIAA PFFCL (Introduction at 7-9). RIAA asserts that these agreements, negotiated during the statutorily prescribed period for voluntary negotiations, s*ee* 63 Fed. Reg. 65555 (November 27, 1998), 65 Fed. Reg. 2194 (January 13, 2000), "involve 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."[13] RIAA PFFCL (Introduction at 8) (emphasis in original). RIAA further asserts that the rates and terms established by these 26 agreements are corroborated by substantial evidence of record including, *inter alia*, the following:

(i) Approximately 115 agreements between individual record companies and similar services;[14]

(ii) An analysis of intellectual property values under the criteria set forth in the *Georgia Pacific* patent infringement case; and

---

[13] With the exception of the "same seller," the Panel concurs with this litany. As discussed *supra*, in the hypothetical marketplace, we view the seller as not a single monopolistic collective, but rather the individual record companies. However, this distinction is rather minor because the RIAA conducted its negotiations under circumstances where it could not exert monopolistic power. The 26 agreements were all negotiated in "the shadow" of the compulsory license. Hence, RIAA could not deny use of the copyrighted work to any service that simply filed the appropriate notice pursuant to Section 114(f)(4)(B)(i). *See* 64 Fed. Reg. 50758 (September 20, 1999).

[14] Excepting one agreement with [redacted] these agreements involved licenses for different rights granted to non-DMCA compliant services. S*ee* RIAA PFFCL ¶¶ 167-69, Appendix A. S*ee also* [redacted].

(iii) An "economic value" estimation.

See Id. at 9.

Based upon these agreements, RIAA proposes the following rates for DMCA compliant webcasting services:

(a) For basic "business to consumer" (B2C) webcasting services, either 0.4¢ for each transmission of a sound recording to a single listener, or 15% of the service's gross revenues;

(b) For "business to business" (B2B) webcasting services, where transmissions are made as part of a service that is syndicated to third-party web sites, 0.5¢ for each transmission of a sound recording to a single listener; and

(c) For "listener-influenced" webcasting services,[15] where the transmissions are partly influenced by the listener, 0.6¢ for each transmission of a sound recording to a single listener. *See* RIAA PFFCL (Appendix C) for a more detailed description of proposed rates and qualifications.

RIAA further proposes a minimum fee, subject to certain qualifications, of $5,000 per webcasting service and a Section 112(e)(1) ephemeral license fee of 10% of each service's performance royalty payable under (a), (b), or (c) *supra*. *See id*. at 3-4.

B. <u>WEBCASTER RATE PROPOSALS</u>

Unlike the RIAA proposals, which are grounded in actual marketplace agreements, the Webcasters proposals are derived from a theoretical economic model.

[15] It should be noted that RIAA believes that such services are not DMCA-compliant and, accordingly, not eligible for the Section 114(f)(2) statutory license. *See* RIAA PFFCL (Appendix C, n.1). RIAA sets forth this proposal only in the event the Panel determines to set a royalty for such services.

The Webcasters' model is fundamentally premised upon the notion that, in the hypothetical marketplace we seek to replicate, copyright owners[16] would license their sound recording digital performance rights and ephemeral reproduction rights to webcasters at a rate no higher than the rates at which music publishers (through the PROs) have licensed their musical work analog performance rights to over-the-air radio broadcasters. *See* Webcasters PFFCL ¶¶ 276-78; Jaffe W.D.T. 16-19. 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. Specifically, Webcasters utilized year 2000 data from 872 radio stations (those stations for which their expert was able to obtain relevant data), which they claim constitutes "a significant portion" of the total fees paid to the PROs in 2000. Webcasters PFFCL ¶ 276. *See also* Jaffe W.D.T. 25-32. By combining this fee data with data on the Arbitron "ratings" or listening audience of these stations, Webcasters converted the over-the-air music stations' fees paid to the PROs into an average fee paid by an over-the-air broadcaster per "listening hour." *See* Jaffe W.D.T. (Appendix B).

Based upon data from Broadcast Data Systems, Webcasters also calculated a fee per listener song by dividing the "listener hour" fee by the average number of songs played per hour by music-intensive format stations. This calculation produced a fee per song and fee per listener hour for the performance of musical works by the over-the-air radio stations of 0.02¢ per song and 0.22¢ per hour, respectively. *See* Jaffe W.R.T. 29-30,

[16] As discussed *supra*, Webcasters believe the copyright owners would be selling their rights through multiple, competing collectives, but the Panel rejects this view. We find that the Section 114 and Section 112 copyright sellers would be the record companies.

Figure 3. However, because, on average, webcasters play 15 songs per hour, compared to the 11 per hour played on over-the-air radio, the per-hour rate was adjusted to 0.3¢ per hour. *See* Webcaster PFFCL ¶ 277. We note, however, that the 0.3¢ figure is not derived by simply multiplying 0.2¢ by 15, as Webcasters suggest. *See id*. Rather, we presume, Professor Jaffe formulated a mathematical proportion and performed the following calculation: 11X = (15)(.22); therefore, X = 0.3¢.

Webcasters assert that the 0.02¢ per song and 0.3¢ per hour benchmarks should be adjusted downward for a variety of factors, but offer quantification for only one factor – difference in promotional value. *See* Jaffe W.D.T. 34-43, Tr. 6517-34 (Jaffe). Webcasters note that radio play unquestionably promotes the sale of record albums. However, sound recording copyright owners receive a greater benefit from the sale of phonorecords than do copyright owners of the underlying musical works. *See* Jaffe W.D.T. 37-38; Tr. 6525 (Jaffe). As discussed *supra*, musical works copyright owners receive payment for each sale of a phonorecord via licensing of their "mechanical" rights. However, the amount of remuneration is set by statute. *See* Jaffe W.D.T. 44-45; Tr. 6526 (Jaffe). By contrast, the profits that sound recording owners command from sales of their phonorecords are under no legal restraints. *See* Jaffe W.D.T. 46-47. If, as Webcasters assume, the value of the sound recording digital performance right is worth no more than the musical work analog performance right, Webcasters argue that the *total* remuneration received by each of the copyright owners derived from performances should be equal. *See* Jaffe W.D.T. 45-46. Webcasters accordingly argue that, if royalties paid to musical works copyright owners are to be used as a benchmark for royalties that should be paid to sound recording copyright owners, an adjustment is required to account for the greater promotional benefits received by the sound recording owners relative to the musical work owners.[17] *See* Jaffe W.D.T. 44-47.

To determine the appropriate adjustment, Webcasters assumed that 27% of all record album sales were directly attributable to record play on the radio.[18] *See* Jaffe W.D.T. 44. Webcasters then calculated the promotional value discount that reflects the difference in the total remuneration derived by sound recording owners and musical work owners from the sale of record albums promoted by over-the-air radio. *See id.* at 47; Webcasters PFFCL ¶ 293, n.124. This calculation implied that a sound recording royalty for over-the-air radio performances should be 52% of the estimated musical works royalty. *See id*. However, to be "conservative," Webcasters applied a discount of only 30% -- *i.e.*, they propose a Section 114(f)(2) royalty fee for sound recording digital performances that is 70% of the musical works analog performance benchmark royalty that they estimated. *See* Jaffe W.D.T. 48; Webcasters PFFCL ¶ 295; Tr. 6534 (Jaffe). Applying this discount to Webcasters per-performance benchmark of 0.02¢ and their per hour benchmark of 0.3¢, yields a proposed per-performance fee of .014¢ and a per-hour fee of 0.21¢.

[17] This, of course, assumes that these collateral benefits were, and would be, considered by the relevant parties in the negotiation of appropriate royalties for the respective rights. No persuasive evidence supporting this proposition was adduced.

[18] This assumption is also suspect. The Soundscan survey, upon which Webcasters rely, reflected only that 27% of the respondents identified "heard on radio" as what most influenced them to purchase record albums. *See* Fine W.D.T. ¶ 14. This does not necessarily imply that record sales increased 27% *solely due* to radio play.

In their PFFCL, Webcasters, for the first time in this proceeding,[19] propose an alternative royalty metric – a percentage-of-revenue fee structure, provided that each webcasting service could elect which fee structure to utilize. *See* Webcasters PFFCL ¶¶ 275, 283, 296. Webcasters propose a fee of 3% of a webcaster's gross revenues,[20] which they assert "is taken straight from the ASCAP/BMI/SESAC broadcast radio licenses." Webcasters PFFCL ¶ 283. Webcasters assert that "the PROs collectively receive approximately 3 percent of broadcast radio music station revenues directly attributable to over-the air radio." *Id*. With respect to this percentage of revenue fee structure, Webcasters apply *no* downward adjustment because "it is an alternative to be elected at the Webcaster's option." *Id*. at 296.

With respect to "business to business" syndicators and to "listener-influenced" webcasting services, Webcasters propose the same rates as proposed for basic webcasting services. *See id*. at 297-305. They argue *inter alia* that "[r]egardless of the type of service, the nature of the public performance is the same; and the value of the performance does not change merely because of the technology of the webcaster or the fact that the sound recording is heard when it is accessed at a third-party web site [syndicated] rather than the originating webcaster's site." *Id*. at 297.

Webcasters propose no *additional* royalty fees for the making of ephemeral copies under Section 112(e) because "[s]uch copies have no economic value separate or

[19] This proposal is surprising because heretofore Webcasters repeatedly asserted that a percentage of revenue metric is inappropriate. *See e.g.,* Jaffe W.D.T. 22; Tr. 4317-18 (determining the relevant revenues associated with Section 114 webcasting would "create[ ] enormous potential measurement problems.") Moreover, this proposal is untimely. *See* Order of November 3, 2001 (to which no party objected).

[20] Webcasters set forth their definition of "gross revenues" at Webcasters RPFFCL ¶¶ 64-65.

distinct from the value of the public performances they effectuate." *Id*. at 354.

Respecting minimum fees, Webcasters assert that the only justification for imposing a minimum fee is to protect against a situation in which the licensee's performances are such that it costs the license administrator more to administer the license than it would receive in royalties. *See* Jaffe W.R.T. 31; Tr. 12387 (Jaffe). This is particularly true under the per-performance fee structure, which presumably provides the appropriate level of compensation for each use of the copyrighted work. *Id*. Moreover, Webcasters assert that the appropriate calibration for the minimum fee is the incremental costs to the license administrator of adding another license to the system regardless of how many performances they make. *See* Jaffe W.R.T. 32; Tr. 12388 (Jaffe). Accordingly, based upon the minimum fees allegedly charged by the PROs, Webcasters propose a minimum fee of $250 per annum. *See* Webcasters RPFFCL ¶ 163.

V. THE PANEL'S DETERMINATION OF ROYALTY RATES FOR WEBCASTER AND BROADCASTER SERVICES

A. APPLICATION OF THE SECTION 114(f)(2) AND SECTION 112(e) STATUTORY FACTORS

1. Section 114

Section 114(f)(2) directs the Panel to base its decision on 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 enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
>
> (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

17 U.S.C. §114(f)(2)(B)

As we previously noted, these two factors do *not* represent additional criteria. They are merely factors to consider, along with any other relevant factors, in setting rates under the willing buyer/willing seller standard. *See* Order of July 16, 2001 at 5. The weight to be accorded each factor, if any, depends upon its relative significance to a determination of fair market value. *See id* citing Satellite Rate Adjustment Proceeding 62 FR 55742, 55746 (October 28, 1997).

As to the first factor (impact on sales), we cannot conclude with any confidence whether any webcasting service causes a *net* substitution or *net* promotion of the sales of phonorecords, or in any way significantly affects the copyright owners' revenue streams. The evidence adduced by RIAA on this issue, consisting entirely of anecdotes and unsupported opinion testimony, is unconvincing. (*See generally* RIAA PFFCL ¶¶ 124-39, 436-53.) Indeed, RIAA did not attempt to offer any *empirical* evidence to support its "concerns" that webcasting causes a net substitution of phonorecord sales. *Id.*

Webcasters also failed to present any compelling evidence. In addition to a plethora of similarly unsupported opinion evidence (s*ee e.g*., Webcasters PFFCL ¶¶ 311, 315-19, 322), they produced some unpersuasive empirical evidence (s*ee generally* RIAA PFFCL ¶¶ 454-85) to support their claim that webcasting actually causes a net promotion of phonorecord sales.

For example, the Soundata survey presented by Mr. Fine evinced a net promotional effect of radio broadcasts, but said little about the net promotional effect of the internet -- and nothing about any net promotional effect of webcasting. *See* Fine W.D.T. 6-8. The study conducted by Professor Mazis suggested that the impact was, at best, *minimally* promotional. Over 80% of the respondents who listened to radio retransmissions indicated that listening did not affect their overall music purchases and another 9% were not sure; similarly, over 70% of the respondents who listened to internet-only streaming reported that listening did not affect their overall music purchases and another 5% were not sure. *See* RIAA Exhibit 102 RP (Tables 29 & 52); Tr. 5555-56 (Mazis). Moreover, the extremely low response rate raises additional questions about the survey. The 47% adult response rate and the 19% teen response rate[21] fall below generally accepted standards. *See* Tr. 12027-30 (Seltzer). Indeed, Dr. Seltzer's critique of the Fine and Mazis studies, while not flawless itself, nevertheless substantially undermines the reliability of the conclusions offered by these two witnesses.

After weighing the credibility of the various conflicting witnesses and assessing the strength of the proffered empirical evidence, the Panel concludes that, for the time period this CARP is addressing, the *net* impact of internet webcasting on record sales is indeterminate. In any event, as explained earlier (*see* discussion in Section III.A.2, *supra*), to the extent those factors influence rates that willing buyers and willing sellers would agree to, they will be reflected in the agreements that result from those negotiations.[22]

[21] In fact, of the 757 teen respondents, 347 were directed to answer questions about webcasting. *See* Mazis W.D.T. 5-6; Mazis W.R.T. 2; RIAA Exhibit 102 RP (Tables 3, 40 & 63). Accordingly, the results presented by Professor Mazis reflect less than 9% of the 4000 teen panel members who were invited to participate in the survey.

[22] By contrast, it would be necessary to adjust theoretical models, such as the Jaffe formulation, that borrowed data from another marketplace. With a theoretical model, these factors would not already have been accounted for by the negotiating parties. In addition, the setting of prospective statutory rates could be affected by record evidence that clearly established that parties to agreements had misperceived relevant economic realities at the time of their negotiation. For example, if comparable marketplace agreements (used to set a rate for one period) were negotiated on the mutual assumption that webcasting caused a net decline in record sales, but the hearing record proved conclusively that it actually caused a net increase in sales, then the Panel's

Regarding the second factor (the relative creative, technological, and financial contributions of copyright owners and transmitters), we also find no persuasive evidence militating in favor of either copyright owners or services. *See generally* RIAA PFFCL ¶¶ 486-98; Webcasters PFFCL ¶¶ 333-52. Clearly, the streaming industry has made meaningful contributions and incurred significant costs and risks in connection with the services it offers to the public. Similarly, copyright owners have made meaningful contributions and incurred significant costs and risks in connection with the creation of their copyrighted recordings.

Again, we would expect these considerations to be fully reflected in any agreements *actually negotiated* between webcasters and copyright owners in the relevant marketplace. Accordingly, if such agreements exist, absent unusual circumstances, no rate adjustment would be required to determine willing buyer/willing seller rates. Relative contributions, costs, and risks would already be subsumed within the negotiated rates.

2. <u>Section 112</u>

Section 112(e) similarly directs the Panel to base its decision in part on information presented by the parties regarding these same two factors, specifically:

> i. whether use of the service may substitute for or may promote the sales of phonorecords or otherwise interferes with or enhances the copyright owner's traditional streams of revenue; and
>
> ii. the relative roles of the copyright owner and the transmitting organization in the copyrighted work and the service made available to the public with respect to relative

rate-setting for subsequent periods should reflect the reduction in royalty rates which this newly-established conclusion would naturally bring about in marketplace pricing.

> creative contribution, technological contribution, capital investment, cost, and risk.

17 U.S.C. §112(e)(4).

Again, we find no persuasive evidence militating in favor of either copyright owners or streaming services.[23] And again, if agreements actually negotiated between webcasters and copyright owners in the relevant Section 114 marketplace can be observed, these considerations should already be subsumed in the rates negotiated by the parties.

B. PER-PERFORMANCE IS THE PREFERRED ROYALTY METRIC

At the outset of its analysis, the Panel must consider two foundational questions. The first relates to the type of metric to be adopted for the royalty rate. The second is whether rate determinations are best derived from theoretical economic analyses or from any of the licensing agreements in the record before us. We address each of these matters in turn.

Regarding the choice of a metric, we note that initially RIAA proposed a percentage-of-revenue option, but by the conclusion of the proceeding, it urged that only a per-performance model be adopted. *See* RIAA Comments Concerning Definitions of Gross Revenues and Performance at 2 (Jan. 18, 2002). A similar evolution in perspective on this issue occurred over the course of RIAA negotiations with the 26 licenses. Initially, RIAA negotiated two percentage-of-revenue agreements with licensees. RIAA

[23] A considerable amount of the hearing record consists of detailed testimony and exhibits concerning the economics of the recording, music publishing, broadcasting, and webcasting industries; how various streaming services operate; and the technology of the internet. While valuable as general background information, the Panel does not find that this evidence materially aids our determination of what royalty rates willing buyers and willing sellers would actually agree to for the licenses at issue.

Exs. [redacted] Soon, however, RIAA determined that per-performance licenses were more advantageous (*see* Tr. 9203 (Marks)), and it began to offer licenses on a per-performance basis. Thereafter, it reached per-performance agreements with a number of licensees. *See, e.g.,* RIAA Exs. [redacted].

From the evidence of record, the Panel concludes that three factors militate in favor of the per-performance approach. First, in reality, revenue merely serves as "a proxy" for what is truly being licensed. Jaffe W.D.T. 22. By contrast, a per-performance metric "is directly tied to the nature of the right being licensed." *Id*. The more intensively an individual service uses the rights being licensed, the more that service shall pay, and in direct proportion to the usage. *See id*. at 21. And unlike a per-hour fee structure, per-performance models appropriately capture partial performances resulting from a "skip song" feature. *See* RIAA RPFFCL ¶ 189.

Second, percentage-of-revenue models are difficult to utilize because identifying the relevant webcaster revenues can be complex, particularly where the webcaster offers features unrelated to music. A given percentage rate can produce widely variant royalties depending upon the revenue base against which it is applied. *See* Marks W.D.T. 7; Jaffe W.D.T. 22; Tr. 9138-39, 9201-03 (Marks); Tr. 4317-18 (Jaffe).

Third, because many webcasters are currently generating very little revenue, use of a percentage-of-revenue royalty for the statutory licenses at question could result in a situation in which copyright owners are forced to allow extensive use of their property with little or no compensation. This potentiality was something Congress specifically cautioned against in enacting DMCA. *See* DMCA Conference Report 85-86.

For these reasons, the Panel concludes that, where feasible to utilize, a per-performance fee metric is highly preferable to a percentage-of-revenue structure or to a per-hour fee structure, if such a rate can be reliably derived from the evidence of record.

C. A THEORETICAL ECONOMIC MODEL VERSUS NEGOTIATED AGREEMENTS

The second foundational issue relates to the type of evidence that can most reliably be used for deriving the royalty rates we must determine in this proceeding. On this issue, the two sides present starkly different viewpoints. RIAA argues that the best available evidence of the rate which willing buyers and willing sellers would agree to can be found in the 26 agreements it actually negotiated with licensees for the rights in question. The Services, on the other hand, contend that these agreements are fatally tainted in numerous respects and that willing buyer/willing seller rates are best derived from the thoughtful, theoretical model developed and explicated by Dr. Adam Jaffe, a distinguished economist. In essence, the parties ask us to choose between theory and practice, with each side pointing out numerous alleged flaws in the opposing party's presentation.

1. The Shortcomings of the Theoretical Model

Preliminarily, we recognize that rate-setting based upon theoretical market projections is a difficult endeavor. *See e.g.*, *National Ass'n of Broadcasters v. Librarian of Congress,* 146 F.3d 907 (D.C. Cir. 1998). This is true in part because it is virtually impossible for a theoretician to identify all of the factors that might influence the structure of a market and the manner in which these factors will interact to establish rates. The complexity of real world markets makes predicting market rates highly susceptible to error. *See* Wildman W.D.T. 15. Real world participants in an actual marketplace discover relevant market-influencing factors as they negotiate deals, and these factors are reflected in the ultimate agreements reached. *See id*. Actual agreements contain embedded information that cannot be captured fully in the projections and estimates of theoretical analysts. *See* Tr. 3369-71 (Wildman). Factors that the analyst suspects might influence hypothetical negotiations should be subsumed and reflected in actual negotiated agreements, but the theorist's capacity for perfect projection is subject to the inherent limits of human fallibility. *See id*.

Moreover, theoretical models are necessarily based upon a series of logical assumptions and analogies. Each assumption or analogy inevitably involves some degree of uncertainty or inexactitude. The cumulative impact of a string of such assumptions may produce a model which differs substantially from real world experience. In this case, for example, the analysis offered by Professor Jaffe relies upon at least a dozen assumptions, as enumerated below:

(1) that different technologies (analog vs. digital) are analogous;

(2) that different sellers (PROs vs. record companies) are analogous;

(3) that different buyers (established over-the-air broadcasters vs. internet entrepreneurs) are analogous;

(4) that different copyrights (musical works vs. sound recordings) are analogous;

(5) that different delivery systems (over-the-air, where cost/listener remains constant vs. internet, where broadband cost/listener increases) are analogous;

(6) that different cost structures (individual song writers vs. integrated creative/production/marketing corporate entities) are analogous;

(7) that different demand structures (a finite universe of performing artists vs. the mass record-buying public) can be analogized;

(8) that infant and mature industries behave similarly;

(9) that different royalty metrics (percentage-of-revenue vs. per-performance) can be accurately converted from one to another;

(10) that "listener hours" can be accurately converted into "listener songs;"

(11) that an end-product number (a dollar volume amount) from one market can form the basis for a backward calculation to a different metric in a different market; and

(12) that a promotional impact in one industry (radio broadcasting) can be reliably quantified and then used as a rate reduction adjustment for a different industry (webcasting).

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. Two examples are addressed below.

2. <u>The Model is Based upon a Different Market</u>

As discussed above, the webcasters' rate model is premised upon the fundamental assumption that in the Section 114(f)(2) hypothetical marketplace, copyright owners would license their internet sound recording performance rights to webcasters at a rate no higher than the rates at which music publishers (through the PROs) have licensed their musical work analog performance rights to over-the-air radio broadcasters. *See* Section IV.B. *supra.* Accordingly, Professor Jaffe calculated proposed performance fees by extrapolation from a large sample of aggregate fees paid to ASCAP, BMI, and SESAC by over-the-air radio stations holding blanket performance licenses.

This analysis by necessity engrafts concepts and presumptions from one marketplace onto another. Dr. Jaffe's model is thus based upon different buyers and different sellers, selling different rights from those at issue in this proceeding.

The Panel agrees with RIAA that the market for the performance of musical works is distinct from the market for the performance of sound recordings. Musical works and sound recordings do not compete in the same market, and they have different cost and demand characteristics. *See generally* RIAA PFFCL ¶¶ 523-35. Moreover, the Panel rejects Dr. Jaffe's premise that the value of performance rights in sound recordings are *necessarily* no greater than in musical works because costs are "sunk." *See id* at ¶ 552-67. This view assumes (erroneously, in our view) that sound recording owners have a static perspective and do not consider the costs of developing new sound recordings when negotiating fees. *See* Schink W.R.T. 6-7; Tr. 13576-78, 13584-89 (Schink).

As to the precise relative value of performance rights in sound recordings *vis-à-vis* musical works, we render no opinion. However, in determining the prices to which willing buyers and willing sellers would agree, the "true" relative value -- even if that could be precisely ascertained -- is less important than the parties' perception of that relative value. Thus, Professor Jaffe's theoretical calculations are far less powerful evidence in this regard than, for example, David Madelbrot's repeated testimony that one of the factors which led Yahoo! to sign the RIAA agreement was Yahoo!'s belief that the sound recording royalty rates in that agreement were "[redacted]" of what Yahoo! paid to the PROs for musical works royalties. Tr. 11250, 11270, 11287-89 (Mandelbrot).

In addition, many of the webcasters' arguments in support of Professor Jaffe's conclusions have significant limitations. *See generally* RIAA PFFCL ¶¶ 578-89 ("master use" and "synch" rights), 590-93 (statutory allocation), 610-21 (international evidence). And Webcasters can take no comfort in the prior Subscription Services Rate Proceeding, in which the Register simply found that neither side had produced compelling evidence of relative value. *See* 63 Fed. Reg. 25394, 25404 (1998). *See also* Order of July 18, 2001 at 2.

3. The Conversion from Percentage of Revenues

Regarding this issue, the Panel again agrees with RIAA that converting a rate from the metric in which it was negotiated into another metric to be used as a benchmark is usually a risky undertaking. *See* RIAA PFFCL ¶¶ 597-600; *cf. ASCAP v. Showtime*, 912 F.2d 563 at 579 (magistrate's opinion). Indeed, the listener-hour conversions calculated by Professor Jaffe bear little resemblance to the blanket license fees *actually paid* by some individual radio stations. *See e.g.*, RIAA PFFCL 602-04**.** For example, during the year 2000, one specific station which was analyzed actually paid four times the amount of fees to the PROs that Professor Jaffe's conversion calculation had predicted. Moreover**,** even if the conversion were mathematically correct, real world considerations may drive marketplace players to utilize one metric and strongly resist another. *See* Schink W.R.T. 6-7; Tr. 13541-53, 13650-69, 13676-78 (Schink).

Given the uncertainty inherent in any theoretical model and our numerous significant concerns regarding the limitations of this specific webcaster analysis, the Panel next examines whether the record before us affords better evidence.

D. COMPARABLE AGREEMENTS ARE THE BEST BENCHMARK

The Panel believes that 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. This belief is buttressed by two factors.

The first is statutory. Both Sections 114 and 112 explicitly invite the Panel to consider the rates and terms negotiated under voluntary license agreements. *See* 17 U.S.C. §§ 114(f)(2)(B), 112(e)(4). Section 114 further invites the Panel to consider other agreements negotiated by comparable digital audio transmission services under comparable circumstances. *See* 17 U.S.C. § 114(f)(2)(B). Second, because as noted above, it is extraordinarily difficult to predict marketplace results from purely theoretical premises, it is clearly safer to rely upon the outcomes of actual negotiations than upon academic predictions of rates those negotiations might produce. *See* Tr. 3369-71 (Wildman).

Indeed, as Professor Jaffe himself testified, comparable marketplace agreements, if available, provide the best evidence of the prices to which willing buyers and willing sellers actually agree. Tr. 6618 (Jaffe) ("If you had available agreements that you believe represent reasonable rates for users that are comparable to the users being licensed by the proceeding, I think that would have been the best thing to do."). *Accord,* Tr. 13675 (Schink) (The best evidence for determining fair market rates is agreements actually negotiated in the marketplace). The Panel's next task, therefore, is to consider whether any of the agreements before us constitute such comparable agreements.

E. THE [redacted] LICENSE AGREEMENT

We concluded above that the Section 114(f)(2) hypothetical marketplace is one where the buyers are DMCA-compliant services, the sellers are record companies, and the product being sold consists of blanket licenses for each record company's repertory of sound recordings. Accordingly, the most reliable benchmark rate would be established through license agreements negotiated between these same parties for the rights described. Unfortunately, the record contains only one agreement that appears to meet all three of these parameters, namely, the agreement between [redacted]. *See* [redacted], testified that [redacted] was a fully DMCA-compliant service.[24] *See* Tr. [redacted]; [redacted] The agreement provided for a royalty rate of [redacted] per performance[25] with [redacted]. Regrettably, while directly on point, this agreement can be accorded little weight because it was never implemented, and

---

[24] Curiously, the license agreement requires compliance with Section 114(d)(2)(C)(i) (the performance complement requirements) but it is silent as to compliance with Section 114(d)(2)(A) (the non-interactivity requirement).

[25] The agreement is silent respecting any ephemeral royalties under Section 112(e). *See* RIAA Exhibit [redacted]. This could be interpreted to mean either that (1) the [redacted] per performance fee *included* the making of ephemeral copies incident to the transmissions or (2) an unspecified additional fee could be due under Section 112(e). The agreement specifies that the Licensee is not granted [redacted] *Id*. at 3. It further provides that the agreement [redacted] and provides examples, none of which relate to making ephemeral copies. Although it is difficult to imagine that the parties intended additional, but unspecified, fees to be paid (or that the making of ephemeral copies would be unnecessary), in light of this unambiguous language, we cannot assume that the intended rate for making ephemeral copies was zero. *See generally* discussion of ephemeral royalties in Section V.N. *infra.*

[redacted] therefore never paid any royalties under it. Rather, [redacted] outsourced its streaming to a third party, which apparently deemed the agreed rate too high and elected instead to avail itself of the compulsory license rate set in this proceeding. *See* RIAA's Reply of October 24, 2001 to the Order of October 2, 2001. On balance, since no royalties were ever paid pursuant to its provisions, we conclude that this agreement is of virtually no use as a rate benchmark. *See* discussion in Section V.G.2. *infra*.

F. THE 26 RIAA LICENSE AGREEMENTS CONSTITUTE THE NEXT CLOSEST APPROXIMATION OF THE HYPOTHETICAL MARKETPLACE

The 26 agreements between RIAA and various services were the product of a marketplace with many characteristics similar to the hypothetical marketplace the Panel is directed to analyze. Although the seller in these negotiations was different (RIAA, rather than record companies), the buyers were the same, and the rights for sale were identical. Of course, the marketplace differed since the agreements were negotiated within the context of a compulsory license, while the hypothetical marketplace is one where no compulsory license would exist. *See* Section III.A.3. *supra*. However, the very fact that RIAA, a single designated negotiating agent of the record companies with potential to yield monopolistic power, negotiated the agreements under the shadow of the compulsory license, renders the agreements more, rather than less, comparable. Stated otherwise, because the agreements were negotiated with DMCA-compliant services in the context of a protective compulsory license, the distinction between *RIAA* as seller, in contrast to the *record companies* as sellers, becomes much less significant. So long as buyers could avail themselves of the compulsory license, RIAA was deprived of a monopoly seller's most effective power, i.e., the ability to withhold a product from the marketplace.

Thus, the 26 RIAA agreements were negotiated in a marketplace with two countervailing features not present in the hypothetical marketplace envisioned by Sections 112 and 114. The antitrust exemption, which allowed RIAA to negotiate for all copyright owners, had the effect of strengthening the seller's bargaining power. And the compulsory license, which allowed services to use all sound recordings without having a single license agreement, had the effect of strengthening the buyers' bargaining power. Based on a knowledgeable weighing of this voluminous record, including its own questioning and credibility assessments of more than 30 witnesses, the Panel concludes that neither of these factors has been shown to outweigh the other, and they should thus be deemed to be effectively counterbalancing. Accordingly, the relative market power of the buyer group and seller group in the hypothetical market would be roughly comparable to the relative market power of the buyer group and seller group in the market which produced these 26 agreements.

In the absence of additional agreements between DMCA-compliant services and record companies, therefore, the Panel concludes that the 26 RIAA license agreements constitute the next closest approximation of the hypothetical market. If analysis determines that a reliable benchmark can be gleaned from these license agreements, the Panel should look to that benchmark rather than the Webcasters' theoretical model, which attempts to deduce a rate through a series of assumptions drawn from a marketplace far removed from the one envisioned in this statute.

G. <u>CLOSE SCRUTINY REQUIRED</u>

For the reasons stated above, the 26 RIAA agreements constitute an appropriate starting point for rate-setting in this proceeding. However, these license agreements must be scrutinized to determine whether individual circumstances or anomalous conditions render them unreliable as benchmarks. This is particularly true under the circumstances present here, where the agreements were all recently negotiated within the context of a newly emerged industry (webcasting) involving newly-created rights (Sections 114 and 112). Because these are new rights, both RIAA and its licensees, including even the most sophisticated ones, negotiated these agreements without benefit of established historical standards. Both sides had "considerable uncertainty about the ultimate equilibrium value for the right." Jaffe W.D.T. 15-16. Such license agreements should be approached with caution, since they may not reflect fully educated assessments of the nascent businesses' long-term prospects. *Cf. ASCAP v. Showtime*, 912 F.2d 563 at 567, 579. The resulting licenses warrant less confidence as benchmarks than would comparable agreements negotiated over a long period, which had withstood the "test of time." *Cf. United States v. ASCAP*, No. 41-1395, 13-14 (S.D.N.Y. June 11, 2001).

Bearing in mind these cautions, we turn to the agreements themselves and note that, with one significant exception discussed at length *infra*, the 26 agreements *generally* provide Section 114(f)(2) webcaster rates of 0.4¢ per performance.[26] *See* RIAA Exs. 60 DR – 85 DR; Marks W.D.T. (Attachment B). Section 112(e) ephemeral license fees of about 10% of performance fees are generally provided in those agreements that expressly

[26] Those agreements prescribing a percentage-of-revenue metric generally fall in the 15% of revenue range.

grant such rights.[27] *See id*. Given the range of rates that one would expect to occur in a newly emerging marketplace such as the one we replicate, the Panel must now consider whether the 0.4¢ per performance and 10% ephemeral rates contained in most of these agreements truly reflect the rates that willing buyers and willing sellers would typically pay in a hypothetical marketplace.

1. The RIAA Negotiating Strategy

Considerable hearing time was devoted to examining the circumstances surrounding the negotiation of each of RIAA's agreements with the 26 licensees. Moreover, the Panel has studied each agreement thoroughly. From this evidence, a clear and definitive pattern is apparent. Before negotiating its first agreement, RIAA developed a strategy to negotiate deals for the purpose of establishing a high benchmark for later use as precedent, in the event a CARP proceeding were necessary. The RIAA Negotiating Committee reached a determination as to what it viewed as the "sweet spot" for the Section 114(f)(2) royalty, both on a percent-of-revenue basis and per-performance basis.[28] *See* Tr. 9415-16, 9418-19, 9422-26. It then proceeded to close only those deals (with the exception of Yahoo!) that would be in substantial conformity with that "sweet spot." *See* RIAA Exhibits 060 DR through 084 DR.

---

[27] Curiously, as in the [redacted] agreement, many of the license agreements contain no grant of ephemeral rights, and they contain language virtually identical to that in the [redacted] agreement, which limits rights to those expressly granted. *See* note 25 *supra.* For the reasons previously stated, we do not consider such agreements as benchmarks for rights *not* granted. *See id.*

[28] This "sweet spot" was not based on any calculation of a reasonable rate of return for copyright owners' investment, nor upon any other economic study. It simply reflected the Negotiating Committee's instinct of what price the marketplace would bear. Tr 1865, 1879-81 (Wilcox); Tr. 9416 (Marks). Thus, these rates have no independent economic validity, they are meaningful only to the extent the marketplace has accepted them.

Numerous internal documents from months of negotiations with many licensees confirm this consistent RIAA strategy. Thus, for example, during negotiation of the critical first agreement, RIAA's Chief Negotiator Steven Marks wrote to the RIAA Negotiating Committee:

[redacted]

RIAA Exhibit 137 DR at RIAA N13617-18

Subsequently, MMM readily acquiesced in RIAA's request to separate the performance license from the ephemeral license. *See Id.* Because, for various reasons, MMM urgently sought to conclude a deal, it attempted little negotiation of the fundamental economic terms of the agreement – other than the minimum fee. *See* Tr. 9632-33; Services Ex. SX 43. *See generally* RIAA Exhibit 137 DR.

The record also reveals that during negotiations with Broadcast.com, Mr. Marks explained that a certain proposal was unacceptable to RIAA because it [redacted] He also informed Broadcast.com that [redacted] RIAA Exhibit 137 DR at RIAA N11732, N1009. Similarly, during a later stage of the negotiations with Yahoo! (which had acquired Broadcast.com), Mr. Marks expressed concern that the deal [redacted] RIAA Exhibit 137 DR at RIAA N11732.

RIAA asserts that the reference to "precedent" throughout the various negotiations was intended to mean "marketplace precedent" -- rather than precedents intended to be used in the CARP. *See e.g*., RIAA RPFFCL ¶ 120. This explanation lacks credibility. RIAA meticulously crafted confidentiality clauses for each and every license agreement. These clauses prohibit any licensee from discussing the terms and conditions of the agreement with other parties. *See* RIAA Exs. 60 DR- 84 DR. But it simultaneously reserved its own right to use each agreement however it wished at the CARP proceeding. *See id*. These clauses belie the notion that RIAA's primary[29] concern was to establish precedents for other potential licensees.

As we have noted, in the statutory marketplace, one would expect to find some buyers - for various reasons – that are willing to pay higher rates for a product than most other buyers pay. But, if a seller is in a position to *temporarily* sacrifice volume, it can afford to negotiate deals only with those buyers willing to pay above-market rates. By engaging in this conduct, the Panel finds, RIAA created a virtually uniform precedent with rates above those that most buyers would be willing to pay.[30]

Moreover, RIAA devoted extraordinary efforts and incurred substantial transactional costs to negotiate successfully a relatively small number (26 agreements out of hundreds of services) of license agreements with mostly minor services -- services that promised very little actual payment of royalties. *See* discussion *infra* Section V.G.2; RIAA Exhibit 126 DP; Marks W.D.T. 4. Such sacrificial conduct makes economic sense

[29] We do not find that establishment of a high CARP benchmark was RIAA's *only* motivation. We do not doubt that RIAA sought to "sign up" as many licensees as it could – particularly "major players" like "AOL, Viacom and Yahoo!" (*see* Tr. 558-60 (Rosen)) – in hope of avoiding an expensive and risky CARP proceeding. RIAA hoped that if a major player fell in line, all others would follow. *See id*. *See also* Tr. 13876-77 (Marks).

[30] By contrast, the [redacted] license, involving the only DMCA-compliant service that negotiated with an individual record company, produced a royalty rate significantly less than the "sweet spot" RIAA rate. *See* Section V.E., *supra*.

only if calculated to set a high benchmark to be later imposed upon the much larger constellation of services.

In fact, RIAA reached agreement with only 26 of the 60 services with which it had "meaningful discussions." RIAA PFFCL ¶ 189. And RIAA offered virtually no evidence to explain why the majority of these services did not conclude an agreement. In the absence of alternative explanations, the Panel infers that this majority of buyers was simply unwilling to agree to the rates RIAA was seeking. Indeed, had RIAA *not* pursued this negotiating strategy, we would have expected to see a much broader range of negotiated rates. The tight range of rates among the 25 non-Yahoo! agreements suggests a take-it-or-leave-it approach. RIAA decided to deviate significantly from its 0.4¢ precedential rate on only one occasion – to successfully negotiate the deal with Yahoo. *See* n.26 *supra*.

Because RIAA was apparently able to close deals at its "sweet spot" with only a minority of licensees, the Panel finds that these non-Yahoo! agreements do not establish a reliable benchmark. Rather, they establish, at best, the high end of the rate range that some services (with special circumstances) might pay. Before addressing the Yahoo! agreement, however, we shall set forth additional bases for determining that the 0.4 ¢ rate (as represented by the 25 non-Yahoo! agreements) is not a useful benchmark.

2. Licensees That Paid Little or No Royalties <u>Or Quickly Ceased Operating</u>

Although RIAA has urged the Panel to adopt the rates represented in the 26 voluntary agreements it negotiated with licensees, one of RIAA's lead economic experts, Dr. Thomas T. Nagle, enunciated principles that would result in the Panel rejecting nearly all of these agreements. Dr. Nagle testified that the Panel should accord no weight to agreements with licensees which are unable to endure in the marketplace. *See* Tr. 2642-48 (Nagle). Dr. Nagle rested his overall analysis on the fundamental assumption that the current webcasting industry consists of a large number of marginal or insignificant entities (*see, e.g.,* Tr. 13393 (Nagle); Nagle W.D.T. 5) and that a dramatic "shake out" must and will occur. *See id.* This, in his view, is both inevitable and desirable because it will bring about market consolidation, which will result in the emergence of a far smaller number of viable webcaster companies. These, in turn, will be able to prosper and endure (operate at a "sustainable scale at this future point of viability" (Nagle W.D.T. 6)) and, not incidentally, be able to afford significantly higher royalty payments to copyright owners. RIAA Ex. 108 DP (Nagle analysis) at 15. The actions of the marginal economic entities which are fated to disappear in this process, in Dr. Nagle's view, are economically inconsequential and offer virtually no probative value as benchmarks for setting future royalty rates. Tr. 2642-48, 13393 (Nagle).

This testimony is significant because the majority of RIAA's 26 licensees fall into the category of smaller entities which are unlikely to endure. A number of them never launched their services, and another group, after launching, have already ceased operation. All but a handful of the 26 licensees either (1) paid zero royalties; (2) paid no royalties beyond the prescribed minimum (due to low revenues or because they streamed so few transmissions); or (3) quickly went out of business. These licensees include Cyberaxis; Multicast Technologies, Inc.; Cornerbrand.com; Beem-Me-Up Broadcasting; Spacial Audio Solutions; Cybertainment Sys. Corp.; Kickradio.com;[31] NRJ Media Corp.;

[31] The [redacted] agreement does not specify a "minimum." *See* RIAA Exhibit [redacted]. It requires a [redacted] advance, which was paid. However, the service has not yet launched, and the fee formula appears illusory. *See id*. *See also* Webcasters PFFCL ¶¶ 216-17, n.102.

JamRadio.com; MoodLogic, Inc.; She Sings Media, LLC; GaliMusica; OnAir.com;[32] Soundbreak.com; Spike Internet Radio, Inc;[33] Visual Dynamics, LLC; eNashville; Fansedge, Inc.; The Buzz Bin.com; and SLAM Media, Inc. *See* RIAA Exhibit 15 RR, 80 DR, 70 DR, 70A DR; 84 DR, 82 DR, 69 DR, 73 DR, 63 DR, 63A DR, 64 DR, 064A DR, 77 DR, 79 DR, 68 DR, 66 DR, 74 DR, 76 DR, 65 DR, 67 DR, 72 DR, 81 DR, 71 DR. Another licensee has paid *de minimis* royalties of less than [redacted] over two license terms.[34] *See* Tr. 9918-31 (Marks); RIAA Exhibit 15 DR, [redacted].

Apart from Dr. Nagle's opinion, several factors support the conclusion that agreements involving non-functioning or minimally-functioning services (under which few or no royalties have been paid) should carry significantly less weight as benchmarks than licensing agreements involving vibrant businesses that have paid significant royalties. First, smaller, economically marginal licensees that expected to earn little revenue, or to stream few transmissions, would care little, when negotiating their agreements, about the fee formula -- other than the minimum fee required. Second, services that quickly terminated their businesses tend to exhibit little business acumen or experience. *See e.g.*, Tr. 13390-92 (Nagle). In this new marketplace, agreements with licensees of these sorts should be accorded significantly less weight. *Cf. ASCAP v. Showtime*, 912 F.2d 563 at 567, 579. Indeed, a strict application of Dr. Nagle's opinion

---

[32] Additionally, the Panel has concerns that OnAir.com perceived an RIAA license to be considerably more advantageous than a statutory license for its particular circumstances. *See* Webcasters PFFCL ¶ 209.

[33] Operators of Spike Internet Radio also appear to have been under time constraints that could have precluded negotiation of individual licenses with the record companies. *See* Webcasters PFFCL ¶¶ 253-54. *See also* Section V.G.3. *infra.*

that any agreement with a service that is not "economically viable" should be accorded *no* weight as a potential benchmark (*see* Tr. 2642-48, 13390-93 (Nagle)) would eliminate all but three or "potentially four" of the 26 agreements from *any* consideration.

The Panel renders no findings with regard to the inevitability of an industry "shake out" or any inherent characteristics of smaller services. However, the Panel does find that certain actions of a clear majority of the 26 licensees appear to demonstrate a significant lack of understanding with respect to important aspects of the DMCA. One clear example, described more fully in Section V.N.3. below, is the failure of a majority of the 26 to negotiate the right to make the ephemeral copies of sound recordings necessary to the successful operation of their services. This demonstrated lack of business acumen tends to further erode Panel confidence in the weight to be accorded these agreements as benchmarks.

3. <u>Licensees that Could Not Wait for the Statutory License</u>

As explained previously, *so long as* prospective licensees could avail themselves of the compulsory license, RIAA would be deprived of any significant potential to exercise monopolist power. *See* Section V.F. *supra*. However, if due to special circumstances, some licensees required immediate RIAA licenses, these licensees would no longer be shielded from the potential monopoly power of RIAA. And negotiating DMCA-compliant, voluntary licenses directly with the record companies may have been

[34] It also appears that the extremely unsophisticated operator of this service, [redacted], may have believed that an RIAA license agreement was *required* even under the statutory license. *See* RIAA Exhibit [redacted] at RIAA N1750.

unattractive.[35] Under such circumstances, the resulting rates must be deemed to constitute above-market rates. In addition to Spike Internet Radio (*see* n.33, *supra*), both musicmusicmusic ("MMM") and Websound fall into this category.

MMM was the very first license which RIAA negotiated at its predetermined "sweet spot." *See* Section V.G.1., *supra*. MMM had at least three reasons to need an immediate license: (1) to diffuse negative publicity stemming from a Canadian cease-and-desist order, (2) to generate positive press promotion by becoming the first RIAA licensee, and (3) to allay concerns of foreign investors respecting an upcoming initial public offering in Germany. Thus, MMM was extraordinarily eager to secure a voluntary license from RIAA. (*See* Webcasters PFFCL ¶¶ 150-53; RIAA Exhibit 128 DR.) Furthermore, MMM clearly perceived an RIAA license to be more valuable than a statutory license. (*See* Webcasters PFFCL ¶¶ 155-61.) In fact, Mr. Spegg of MMM candidly acknowledged that, because of these factors, [redacted][36] *See* Tr. 12929-33 (Spegg). Except as to the precise definition of the revenue base, MMM docilely accepted RIAA's proposed [redacted] of revenue fee model virtually without substantive negotiation. *See id*.

---

[35] For example, time may not have permitted such negotiations. Or, services might have found the prospect of negotiating a DMCA-compliant license with multiple record companies (that all had access to confidential RIAA records) quite unattractive. Indeed, only one service did conclude a DMCA compliant voluntary license. *See* Section V.E. *supra.*

[36] We assume this reasoning also applied to the renewal license (*see* RIAA Exhibit 60A DR). We also note that in the renewal agreement, MMM successfully negotiated a type of mutual MFN clause whereby [redacted] *See id.* This further renders the agreement less useful as a benchmark. It would be circular reasoning for the Panel to rely upon an agreement to establish a marketplace rate [redacted]

The Panel also finds that Websound felt a similar sense of urgency. Websound appeared to have been under two time pressures: (1) to resolve uncertainty regarding whether the service would qualify for the statutory license (*see* RIAA Exhibit 136 DR at N9422), and (2) to secure confirmation of its license status for its customers. *See id* at N9421-23, N9720, N9751, N9772-73. *See also* Tr. 10122-26 (Marks). It is also significant that Websound is a very minor player in this market. Despite acceding to one of the highest royalty rates, it has paid less than [redacted] since the agreement was executed in September 2000 – less than [redacted] of the fees paid by Yahoo! over a similar period. *See* RIAA Exhibit 15 RR.

For these reasons, the Panel concludes that the MMM and Websound agreements reflect buyers at the high end of the rate range and are, as such, of little use as benchmarks for the average marketplace rate.

Putting aside licensees which either (1) paid no royalties beyond the prescribed minimum**,** (2) quickly ceased operating, or (3) could not wait for the statutory license, only three of RIAA's 26 licensees remain: MusicMatch; Lomasoft; and Yahoo!. Each of these three merit individual discussion.

4. <u>MusicMatch License Agreement</u>

Because the negotiation of the MusicMatch agreement was closely associated with the settlement of infringement litigation initiated by RIAA, it cannot be reasonably characterized as the product of marketplace negotiations between a typical willing buyer and a typical willing seller. Indeed, in order to end RIAA's litigation against it, MusicMatch eventually accepted license fees and terms less favorable than those it had rejected prior to the litigation. *See* Webcasters PFFCL ¶¶ 137, 140-44; RIAA exhibit 115

DR; RIAA Exhibit 152 DR. The Panel also notes that this agreement contains a type of MFN clause [redacted][37] This provision further erodes the usefulness of this agreement as a benchmark for what willing buyers and willing sellers would agree to in a hypothetical marketplace where no statutory license (and therefore no CARP proceeding) existed. *See* n.37, *supra*. Accordingly, the Panel finds that this agreement reflects rates above those that willing buyers and sellers would normally negotiate and, in any event, its MFN clause renders it of little use as a benchmark.

5. <u>Lomasoft License Agreement</u>

The Lomasoft agreement, RIAA's second license, was negotiated shortly after the MMM license described previously. *See* Marks W.D.T. (Attachment B). With minor exceptions, it contained the same percentage of revenue fee model as the first license.[38] *See id*. The record indicates that Lomasoft is another small service, whose two operators had no prior music licensing experience. *See* Tr. 13109-13, 13119 (Heilbronn). Moreover, since concluding its license agreement with RIAA in August 1999, Lomasoft paid total royalties of approximately [redacted] (about [redacted] of Yahoo! payments). *See* RIAA Ex.15 RR.

The probative value of the Lomasoft license is also diminished because it has expired and not been renewed. *See* Tr. 13105, 13114 (Heilbronn). Apparently realizing that he initially overpaid, Mr. Heilbronn never seriously discussed renewal of the license.

---

[37] [Deleted due to correction of footnote 36.]

[38] RIAA informed Lomasoft that [redacted] (emphasis added). RIAA Exhibit 129 DR at RIAA N8552.

He testified that [redacted] Tr. 13115.

Evidently, Lomasoft deemed negotiations with RIAA a futile mismatch. We do not doubt this to be the case. Lomasoft negotiated a license agreement that does not even grant it the right to make multiple ephemeral copies (*see* RIAA Exhibit 61 DR at §§ 2.2, 2.5), although it appears that the company requires such copies. *Cf*. Tr. 14972-74. Indeed, Lomasoft believes that the *performance* license *did* grant it the right to make ephemeral copies at no additional charge (*see* Tr. 13106-07 (Heilbronn)), even though the agreement clearly excludes such rights. S*ee* RIAA Exhibit 061 DR at §§ 2.2, 2.5. This record reflects grossly mismatched negotiating parties.[39]

[39] In addition to Lomasoft, a clear majority of the original 26 RIAA agreements did *not* grant the right to make ephemeral copies, including original licenses for Radiofreeworld, NRJ Media, JamRadio, Visual Dynamics, OnAir.com, eNashville, GaliMusica, Spacial Audio Solutions, Multicast Technologies, SLAM Media, Fansedge, Cybertainment, Beem-Me-Up, and Cornerband. We recognize the possibility that some of these services may have erroneously perceived that they could operate their services without this right. C*f*. Tr. 14970-71 (Garrett). But interestingly, of these licensees that ultimately renewed their licenses, each renewal contained the grant of rights to make ephemeral copies (for a specified fee). *See* RIAA Exhibits [redacted]; Tr. 14969 (Garrett) [redacted]. Because the record does not reflect that any of these licensees changed the manner in which they delivered their services from the first license to the second, we must assume that they required an ephemeral license all along. Moreover, RIAA's own expert witness testified that the process of "ripping" CDs to a server entails copying. *See* W.D.T. of Griffin 6. *See also* Tr. 8651 (Talley) (ephemeral [buffer] copies are produced whenever a CD is played). Thus, these licensee's lack of sophistication further enhanced RIAA's ability to secure above-market rates that it could later offer as benchmarks.

Given this totality of circumstances, we have little confidence that the Lomasoft agreement reflects a representative rate that willing buyers and willing sellers would normally negotiate.

6. **Weight To Be Given the 25 Non-Yahoo! Agreements**

For the reasons cited previously, and for many additional ones not addressed here,[40] the Services assert that none of the RIAA license agreements are entitled to any weight whatever in establishing the statutory royalty rates. *See* Webcasters PFFCL ¶ 65. Conversely, RIAA does not concede a single problem with regard to any of these license agreements and continues to offer them all as record support for its rate proposals. RIAA argues that all of these licensees, as well as the circumstances surrounding the negotiation of the license agreements, are representative of the real world marketplace. *See generally* RIAA PFFCL ¶¶ 271-314. For example, RIAA asserts that many webcasters are subject to time constraints, require prompt licensing for certainty or other reasons (*see id*. at 299-301), or desire positive publicity. *See id*. at 309. While the Panel agrees that the non-Yahoo! licensees are not unique, RIAA has certainly not shown that they are representative of the majority of webcasters. Doubtless, some licensees do share individual circumstances that would induce them to pay higher rates than services that do not share such circumstances. *See, e.g.,* Tr. 2614-18, 2762 (Nagle) ("soda on the beach" example). But such licensees merely establish the upper bounds of the expected rate range, not the rates to which more representative buyers would willingly agree.

---

[40] *See generally* Webcasters PFFCL ¶¶ 65-272. These additional arguments generally entail allegations that (1) the licensees were not comparable types of services; (2) the licenses were negotiated under non-comparable circumstances; or (3) the licenses negotiated reflect RIAA's unconstrained monopoly power.

As to those licensees that paid little or no royalties, RIAA notes that some of the Services that are party to this proceeding are of comparable size or have ceased operations. *See id.* at 288-91. This entirely misses the point. If those Services had reached agreements with RIAA, and then paid no royalties beyond the recited minimum, or quickly went out of business, the Panel would accord those agreements very little weight either. For the reasons previously cited, it is difficult to imagine how one could rely on such agreements with any confidence.

In sum, the Panel concludes that the 25 non-Yahoo! license agreements (as well as the [redacted] agreement) are unreliable benchmarks. They are entitled to very little weight for the purpose of determining the rate that willing buyers and willing sellers would normally negotiate in the relevant marketplace. The RIAA agreement with Yahoo!, however, is marketplace evidence of an entirely different character.

7. The Yahoo! License Agreement

Initially the Panel notes that Yahoo! alone accounts for over [redacted] of all royalties paid to RIAA under the 26 relevant voluntary licenses. *See* RIAA Exhibit 15 RR. And because it pays substantially lower rates than other licensees, the [redacted] payment percentage suggests that Yahoo! transmissions account for far more than [redacted] of all DMCA-compliant performances for which sellers have received payments. On this basis alone, barring special circumstances, the Yahoo! rates should be accorded significant weight.

There is another compelling reason for according the Yahoo! agreement great weight. Of all the parties with whom RIAA negotiated license agreements, Yahoo! is the only one with resources, sophistication, and market power comparable to that of RIAA.

Yahoo! is one of the world's leading internet companies. *See* Marks W.D.T. 27-28; Tr. 11384 (Mandelbrot); Panel Rebuttal Hearing Exhibit 1 at 1, 3, and 7. For the calendar year (2000) in which its license agreement with RIAA was executed, Yahoo! had net revenues of [redacted] and net income of [redacted]. Panel Rebuttal Hearing Exhibit 1 at 3. Thus, the Yahoo!-RIAA negotiation was the only one to reflect a truly arms-length bargaining process on a level playing field between two major players of comparable skill, size, and economic power.

(a) <u>Description of the Yahoo! Streaming Service</u>

In the audio streaming portion of its service, Yahoo! operates as an "aggregator" that serves as a portal for AM/FM radio stations and other webcaster sites. *See* Panel Rebuttal Hearing Exhibit 1 at 3. At the time the Yahoo! license agreement was negotiated, about [redacted] of its streaming performances were radio retransmissions[41] ("RR"), in which, pursuant to a business arrangement with an AM or FM radio station, Yahoo! transmitted that station's broadcast signal over the internet. At that time, internet-only ("IO") performances - - transmission of programming not simultaneously broadcast over-the-air by any radio station - - constituted the remaining [redacted] of Yahoo!'s transmissions. This approximate ratio was expected to continue for the next [redacted] *See* Panel Rebuttal Hearing Exhibit 1 at 5.

(b) <u>The Yahoo! Terms</u>

The pertinent terms of the Yahoo!/RIAA license agreement follow:

---

[41] Retransmission is defined in 17 U.S.C. §114(j)(12) to mean a further, simultaneous transmission of an initial transmission.

- An initial fee of [redacted] for the first [redacted] performances commencing retroactively to October 28, 1998; this is a lump sum payment that does not depend on the type of performance (RR versus IO) (*see* RIAA Exhibit 075 DR at § 3.1);

- After the initial [redacted] performances, the prescribed rate for IO performances is [redacted] per performance (*see id.* at § 1.11) and the rate for RR performances is [redacted] per performance (*see id.* at § 3.5.1);

- A lump-sum [redacted] payment for ephemeral recordings through December 31, 2000 and a lump-sum [redacted] payment for each subsequent renewal term (*see id.* at §§ 3.1, 3.4);

- A [redacted] lump sum fee for featured performances on non-music radio stations through December 31, 2000, plus [redacted] per year during each renewal term (*see id.* at §§ 3.1, 3.4);

- An initial term running from [redacted] (*see id.* at §§ 3.2.2, 3.2.3, 6.1.2);

- A type of MFN clause in which Yahoo! is entitled to [redacted] (*see id.* at § 3.6.1);

- A confidentiality clause [redacted] (*see id*. at §§ 5.1, 5.2);

- A non-cooperation clause that [redacted] (*see id.* at § 3.7.3); and

- A "whereas" clause in which it is recited that approximately [redacted] of Yahoo!'s radio retransmissions are within a 150-mile radius of the originating radio station. S*ee id*. (introductory clauses).

Most of the performance fees paid by Yahoo! to date were paid under the undifferentiated, lump sum payment applicable to the first [redacted] performances. This payment basis continued until late 2000. *See id* at § 3.1; Tr. 11275 (Mandelbrot); RIAA Exhibit 15 RR; Webcasters PFFCL ¶ 107, n.50. That payment was the equivalent of a "blended" rate of [redacted] per performance ([redacted] performances) (*see* Tr. 11278 (Mandelbrot); Panel Rebuttal Hearing Exhibit 1 at 4; Webcasters PFFCL ¶ 107, n.51) and was explicitly so described by the parties. RIAA Ex. 137 DR at N0939. Beginning in late 2000, Yahoo! began paying fees under the differentiated rates of [redacted] per IO performance and [redacted] per RR performance. Because, in the near term, Yahoo!'s streaming activities were expected to remain at approximately [redacted] RR and [redacted] IO, Yahoo! perceived the [redacted] RR and [redacted] IO differentiated rates, for its performances in excess of [redacted], as tantamount to a blended rate of [redacted] (*see* Tr. 11279, 11292 (Mandelbrot), Panel Rebuttal Hearing Exhibit 1 at 7), and again, this was explicitly referenced during the negotiations. RIAA Ex. 137 DR at N0946. Indeed, that projection proved fairly accurate throughout the period up to the time of the hearing herein. *See* Tr. 11279, 11333, 11345 (Mandelbrot). The *total* performance fees paid by Yahoo! through August 2001, yielded an effective rate of [redacted]. *See* Webcasters PFFCL ¶ 108 n.52; Panel Rebuttal Hearing Exhibit 1 at 7.

(c) <u>The Yahoo! Negotiation</u>

Both the Services and RIAA agree that RIAA was highly motivated to reach an agreement with Yahoo! *See* RIAA PFFCL ¶ 123; Webcasters PFFCL ¶ 114. RIAA hoped that the news of an agreement with a "major player" would spur other webcasters to sign agreements and obviate the need for a CARP proceeding. *See id*. *See also* n.29, *supra*. However, RIAA was also keenly aware that any agreement with rates below its prior established benchmarks might be used against it at the CARP proceeding. *See e.g.*, RIAA Exhibit 137 DR at N11732. Accordingly, RIAA undertook two actions to protect itself against this risk. First, it insisted upon the non-cooperation clause that [redacted]. S*ee* RIAA Exhibit 75 DR at § 3.7.3. Second, RIAA demanded the "whereas" clause which recited that approximately [redacted] of Yahoo!'s radio retransmissions are within a 150-mile radius of the originating radio station. *See id* (introductory clauses). The significance of this clause is explained later in this section.

Naturally, Yahoo!'s primary concern, as characterized by its negotiator, was to negotiate a license agreement under which it would pay [redacted] regardless of whether its fees were expressed as a blended rate or as differentiated rates for RR and IO performances. Tr. 11299, 11255-57 (Mandelbrot). But, because [redacted] of its transmissions were RR performances, Yahoo! was willing to accept a higher IO rate in exchange for a lower RR rate in order to achieve the lowest overall effective rate for all its transmissions. *See id*. at 11253-56.

Indeed, both parties were willing to, and did, artificially raise the IO rate in exchange for artificially lowering the RR rate. *See id*. at 11256-57; 11281. This arrangement met the needs of both Yahoo! and RIAA. Yahoo! was pleased to achieve the lowest possible overall rate**,** while RIAA was pleased to raise the IO rate, so as to protect its .04¢ benchmark to the maximum extent possible. *See* id; Panel Rebuttal Hearing Exhibit 1 at 4; Tr. 11279-81, 11395-96 (Mandelbrot). *See also* Tr. 10237-38 (Marks); RIAA 137 DR at N14540 (Marks e-mail to negotiating committee member stating that this strategy [redacted]). Moreover, RIAA hoped that the confidentiality and non-cooperation clauses would prevent Yahoo! from later [redacted] the integrity of the [redacted] IO rate.[42] Tr. 11419, 11283-84 (Mandelbrot).

The Panel concludes that RIAA was less concerned about the lower RR rate for two reasons. First, since RIAA had not previously negotiated a license agreement with

[42] Clearly, RIAA was concerned about protecting its IO benchmark of 0.4¢ to the maximum extent possible. Early in the negotiations when a blended rate of [redacted] was on the table, RIAA expressed concerns that a stated blended rate [redacted] RIAA 137 DR at N11732. Notwithstanding, RIAA ultimately agreed to an effective (but *unrecited*) blended rate of [redacted]. *See* Section V.G.7.b., *supra; see also* Tr. 11395-96 (Mandelbrot) ("**Q** And was there discussion about why it was that the language was such that you not only couldn't participate, that you couldn't quote cooperate with any party opposing licensor and the CARP? **A** [redacted]

any webcaster that retransmitted radio signals,[43] it had no RR benchmark to protect**.** Second, and more importantly, RIAA clearly intended to rely upon the "whereas" clause which recited that approximately [redacted] of Yahoo!'s radio retransmissions are within a 150-mile radius of the originating radio station. *See id.* at 11409-12. Some context is required to appreciate the significance of this clause.

At the time of the Yahoo! negotiations, radio broadcasters were claiming in pending litigation that their retransmissions of their own radio signals over the internet were exempt from the copyright laws**.** And even if not all of their retransmissions were exempt, they argued, at least their own retransmissions to listeners *within 150 miles* of their radio stations were exempt under Section 114(d)(1)(B)(i).[44] *See* Tr. 9304-05, 10203, 10210, 10232-34, 14146-50 (Marks); Marks W.D.T. 15-16.

Naturally wishing to exploit the alleged "uncertainty" respecting these claims, Yahoo! negotiators cited them as one basis, among many, for a lower RR rate. *See id*., Tr. 11307-08 (Mandelbrot). Understandably, they were also willing to agree to a "whereas" clause that implied that the low RR rate was somehow related to this alleged legal uncertainty respecting the 150-mile provision. In short, it cost Yahoo! nothing to accede to RIAA's insistence upon this clause. Both Yahoo! and RIAA**,** however, understood the obvious -- that *no uncertainty* existed as to whether any *Yahoo! retransmissions* were

[43] Subsequent to Yahoo, RIAA concluded an agreement with Cyberaxis, a small service that retransmitted a single radio station signal. *See* RIAA Exhibit 80 DR at § 1.7. This small operation [redacted]. *See id*, RIAA Exhibit 15 RR.

[44] These claims were subsequently rejected by the Librarian (*see* Order of July 16, 2001 at 5) and a federal district court. *See Bonneville Int'l, et al. v. Peters*, 153 F. Supp. 2d 763 (E.D. Pa. 2001), appeal pending. The Panel expresses no view concerning the merits of these claims. We have simply proceeded, in accordance with the Librarian's Order, to determine willing buyer/willing

exempt. *See* Tr. 11308-10; 11380-87 (Mandelbrot); 10181-83, 11380, 13853-55 (Marks). If an exemption could possibly apply to anyone, it would apply to *broadcasters* – not to third party transmitters such as Yahoo!. The only rational argument available to Yahoo! was that it would be at a competitive disadvantage should either of the alleged exemptions ultimately be validated. *See id*. Mr. Mandelbrot testified that Yahoo! understood that this argument was extremely weak and had no significant impact on the rates ultimately negotiated. *See id*. The Panel finds Mr. Mandelbrot's assertion credible and agrees that this argument did not significantly affect the negotiated rates. However, RIAA was conveniently left with the "whereas" clause, which enabled RIAA to argue before this Panel that the [redacted] RR rate reflects a "real" rate of [redacted] that had been discounted[45] to account for the alleged "legal uncertainty" at the time of the negotiation. *See e.g.*, RIAA PFFCL ¶¶ 122, 128.

(d) <u>Other Factors Affecting the Yahoo! Rates</u>

As described above, the Panel has concluded that Yahoo!'s [redacted] IO performance rate was elevated above the IO rate that the parties *would have* agreed upon, but for their agreement to lower the RR rate. Two other significant factors support an IO rate lower than [redacted] – the MFN clause and Yahoo!'s assessment of the cost of arbitrating the CARP proceeding.

The MFN entitled Yahoo! to [redacted].

---

seller rates for various types of streaming, including broadcasters, based on the evidence before us.

[45] The alleged discount ostensibly reflects that Yahoo! paid only for those transmissions that were not "exempt," thereby reducing the otherwise [redacted] rate to the [redacted] RR rate.

Unlike the musicmusicmusic MFN clause that is [redacted], the Yahoo! MFN [redacted]. However, because the clause provides for the possibility of reduced royalties at some future time, it does add some indeterminate amount of value for Yahoo!.

Another significant factor relates to arbitration costs. RIAA and Yahoo! both understood that if Yahoo! had chosen to participate in this CARP proceeding, it would have been expected, as a "major player," to shoulder a significant portion of the arbitration costs. *See* Tr. 10142-45 (Marks); 111248-49, 11269-76 (Mandelbrot). Yahoo! estimated that these costs, along with lost "opportunity costs,"[46] could approach [redacted]. *See id*. at 11274-76. Naturally, Yahoo! was willing to accept inflated royalty rates if it could realize an even greater savings in arbitration costs. Of course, because RIAA was also motivated to save arbitration costs (that it would bear almost exclusively), it too was arguably willing to accept a somewhat *lower* rate if it believed settlement with Yahoo! would spur an industry-wide settlement and thereby avoid the necessity of RIAA incurring any arbitration costs.[47] On balance, however, we think the issue of arbitration costs militates in favor of Yahoo!. If Yahoo! reached agreement with RIAA, it definitively avoided arbitration costs. In contrast, if RIAA reached agreement with Yahoo!, the existence of many other unsigned licensees meant that RIAA still faced a

[46] Referring to costs associated with Yahoo! managers directing time and resources toward the CARP arbitration, rather than to developing new aspects of the business. *See* Tr. 11248-49, 11271-76 (Mandelbrot).

[47] RIAA President Hillary Rosen testified that there were really only three big players on the internet (namely, AOL, Viacom, and Yahoo!) and that RIAA's hope was that an agreement with Yahoo! would prompt the other two to follow. Tr. 559 (Rosen). Of course, it is quite unlikely that AOL and Viacom, who are as sophisticated as Yahoo! would agree to rates higher than Yahoo!'s. Thus, RIAA's goal of an "industry wide solution" really reflected a willingness to accept rates in the Yahoo! range if those could be established across the board.

substantial prospect of having to arbitrate, as indeed has happened. For this reason, we believe the concern about arbitration costs also implies somewhat *inflated* rates.

Other considerations arguably imply even further inflated rates for both RR and IO. *See* Webcasters PFFCL ¶¶ 121-27. For example, Webcasters argue that the Yahoo! agreement eliminated certain legal ambiguities for Yahoo! and provided other benefits that the statutory license does not afford. *See id*. at ¶ 126. However, it is unclear that the agreement actually resolves the legal ambiguities cited by the Webcasters. *See e.g.*, Tr. 11377-78 (Mandelbrot) (conceding that the agreement provides no more rights than permitted by the DMCA). The other alleged benefits are of minor consequence.[48]

(e) <u>Impact of the Yahoo! Agreement</u>

We began our discussion of the Yahoo!/RIAA agreement by noting its economic significance. First, Yahoo! accounts for both the vast majority (approximately [redacted]) of DMCA-compliant royalties paid and an even larger percentage of the number of performances transmitted. Second, this agreement also represents the results of a level playing field negotiation. Sophisticated business people with the legal and financial resources to press their interests forcefully sat on both sides of the negotiating table that produced this agreement. Indeed, the Yahoo! license agreement appears to be the sole

[48] RIAA argues that the Yahoo! rates actually reflect below-market rates based upon two factors. First, RIAA asserts that it "gambled that agreeing to a below-market rate with Yahoo would avoid the uncertainty and costs associated with a CARP proceeding." RIAA PFFCL ¶¶ 120-24. We already addressed these issues (settlement with Yahoo! obviously did not guarantee avoidance of CARP proceeding). *See* Section V.G.7. c and d, *supra.* Second, RIAA claims that it acceded to below-market rates in return for a large lump sum payment. *See* RIAA PFFCL ¶ 127. While there is obviously some value in receiving an advance payment, that value is substantially outweighed by the other factors at play. These other factors include (1) the total payments that would be due under the agreement (dependent upon the agreed rates) and (2) precedential value for the CARP proceeding. Moreover, in the voluminous record materials related to this

agreement where the rate was *not* the result of an essentially take-it-or-leave-it negotiating process. Third, the terms of this agreement provide, after the initial period, for different rates for different types of transmissions, a consideration which Section 114 (f)(2)(B) specifically directs us to employ in our rate-setting. Thus, the elements of this agreement, its economic significance, and the matching strengths of the parties who negotiated it, all support its use as the most reliable benchmark for what a willing buyer and a willing seller would agree to in the marketplace.

However, before reaching a final conclusion that the Yahoo! agreement constitutes the most representative benchmark available to us, the Panel must address one final argument. RIAA contends that three forms of corroborating evidence demonstrate that the 0.4¢ rate specified in most of the 25 non-Yahoo! agreements constitutes the most appropriate benchmark. We address this claim below.

H. RIAA'S "CORROBORATING EVIDENCE"

RIAA asserts that its proposed benchmark rates -- a performance royalty of 0.4¢ per performance plus an additional 10% ephemeral copy royalty -- are corroborated by three forms of record evidence, namely (1) 115 individual record company agreements, (2) an analysis of the standards enunciated in the *Georgia Pacific* case, and (3) an expert Economic Value Estimation. The Panel concludes that RIAA's argument is not persuasive and addresses briefly the principal deficiencies in each type of "corroborating evidence."

---

negotiation, the lump sum payment plays a minor role in the many evaluations exchanged both between the parties and within the RIAA Negotiating Committee.

1. The 115 Record Company Agreements

For reasons similar to those enunciated in our critique of the Webcasters' benchmark, the Panel rejects these agreements as useful benchmarks for the Section 114 rights at issue here. While the licensees in these agreements (digital music users) are similar to Section 114(f)(2) buyers, except for the [redacted] agreement previously discussed, the record company agreements cover different rights not subject to the Section 114(f)(2) statutory license. By contrast, the 26 RIAA agreements license the precise rights at issue here. Moreover, to the extent the Panel were inclined to utilize these record company agreements, the effect would likely be to undermine, not corroborate, RIAA's proposals in that many of the agreements reflect rates below those which RIAA is proposing. For example, license agreements for [redacted] recite rates ranging from [redacted]. *See e.g.*, RIAA Exs. 90 DR - 95 DR. Yet, RIAA proposes 0.5¢ for webcasting syndication services and 0.6¢ for listener influenced webcasting services (neither are on-demand). *See* Section IV.A., *supra*.

2. The *Georgia Pacific* Analysis

RIAA expert, Dr. Robert Yerman, testified about certain criteria enunciated in the case of *Georgia Pacific v. United States Plywood Corp*., 318 F. Supp. 1116 (S.D.N.Y. 1970), for the purpose of determining appropriate damages in patent infringement cases. After applying these criteria to the 26 RIAA agreements, he concluded that they generally support the rates proposed by RIAA. *See* Yerman W.D.T. 1, 5-6. The Panel agrees with Dr. Yerman's general conclusion that the 26 RIAA agreements are *potentially* compelling rate benchmarks**.** *See* Sections V.D. and V.F., *supra.* However, Dr. Yerman's conclusions are significantly undermined by two important factors. First, they were based solely upon a review of the text of the 26 agreements. He did not review any of the circumstances surrounding the negotiation of those agreements, as the Panel has done. *See e.g.*, Tr. 3727-29 (Yerman). Consequently, his analysis sheds no light on the weight to be accorded each agreement and really adds little to the notion (which we have already accepted) that comparable agreements are the best *potential* benchmarks.[49]

Another limitation on Dr. Yerman's analysis, as explicated by Webcasters' expert witness Prof. William Fisher (Fisher W.R.T. ¶13; Tr. 11606-07 (Fisher)), is that the *Georgia Pacific* case articulates standards for determining remedies for prior infringement. This context introduces an extraneous element, characterized as having "a punitive cast to it" (*id.* at 11606), which is not present in the non-infringement marketplace that the Panel is directed to replicate, and which undermines its usefulness for our purposes. Accordingly, the *Georgia Pacific* analysis does not, in any sense, undermine our previous reasoning.

3. <u>The Economic Value Estimation</u>

As described previously, RIAA witness, Dr. Thomas Nagle, conducted a pricing strategy analysis designed to predict the royalty rates that hypothetical webcasters would be willing to pay. He concluded that the rates proposed by RIAA are consistent with the rates he would recommend based upon this analysis. *See* Tr. 2531-32. The analysis seeks to ascertain the price that a theoretically viable webcaster would have been able to

[49] These comments apply equally to the testimony of Dr. Wildman. *See* W.D.T. (Wildman) 1, 3-5, 15-19.

afford and still remain viable at some point in the future beyond the statutory license period. *See* RIAA PFFCL ¶¶ 411-23.

As previously noted, Dr. Nagle contends that most webcasting services are not economically viable and will not survive. *See e.g.*, Tr. 13393 (Nagle); Nagle W.D.T. 5. Thus, he asserts, the current economic value of the statutory licenses must be estimated for webcasters that will operate at a "sustainable scale at this future point of viability." Nagle W.D.T. 6. That current value is determined by the price that such webcasters could afford to pay after first paying their other expenses, and retaining sufficient profit to earn "a reasonable return (which he places at 20 –30%) on their investment." RIAA Exhibit 108 DP (Dr. Nagle's analysis) at 15 - 16.[50] In essence, Dr. Nagle posits that record companies could extract every last penny from webcasters beyond the amount they needed to pay other expenses and derive such a return.

Dr. Nagle's analysis necessarily relies upon a myriad of highly questionable assumptions that appear inconsistent with foreseeable market conditions.[51] For example, Dr. Nagle assumes that the future viable webcaster will sell audio ads at $30 CPM, selling about 60% of its inventory by 2005 (his projected date of viability). *See* Tr. 2569-73. These figures appear overly optimistic. *See e.g.*, Tr. [redacted] audio ads are currently in the range of $5 to $15 with sales of less than 10% of inventory). Moreover, Dr. Nagle's estimate of projected unique listeners at the future date of viability is not based upon any reliable projection. He merely calculates the number of unique

---

[50] We view this allowance as quite arbitrary. If the webcasting industry represents the type of risk to investors that Dr. Nagle appears to suggest, a 20-30% return on investment may be inadequate.

[51] We recognize that some of these projections are partly based upon business plans of a few webcasting services. However, we do not regard these projections, which are intended for investors and appear to be constantly revised downward, as particularly reliable.

listeners he believes *are required* for profitability without regard to the likelihood of attracting that number of listeners. *See* Tr. 2570 (Nagle).

We conclude that Dr. Nagle's analysis does not support any particular rate level. Moreover, Dr. Nagle's analysis firmly supports use of the Yahoo! agreement as a reliable benchmark, as contrasted with the other 25 licensees, many of which have already failed the test of marketplace endurance. *See* Section V.G.2., *supra*. Accordingly, we now proceed to a determination of specific royalty rates.

I. DETERMINATION OF SECTION 114(f)(2) WEBCASTING RATES.

The Panel previously concluded that the 26 RIAA license agreements *potentially* constitute the best approximation of the hypothetical marketplace we attempt to replicate. However, the 25 non-Yahoo! agreements merit extremely little weight as benchmarks for the rates that willing buyers and willing sellers would normally negotiate in the relevant marketplace. Only the Yahoo! agreement reflects a reliable approximation of such rates in the marketplace we attempt to replicate.

As previously noted, the "bottom line" combined rate was of paramount importance to Yahoo!, but both parties also benefited from the artificially wide disparity between the RR and the IO rates. Significantly, the Yahoo! agreement also establishes that, in the actual marketplace, willing buyers and willing sellers negotiate RR rates considerably lower than IO rates. This seems eminently understandable.

The dramatically different RR and IO marketplace rates contained in the Yahoo agreement reflect essentially undisputed testimony that traditional over-the-air radio play has a tremendous promotional impact on phonorecord sales. Indeed, record companies have spent many millions of dollars over many decades to promote over-the-air play of their releases. *See, e.g.,* Tr. 530-33 (Rosen), 937-52 (Altschul), 1150-53 (Ciongoli), 1783-85 (Wilcox), 2412 (Kenswil), 5717 (Fine), 5886 (Donahoe), 7657 (S. Fisher). Also, endorsements from familiar, trusted radio station DJs are a key element in promoting sales. McDermott W.R.T. 4; Tr. 7709-10 (S. Fisher). To the extent that internet simulcasting of over-the-air broadcasts reaches the same local audience with the same songs and the same DJ support, there is no record basis to conclude that the promotional impact is any less. Tr. 5894-95, 6002 (Donahoe); *see also* Tr. 12861 (McDermott). This factor was likely considered by RIAA and Yahoo!, and is evidently reflected in the resulting difference between RR and IO negotiated rates. Apparently, RIAA concerns about displacement of CD sales from internet performances do not apply equally to retransmissions of radio broadcasts. *See, e.g.,* Tr. 1112-15 (Katz); *see also* Jaffe W.R.T. 41-42.

In any event, the Panel's task is now clear. If the Yahoo!/RIAA agreement is to be used as a benchmark for determining the hypothetical marketplace rates, we must adjust downward the IO rate to offset the inflationary factors previously identified in Section V(G)(7)(c) and (d), and we must adjust upward the RR rate.

1. <u>The Internet-Only Webcasting Rate</u>

The Panel's analysis implies a willing buyer/willing seller marketplace rate somewhere between [redacted] (the artificially high IO-only rate) and the effective or blended rates. In the absence of compelling reasons to do otherwise, we select the midpoint[52] in that range as the approximate marketplace rate for IO performances.[53] In order to make this calculation, we must select which of the three effective or blended rates ([redacted]) to use as the endpoint. *See* Section V.G.7.b., *supra*.

The [redacted] effective rate is the least significant. This rate was never negotiated, nor even discussed by the parties. It merely reflects an historical fortuity that resulted from the particular mix of IO and RR performances that occurred from the effective date of the license agreement through an arbitrary date for which data was available.

However, respectable arguments can be made for use of either the [redacted] or [redacted] rates as endpoints. On balance, we find the rationale for using [redacted] to be more persuasive. The [redacted] blended rate constitutes the precise per-performance rate negotiated by the parties for the first [redacted] performances. It is also the precise fee actually paid for each performance and the rate under which the majority of Yahoo! performances were paid. By contrast, the [redacted] blended rate merely represents the parties expectation of the rate that *would* effectively be paid *if* the ratio of RR to IO

---

[52] Selection of a midpoint within a "zone of reasonableness" constitutes rational ratemaking. *Cf. National Cable Television Assoc. v. Copyright Royalty Tribunal*, 724 F.2d 176, 182 (DC Cir. 1983) ("ratemaking is an intensely practical affair…[that] necessarily involves estimates and approximations…that…lie within a zone of reasonableness" (internal quotation marks and citations omitted)).

[53] We note Webcasters' assertion that the Yahoo! agreement should not serve as a benchmark for webcasting because Yahoo!'s primary business model is *not* webcasting. *See* Webcasters PFFCL ¶¶ 101, 135. This argument has little merit. Webcasters consist of a diverse community of services, all utilizing streaming, but comprise a range of different business models including many services whose primary business model is not webcasting. *See e.g.*, Webcasters PFFCL ¶ 3; RIAA PFFCL ¶ 127. The Panel is aware of no substantial evidence that Yahoo! is not comparable to other webcasters for purposes of rate setting. And the fact that Yahoo! is an aggregator is similarly inconsequential. No party hereto has argued that agreements with aggregators are *per se* inappropriate as rate benchmarks for other basic webcasters, and we are aware of no record support for such an assertion.

performances remained at precisely [redacted]. This projection proved fairly accurate (but not precisely so) throughout the period up to the CARP proceeding. *See* Tr. 11279, 11333, 11345, 11402 (Mandelbrot). Moreover, both parties expected the ratio to decline over time, thereby yielding a slightly higher effective rate. *See* Tr. 10196-97 (Marks). Finally, selecting the [redacted] rate rather than the [redacted] rate gives some minimal weight to the higher rate, non-Yahoo! RIAA (and [redacted]) agreements. We believe this constitutes all the weight those agreements should be afforded.

The midpoint between [redacted] and [redacted] is 0.14¢ (rounded to the nearest hundredth cent). Accordingly, in the absence of persuasive contrary evidence, the Panel concludes that in the hypothetical marketplace, the Section 114(f)(2) performance royalty rate which willing buyers and willing sellers would normally have negotiated is 0.14¢ per performance for basic (business-to-consumers) webcasting services.

2. <u>The Radio Retransmissions Rate</u>

The Panel applies the same methodology to determine the appropriate RR rate. Our analysis implies an actual willing buyer/willing seller marketplace rate somewhere between [redacted] (the effective rate actually negotiated and paid by Yahoo! for the first [redacted] IO and RR performances) and [redacted] (the artificially low RR rate). In the absence of compelling reasons to do otherwise, we similarly select the midpoint[54] of 0.07¢ (again rounded to the hundredth cent) as the rate which most clearly reflects the performance

---

[54] The reader should not infer from this methodology that Yahoo! and RIAA necessarily agreed to artificially lower the RR rate by 50% and concomitantly raise the IO rate proportionally. Our analysis takes account of the other factors identified in addition to the artificiality factor. In each instance we select midpoints because we are unaware of record evidence that would lead us to another result.

rate which willing buyers and willing sellers would have commonly negotiated in the hypothetical marketplace.[55]

J. SECTION 114(f)(2) RATES FOR OTHER WEBCASTING SERVICES

We have determined the Section 114(f)(2) performance rates for basic business to consumer ("B2C") webcasting services and for webcasting services that retransmit radio broadcasts. In this section we consider rates for other categories of webcasting services.[56]

1. "Business to Business" Webcasting Services ("Syndicators")

RIAA claims that business to business ("B2B") webcasting services, where transmissions are made as part of a service that is syndicated to third party web sites, should pay a higher rate than B2C webcasters. The syndicator creates "branded" internet radio-like stations for third-party sites that appear to the user as, for example, "Eddie Bauer Radio" or "Bolt Radio." *See* Griffin W.D.T. 16-17; Tr. 1284-92 (Griffin), 7477-79 (Moore). The programming can be customized to the demographics of the sites' customers. *See* Tr. 14069-77 (Marks); Marks W.D.T. 16-17. And due to the limitation

[55] The Panel notes that the rates we have determined (0.07¢ for radio retransmissions and 0.14¢ for internet-only transmissions) are quite close to the rates ([redacted]. *See* RIAA Ex. 137 DP at N945-46. At other points in the negotiation, RIAA also indicated [redacted] (RIAA Ex. 137 DR at N11721, 14544) [redacted] (*see id.* at N11732). This evidence suggests that our rates are well within a reasonably narrow range which includes rates [redacted].

[56] Of course, there are numerous possible categories of webcasting services -- limited only by one's imagination. In this discussion, we address only categories for which we believe the record *arguably* supports a separate rate.

set forth under Section 114(j)(6),[57] some third-party sites might not be eligible to offer webcasting without the services of a syndicator. *See* Tr. 14069-77 (Marks). In many respects, the syndicator is analogous to the business establishment music services that provide music in traditional brick and mortar stores.[58] *See* RIAA PFFCL ¶ 282; Moore W.R.T. 2. RIAA cites Websound, MoodLogic and OnAir.com as RIAA licensees that exemplify syndicators. See RIAA PFFCL ¶ 285.

Webcasters respond that, regardless of the type of service, "the nature of the public performance is the same; and the value of the performance does not change *merely* because of the technology of the webcaster or the fact that the sound recording is heard when it is accessed at a third-party web site rather than the originating webcasters' web site." Webcaster PFFCL ¶ 297 (emphasis added). In any event, the central question is whether the record supports a higher rate for B2B services based upon an application of the willing buyer/willing seller standard. We conclude that it does not.

We acknowledge that a few syndicators (that syndicated or intended to in the future) signed license agreements with RIAA containing rates above the predominant rate of 0.4¢. *See* RIAA Ex. [redacted].

However, a far greater number of agreements that permit syndication provide rates near or below the predominant 0.4¢ rate. *See* RIAA Exhibit [redacted]

[57] Under the definition of "eligible nonsubscription transmission," the primary purpose of the transmitting service must be to provide to the public "audio or other entertainment programming." 17 U.S.C. § 114(j)(6).

[58] Interestingly, business establishment music services are exempt from paying *any* performance fees. *See* 17 U.S.C. § 114(d)(1)(C)(iv).

[redacted]. Of course, the agreement worthy of the most weight is the Yahoo! license. In sum, we find insufficient record evidence to support a separate rate for syndicator services and conclude accordingly that such performances shall be at a rate of 0.14¢ per performance.

2. **<u>"Listener-Influenced" Services</u>**

RIAA maintains that so called "listener-influenced" services are ineligible for the Section 114 statutory license and urges the Panel *not* to set a royalty rate for such services. RIAA PFFCL ¶ 226. However, if the Panel feels compelled to do so, RIAA submits that the rate should be set at 0.6¢ per-performance. RIAA PFFCL ¶ 227.

RIAA defines listener-influenced services (also referred to as "personalized services") as "those that allow their listeners some control over the programming they receive through the rating of artists, albums or songs, as well as providing listeners with a skip forward to the next song." RIAA PFFCL ¶ 286. Although the listener will not know which song will be coming next, by supplying ratings and using the skip feature, the listener has more control over the songs heard than a listener of a basic genre-based webcasting service. *See id*. Because RIAA deems most listener-influenced services as ineligible for the Section 114 statutory license (*see* notes 1 and 15, *supra*), and because RIAA is not permitted to negotiate as a common agent for non-statutory Section 114 licenses, it does not rely upon the 26 agreements as benchmarks for setting rates for such services. Rather, it relies upon several agreements between record companies and non-DMCA-compliant services.

The Panel's sentiments respecting services that offer listener influence are similar to those expressed respecting syndicators. While RIAA may believe that listener-influenced services displace demand for sales of their phonorecords (*see e.g.*, Tr. 1508-12 (Griffin)), there is no empirical evidence before us to confirm this belief. And RIAA's reliance upon agreements with non-DMCA compliant license agreements is unavailing. By definition, these license agreements grant rights beyond those conferred by the relevant statutory license. One would expect a rate premium for such additional rights. We also note that RIAA has reached agreements with several licensees that offer listener influence at rates consistent with its predominant rate (without premium). *See e.g.*, RIAA Exhibit [redacted] Tr. 9354-57 (Marks), [redacted].

Finally, the Panel cannot imagine how one would meaningfully draw the line between those services eligible for the basic webcasting rate and those that would be subject to a separate rate for listener-influenced services. Indeed, neither side has adequately described such a line of demarcation. We conclude that so long as a service complies with, and is deemed eligible for the statutory license, it should not pay a separate rate based upon listener influence.[59]

[59] Of course, we do not interpret the Librarian's Order of July 16, 2001 as compelling us to set a separate rate for listener-influenced services if we conclude, as we have, that the record does not support one.

K. ROYALTY RATES FOR COMMERCIAL BROADCASTERS

1. Introduction

Commercial broadcasters are FCC-licensed radio stations. Some currently operate, and others contemplate operating, services which simultaneously stream (retransmit) their over-the-air broadcasts via the internet. These streamed retransmissions are known as "simulcasts." *See, e.g.,* Proposed Definitions of RIAA, February 12, 2002 at 16. Some broadcast stations also offer "archived" programming, "side channel" programming, and "substituted" programming. *See* Section K.5. *infra*. The Panel must determine what rates to set for these various transmissions.

2. Procedural History

As previously noted, this proceeding was suspended for the period November 9, 2001 through December 2, 2001, to allow the parties an opportunity to pursue additional settlement negotiations. *See* Section II.D., *supra*. The negotiations resulted in a confidential settlement agreement between NPR and RIAA, and an accord respecting the great majority of the non-rate terms. *See id.* Commercial Broadcasters also reached a *tentative* settlement with RIAA. However, the settlement was contingent upon the agreed rates remaining confidential until after the Panel rendered its Report respecting non-broadcasters. *See* Request to Withdraw Issues from CARP, December 14, 2001. This contingency presented special challenges because, unlike the NPR/RIAA private agreement, which settled all matters among a finite class of services, the broadcaster/RIAA agreement affected only the signatories. *See* Order of December 20, 2001. The Panel remained obligated to set rates and terms for non-signatory broadcasters. Despite multiple, creative attempts by the Copyright Office and the parties to fashion a mutually acceptable procedure that preserved the required confidentiality, no agreement could be concluded. Accordingly, the Librarian directed the Panel to determine rates and terms for Commercial Broadcasters. *See* Order of January 7, 2002.

3. Positions of the Parties

RIAA urges the Panel to adopt the very same rate for commercial broadcaster streamers as the rate it proposes for B2C IO webcasting. *See* RIAA PFFCL (Broadcasters) ¶ 1. RIAA maintains that no record evidence leads to a different result, and that the Services' fee model should be rejected for all of the reasons previously discussed. *See id* ¶¶ 1-11.

Broadcasters note that broadcasters represent more than 1500 of the 2300 entities which filed Notices of Intent to use the statutory license. *See* Broadcasters PFFCL ¶ 33; Marks W.D.T. n.2. They argue that the fact that RIAA was able to negotiate agreements with only 26 webcasters, but with none of the 1500 broadcasters, demonstrates that broadcasters and webcasters represent different groups of "willing buyers," which would negotiate different rates in the marketplace. *See* Broadcasters PFFCL ¶¶ 27, 33; Tr. 7660-61 (S. Fisher).

4. Determination of Commercial Broadcaster Rates

With respect to webcasters, we previously stated that if we can observe agreements that willing buyers and willing sellers *actually negotiated* in the relevant marketplace, we would generally expect their negotiated rates to already reflect the parties' joint perceptions of the various factors identified in Sections 114(f)(2)(B) and 112(e)(4). In that event, no further rate adjustment would generally be required to determine a willing buyer/willing seller rate. Although no party has adduced a single digital sound recording performance license agreement with any radio broadcaster, the Yahoo!/RIAA agreement entails retransmissions of the same types of radio stations signals, albeit by a third party – Yahoo!. The Panel has already determined that the typical willing buyer/willing seller rate for that RR rate is 0.07¢ per performance. The Panel must now decide whether the record suggests a different rate for retransmission of an identical radio signal by the *station itself* -- rather than by a third party. We find the record (and consideration of the statutory factors) utterly devoid of evidence implying a *higher* rate and *insufficient* to warrant a lower rate.

Regarding the displacement of record sales, Section V.I. above discusses the extensive record evidence regarding the promotional effect of radio airplay. Some record evidence also suggests that record companies are less fearful of simulcasts by *both* broadcasters and third parties -- as contrasted with conventional multi-genre webcasting. *See e.g*. Tr. 1112-15 (Katz) (these streaming activities constitute the "safer end" of the spectrum warranting a lower rate). This implies a lower rate than the webcaster performance rate, for *both* broadcasters and third party retransmitters. However, we find no record evidence suggesting a different rate *as between* broadcasters and third party retransmitters.

Though not explicitly argued by any party, several other rational arguments could be advanced in favor of a *lower* rate for broadcasters *vis-à-vis* those third-party retransmitters which also aggregate stations (such as Yahoo!). First, third-party aggregators like Yahoo! aggregate hundreds of radio stations on their portal sites. This arguably provides the listener with a more satisfying listener experience than derived from a traditional broadcast radio dial. One might then contend that third-party aggregators derive more value from the sound recordings than do broadcasters that merely retransmit their own signals. Second, aggregators might arguably pay more to buy access to new, wider audiences than broadcasters would pay to stream to people who were already their listeners. And third, aggregators who have to pay a performance royalty to stream to all of their listeners might arguably pay more than broadcasters who have never paid any performance royalty during decades of broadcasting experience. In the final analysis, however, there is no record basis to quantify any possible difference in value due to these factors. Stated differently, the Panel does not and cannot know whether these arguments would impact the rate negotiated by a willing buyer and willing seller, or to what degree.

RIAA continues to press its contention that the Yahoo! RR rate is an inappropriate benchmark because it reflected alleged legal uncertainties surrounding the retransmission of broadcast signals. *See* RIAA PFFCL (Broadcasters) ¶ 14. We have already addressed this issue and confidently concluded that these alleged "exemptions" were "red herrings" that did not affect the negotiated rates. *See* Section V.G.7.c. and text accompanying n.44 *supra*. If at some future date, broadcasters were to prevail on their 150-mile exemption claim, we assume the courts would fashion a method of appropriately reducing the royalty to exclude listeners within that area. Contrary to RIAA's claim (*see* RIAA PFFCL (Broadcasters) ¶ 18), such reduction would *not* constitute a "double counting of the 150-mile exemption" because we have made the factual finding that the alleged exemption was *not* factored into the Yahoo! RR rate. *Id*.

In sum, the Panel finds no reason to set a different rate for broadcasters (that simulcast their own signals) than for third parties that retransmit the same signals on behalf of the broadcasters. Accordingly, we determine the willing buyer/willing seller commercial broadcaster rate also to be 0.07¢ per performance.

5. **Archived Programming, Side Channels, and Substituted Programming**

A broadcaster's steaming activity may involve making available to listeners previously-aired ("archived") radio programming, internet-only programming on their web sites ("side channels"), and/or "substituted programming" that is streamed whenever a broadcaster lacks authorization to stream a portion of the over-the-air programming.[60] *Cf*. Tr. 8556-67 (Davis); 5467-68 (Halyburton); RIAA Exhibit 140 DP-X.

The record is devoid of direct evidence of the willing buyer/willing seller rate for archived radio retransmissions. But the Panel must resolve *which* rate, of those we have already determined, should apply to these retransmissions – the 0.07¢ RR (and commercial broadcaster) rate, the 0.14¢ IO rate, or some other rate.

As part of their contingent settlement agreement discussed above, Broadcasters and RIAA evidently resolved all issues respecting archived programming, side channels, and substituted programming. *See* Proposed Terms filed on December 20, 2001, at ¶ 1(e) (setting forth definitions that would apply to the settlement). Broadcasters assert that, although the settlement has not been effectuated, the jointly submitted, proposed terms remain binding on all parties. *See* Broadcasters PFFCL ¶ 1, n.1. And these agreed terms contain a definition of AM/FM streaming that includes transmissions of certain archived

[60] For example, a professional sports franchise might conceivably license a radio station the rights to broadcast an event over-the-air, but withhold the rights to simulcast the event over the Internet.

programming, side channel programming, and substituted programming. *See id*; Proposed Terms of December 20, 2001, at ¶ 1(e). Accordingly, Broadcasters implicitly claim that these transmissions should be encompassed within the royalty rate set for commercial simulcast transmissions. *See id*. RIAA vehemently disagrees and contends that that definition was rendered moot when the settlement agreement was discarded. *See* Copyright Owners Submission Explaining Proposed Terms of February 1, 2002, at 2-4. The Panel fully agrees with RIAA. The definition of AM/FM streaming is so inextricably linked to the contingent settlement, it has lost all value for purposes of rate-setting. *See also* Section VII.C.1., *infra*.

In accordance with our previously articulated reasoning, the best benchmark for determining royalty rates for the transmission of archived programming, side channel programming, and substituted programming, is the Yahoo!/RIAA license agreement. That agreement provides compelling record evidence of two willing buyer/willing seller rates: (1) a rate for internet retransmissions of AM/FM broadcasts (RR rate); and (2) a rate for all other internet transmissions. The former is significantly lower than the latter. This apparently reflects marketplace assessment of the various promotion and substitution effects, along with myriad other factors.

The Yahoo!/RIAA license agreement defines a radio retransmission performance as [redacted] RIAA Ex. 75 DR at §1.16. The term "retransmission" is not further defined. Therefore, in the absence of contrary record evidence, the Panel adopts the definition of that term as set forth in 17 U.S.C. §114, namely "a further transmission of an initial transmission … if it is *simultaneous* with the initial transmission." 17 U.S.C. § 114(j)(12) (emphasis added).

Accordingly, absent contrary evidence, the Panel concludes that the Yahoo! RR rate applies only to *simulcast* transmissions and does not include archived transmissions, side channel transmissions, or transmissions containing substituted programming. Consistent with this approach, the Panel declines to include these transmissions within the 0.07¢ RR rate adopted for commercial broadcaster retransmissions. As RIAA correctly maintains, archived transmissions, side channel transmissions, and transmissions containing substituted programming, are essentially webcasting. *See* RIAA PFFCL (Broadcasters) ¶¶ 21-25; Proposed Definitions of RIAA of February 12, 2002 at 19. The Panel finds no record evidence warranting a separate rate for these transmissions and, therefore, adopts the 0.14¢ IO rate.

Indeed, the Panel determines that the 0.07¢ performance rate applies only to simulcast transmissions. *All* other transmissions are subject to the 0.14¢ performance rate.

L. ROYALTY RATES FOR NON-CPB AFFILIATED, NON-COMMERCIAL BROADCASTERS

At the outset of this Report, we noted that NPR has reached a private settlement with RIAA respecting webcasting by public broadcasters represented by NPR. *See* n.2, *supra*. However, NPR represents only itself, its member radio stations, and non-member radio stations which are eligible to receive federal funding from the Corporation for Public Broadcasting ("CPB"). *See* Murdoch/Woodbury W.D.T. 2. NPR does *not* represent the universe of non-commercial radio stations that are non-CPB affiliated.

Accordingly, the Panel must decide whether the existing record warrants a separate rate for webcasting by these non-commercial radio stations.[61]

Applying the same commercial broadcaster rate to non-commercial entities affronts common sense. A predecessor panel observed that, while commercial broadcasters can pass along some portion of their costs to their advertisers, "[n]o comparable mechanism exists for Public [non-commercial] Broadcasters." RIAA Exhibit 220 DP-X at 24 (CARP Report adopted by Library, Noncommercial Education Broadcasting Rate Adjustment Proceeding, 63 FR 49823). Unlike commercial broadcasters, "programming costs are not automatically accommodated through market forces. Contributions from government, business, and viewers remain voluntary." *Id*. "For these reasons, commercial rates almost certainly overstate fair market value to Public Broadcasters." *Id*. That panel concluded that "commercial license rates can *not* appropriately be used as a benchmark to determine Public Broadcasters' rates." *Id*. at 29 (emphasis in original).

Unfortunately, determination of the willing buyer/willing seller fees for non-CPB affiliated, non-commercial radio stations ("non-CPB broadcasters") presents an extraordinary challenge. Despite admonitions to all counsel from the Panel as early as September 7, 2001 (well prior to the rebuttal phase), the record remains virtually barren respecting such broadcasters. *See* Tr. 9009-13. The record tells little about those non-

[61] Non-commercial radio stations are those that meet the definition of public broadcasting entities found at 37 C.F.R. § 253.2.

CPB broadcasters that are represented by the NRBMLC,[62] and virtually nothing about those that are not.[63]

NRBMLC struggles mightily to quantify a proposed rate founded in record evidence. It urges the Panel to base non-commercial broadcaster rates upon the flat fees currently paid to the PROs for their over-the-air musical works performance rights, as set forth in 37 C.F.R. §§ 253.5(c), 253.6(c). *See* NRBMLC PFFCL ¶¶ 20-24. Putting aside our hesitancy to utilize over-the-air musical works performance rates as a proxy for webcasting sound recording performance rates, those fees were settled pursuant to joint proposals that are not part of this record. We do know, however, that those rate proposals were

> made on a nonprejudicial and nonprecedential basis. Therefore, the Librarian recognizes that the joint proposals do not reflect any assessment by any of the parties of the absolute or relative value of the right of the performance of music in the ASCAP, BMI or SESAC repertory by college radio stations …. [and] community radio stations.

62 Fed. Reg. 63502, 63504 (December 1, 1997). *See also* RIAA Exhibit 220 DP-X at 21-22 (CARP Report adopted by Library, Noncommercial Education Broadcasting Rate Adjustment Proceeding, 63 FR 49823) (Panel concluded that voluntary agreements containing "no-precedent clauses" are highly suspect as rate benchmarks, requiring an examination of the "totality of circumstances"). Absent a rigorous examination of the

[62] A party to this proceeding, the National Religious Broadcasters Music License Committee ("NRBMLC"), apparently represents a certain subset of the non-CPB broadcasters (although the record does not reflect the size of that subset), as well as many commercial broadcasters. In that capacity, they filed Proposed Findings of Fact and Conclusions of Law ("NRBMLC PFFCL") concerning this issue. *See* NRBMLC PFFCL ¶ 1.

[63] The only witness presented by NRBMLC was Joe D. Davis, Senior Vice President for Salem Communications -- a very profitable commercial company traded on the NASDAQ exchange that owns 85 radio stations, a network, a media company, and an internet company. *See* Tr. 8540-44,

agreements that led to adoption of the rates set forth in Part 253, *supra*, this Panel must decline to adopt those rates as a benchmark.

NRBMLC attempts to bolster its proposal by citing the testimony of Dr. Murdoch, who testified on behalf of NPR. At the request of the Panel, Dr. Murdoch reluctantly[64] attempted to establish the ratio of fees currently paid by NPR to the PROs, as compared to the fees that NPR stations *would* pay the PROs if they were commercial radio stations. *See* Murdoch W.R.T. 6-10. Dr. Murdoch concluded that *if* the Panel insisted upon using "a commercial fee rate expressed on a *revenue* basis … as a starting point for setting [*NPR*] website fees, it would be appropriate…to reduce the commercial fee rate by 90% to determine the fee rates to be paid by [*NPR*] webcasters." *Id* at 9 (emphasis added). Again putting aside the Panel's serious concerns about (1) using over-the-air musical works performance rates as a proxy for webcasting sound recording performance rates, and (2) using NPR as a proxy for non-CPB Broadcasters, Dr. Murdoch candidly conceded other problems that render her strained conclusion "fraught" with problems. *See id* at 9-10. For example, she explains that, should the Panel set commercial rates on a percentage of revenue basis (which we have not), identifying a public radio station's revenue attributable to music webcasting would be "exceedingly difficult." *Id*.at 9. And

8574-84. Davis works with Salem's radio stations -- not the internet company -- and his testimony about non-commercial stations was primarily anecdotal. *See* Tr. 8542, 8554-55.

[64] Citing the Noncommercial Education Broadcasting Rate Adjustment Proceeding CARP, Dr. Murdoch opined that "the complexities of deriving fees for public broadcasters from benchmark fees for commercial broadcasters are not trivial, and are best avoided in situations where a public broadcasting benchmark exists…. Nonetheless, in response to the Panel's specific request, we have identified the nature of the adjustments that the Panel would need to recognize to derive a fee for public radio webcasters from a commercial webcaster benchmark." Murdoch W.R.T. 7.

if the Panel adopted a per-performance fee metric for commercial broadcasters (as we have),

> the adjustment to arrive at a [per-performance rate]…for public radio websites is less clear due to the limitations of information available to us. A problem in identifying the correct adjustment factor arises because the discount rate that we were able to calculate compounds a music use adjustment factor and a noncommercial adjustment factor. The per-[performance] … rate requires the adjustment for the noncommercial nature of public radio websites but does not require the adjustment for public radio's less-intensive music use. The Panel would find it necessary to deconstruct the 90 percent discount factor we have identified.

Id. at 10. Moreover, it appears that the revenue figure used in Dr. Murdoch's calculations was improperly inflated by the inclusion of revenue from non-CPB broadcasters and by revenue of NPR itself (which is not a radio station entity). *See* RIAA RPFFCL (re non-CPB broadcasters) ¶ 17. *See also* RIAA PFFCL (re Broadcasters) ¶ 42. In sum, the Panel must reject both approaches advanced by NRBMLC.

RIAA's methodology also suffers infirmities. Absent record evidence supporting a particular rate for non-CPB broadcasters, RIAA "borrowed a ratio" from the Noncommercial Education Broadcasting Rate Adjustment Proceeding CARP Report, *supra*. *See* RIAA PFFCL ¶¶ 237. RIAA maintains that the panel awarded ASCAP and BMI approximately one-third of the sum they had requested as a royalty fee for the Section 118 public broadcasting compulsory license, and ASCAP and BMI had based their request on royalties paid by commercial broadcasters. Based upon this ratio, RIAA is "willing to offer" non-CPB broadcasters a two-thirds discount from the commercial broadcaster rate.[65] *See* RIAA PFFCL (re Broadcasters) ¶ 44. Otherwise, RIAA contends,

[65] The RIAA offer is silent as to NRBMLC's request for the fee to include (1) substituted programming (where the station lacks the rights to transmit certain over-the-air programming via the internet), (2) previously aired archived programming, and (3) up to two side channels

the record reflects that non-CPB broadcasters "should pay the same royalty rates that apply to ... commercial broadcasters." *Id*. Given the state of the record, the Panel reluctantly would have to agree. Absent record evidence to support a differentiated rate, should the Panel decline RIAA's offer, non-CPB broadcasters would be subject to the commercial rate.

Accordingly, rather than subject the non-CPB broadcasters to the commercial rate, the Panel hereby accepts RIAA's invitation[66] to set a rate for non-CPB broadcasters at a rate which is one-third of the commercial broadcaster[67] rate of 0.07¢ per-performance. Rounded to the nearest hundredth of a cent, the derived rate equals 0.02¢ per-performance.

In accordance with the Panel's findings respecting the commercial broadcasters, we determine that this rate of 0.02¢ should not apply to archived radio broadcast programming *subsequently* transmitted via the internet. Nor should it apply to transmissions of substituted programming. The 0.02¢ rate applies only to simulcasts -- retransmissions under 17 U.S.C. § 114(j)(12). However, consistent with RIAA's one-

---

consistent with and in furtherance of the educational purpose of the station. *See* NRBMLC PFFCL ¶ 40; RIAA PFFCL (re Broadcasters) ¶¶ 44-52.

[66] We assume that in a willing buyer/willing seller negotiation, the negotiated rate would be no higher than the rate "offered" herein by RIAA.

[67]Curiously, one week prior to the deadline for submission of this Report, RIAA asserted that their offer was not intended to be interpreted as one-third of the rate determined by the Panel for commercial broadcasters, but rather "one-third of the rate adopted for Webcasters." Proposed Definitions of February 12, 2002 at 14, n.6. This claim defies logic. Both the Panel and the Services plainly understood the offer as referring to the commercial broadcaster rate. *See id*. Indeed, we invite RIAA to review its initial offer: "Copyright Owners are willing to accept a rate for Noncommercial Broadcasters that is no less than one-third of the rate paid for commercial *broadcasters*." Reply of Copyright Owners and Performers to Non-CPB Entities (December 18, 2001) at 3 (emphasis added). The Panel declines to modify its position based upon RIAA's eleventh hour assertion.

third offer, and its implicit recognition that non-commercial broadcasters should not be subject to commercial rates, transmissions of archived programming and substituted programming shall be subject to a rate of one-third the commercial IO rate of 0.14¢. Again rounded to the nearest hundredth of a cent, the derived rate equals 0.05¢ per performance.

Respecting side channel transmissions, these obviously do not qualify for the simulcast rate. In accordance with our reasoning, these transmissions would also be subject to the 0.05¢ per performance rate (one-third of the commercial IO rate of 0.14¢). However, the Panel accepts as appropriate the limitations proposed by NRBMLC. *See* n.65 *supra*. These limitations were proposed by NRBMLC (*see* NRBMLC PFFCL ¶ 40) apparently in recognition that allowing unlimited side channels could permit non-CPB broadcasters to essentially become commercial webcasters.

In summary, the Panel determines the performance royalty rate for non-CPB broadcaster retransmissions (simulcasts) to be 0.02¢ per performance. The rate for transmissions of archived programming substituted programming, and transmissions of one or two side channels of programming, consistent with the educational mission of the station, shall also be 0.05¢ per performance. The rate for transmissions on any side channels beyond the two shall be the same as the commercial non-simulcast rate, i.e., 0.14¢ per-performance.

M. THE MINIMUM FEE FOR WEBCASTING SERVICES

Both Sections 114(f)(2)(B) and 112(e)(4) direct us to set a minimum fee for each type of service. Because the Panel is setting a Section 114 rate (and concomitantly a Section 112 rate) that is based upon the number of performances that a service transmits, rather than a percentage of revenues generated by the service, the issue of minimum fees is of lesser significance. *See* Marks W.D.T. 17-18. RIAA was rightfully concerned that a start-up service with little revenues could transmit a large volume of performances, but pay very little in royalty fees, if fees were based upon a percent-of-revenue model. *See id*.

The Panel concurs with the Services that one purpose of the minimum fee is to protect against a situation in which the licensee's performances are such that it costs the license administrator more to administer the license than it would receive in royalties. *Cf*. Jaffe W.R.T. 31; Tr. 12387 (Jaffe). Another arguable purpose is to capture the intrinsic value of a service's *access* to the full blanket license, irrespective of whether the service actually transmits any performances. *See* RIAA RPFFCL ¶ 249. Whichever the purpose of the minimum fee requirement, the Panel believes that the lowest fee negotiated by RIAA under the per-performance fee model would necessarily cover the perceived administrative costs and the value for access to the blanket license. This belief is premised upon one fundamental assumption -- that a sophisticated and experienced negotiator, such as RIAA, would not negotiate a minimum fee that would expose it to a loss. We are quite comfortable with this assumption. Accordingly, we adopt the minimum fee prescribed in the [redacted] license agreement of $500 per annum,[68] which covers both the Section 114 license and the Section 112 license. *See* [redacted]. Our reliance upon the minimum fee prescribed in the [redacted] license agreement is in no way inconsistent with our prior decision to accord virtually no weight to that agreement with respect to the per performance fee. As previously explained, [redacted] is one of a large number of licensees that never

[68] This minimum fee appears to be generally comparable to the combined minimum fees set by other collection agencies such as the PROs. *See* Webcasters PFFCL ¶¶ 363-64.

paid royalties pursuant to the performance rate structure. It merely paid pursuant to the minimum fee requirements.

Accordingly, we apply this minimum fee to all webcasting services. Each statutory licensee is required to pay a minimum license fee of $500, payable as a non-refundable advance against future royalty fees in that year, due upon the first monthly payment of each year. And in accordance with the [redacted] license agreement, the minimum fee shall *not* be prorated based upon the date paid, but shall be due in full for any calendar year in which a service holds a statutory license.

N. SECTION 112(e) EPHEMERAL RECORDING RATES FOR WEBCASTING SERVICES

1. The Nature of Ephemeral Copies

Ephemeral copies of digital recordings, as addressed in §112 of the Copyright Act, refer to temporary copies of sound recordings made to enable or facilitate the digital transmission of such recordings. These may include, for example, multiple copies made to sit on multiple hard drives or servers, or copies configured differently to facilitate streaming at different bitrates and "codecs." Zittrain W.D.T. 2-6, 12; Tr. 4588 (Porteus); Porteus W.D.T. 12; Pearson W.D.T. 9-10; Wise W.D.T. 9; Juris W.D.T. 7; Roy W.D.T. 8; Moore W.D.T. 5; Tr. 6555-56 (Jaffe). Webcasters and broadcasters may use a single ephemeral copy in the streaming process without charge. 17 U.S.C. §112(a)(1). The creation or use of multiple ephemeral copies, however, is subject to a statutory license. One part of this Panel's responsibility is to set a royalty rate for the use of multiple ephemeral copies by webcasters and broadcasters. §112(e)(4). The royalty rate for the use of ephemeral copies by Business Establishment services is determined in Section VI of this Report.

The record establishes that ephemeral copies are integral to most digital performance streaming, but the testimony is contradictory regarding whether ephemeral copies have independent value apart from, or because of, their use in the streaming process.

2. The Value Of Ephemeral Copies

(a) The Services' View

As throughout this proceeding, the Panel is offered two contrasting views regarding what the appropriate analysis should be. The Services urge the Panel to adopt economic analysis reasoning, primarily by Professor Jaffe, while the Copyright Owners and Performers urge that the appropriate guidance is to be found in the 26 agreements negotiated between RIAA and its licensees.

Services witnesses argue that, because the only purpose of ephemeral copies is to facilitate licensed public performances, they have no economic value separate or distinct from the value of the performances they effectuate. Jaffe W.D.T. 52-54; Tr. 6556 (Jaffe). Because the payment of the performance royalty has already compensated the copyright owner for the full value of the public performance, according to this logic, paying any additional amount for the ephemeral right would constitute an inappropriate double payment. Tr. 3904 (Fisher). Arguing by analogy, ephemeral copies should be seen as similar to car keys, which are used to start and operate an automobile. See Jaffe W.D.T. 54. Although they are necessary for operation (except possibly for "hot wire" specialists), their "value" is included in the overall purchase price paid for the car.

Similarly, appropriate royalty payments for performance rights include payment for incidental ephemeral rights. Designating any separate value for an ephemeral right is thus arbitrary, and any amount so set should be subtracted from the royalty rate for the performance right in order to keep the combined cost of the two rights the same. Jaffe W.D.T. 52-54; Tr. 6556 (Jaffe). Again by analogy, if a $10 price tag were to be attached to car keys, the price of the automobile should be reduced by $10 to keep the total price constant. Jaffe W.D.T. 54; see also Tr. 6556-57, 12700-01 (Jaffe); Services RPFFCL ¶27.

(b) The Copyright Office View

Advocates of the "car keys" analogy urge the Panel to follow the August 2001 Report of the U.S. Copyright Office, issued during the pendency of this proceeding, which characterized §112(e)'s imposition of a separate ephemeral rate as an "aberration." This Report states: "we [see] no justification for…the imposition of a royalty obligation under a statutory license to make copies that have no independent economic value and are made solely to enable another use that is permitted under a separate compulsory license." Jaffe W.R.T. Ex. 6, U.S. Copyright Office, DMCA Section 104 Report at 114 fn. 434 (August 2001). The Copyright Office also advocated this view in 1998. *Id.*

(c) The Congressional View

Although the Copyright Office did urge this policy position in 1998, both the text and the legislative history of §112 indicate that Congress declined to adopt it. 17 U.S.C. §112(e); DMCA Conf. Rpt. 89-91; DMCA Section-by-Section Analysis 52-53, 61-62. Whatever the Panel's private views regarding the merits of this policy debate (and the Panel affords great weight to the views of the Copyright Office professionals who have developed considerable expertise in these matters), this policy determination must be made by the Congress, not by the Panel. Unless and until Congress amends the current statute, the Panel's duty is clear: the Panel's responsibility is to follow the current Congressional mandate set forth in § 112(e)(4) and determine a separate rate for ephemeral copies.

(d) <u>Evidence from the Marketplace</u>

The record also establishes another reason to guide Panel analysis to this conclusion. In mandating a separate ephemeral compulsory license in §112(e)(4), Congress established the willing buyer/willing seller measure as the standard to be followed, and the Copyright Office has affirmed that "willing buyer/willing seller" is the standard this Panel must apply in determining an ephemeral royalty rate. July 16, 2001 Order at 5. It would be one thing if record evidence established that buyers of privately-negotiated licenses had refused to pay any separate ephemeral royalty or, if they had, had insisted that their performance royalty be reduced by the amount of their ephemeral royalty. However, as discussed below, record evidence before the Panel establishes the contrary: separate ephemeral rates, above and beyond the performance royalty were, in fact, often agreed to in the 26 RIAA statutory licensing agreements. Thus, whatever the merits of the theoretical economic analysis, actual actors in the marketplace have demonstrated behavior which matches the standard that Congress and the Copyright Office have indicated must be applied. For this reason, we turn next to an examination of the 26 agreements as they pertain to ephemeral royalty rates.

3. <u>Four Measures from the 26 Agreements</u>

In Section V.G. above, we explained why we have concluded that 25 of RIAA's 26 license agreements are entitled to little weight in determining the predominant performance royalty which willing buyers and willing sellers would agree to in the hypothetical marketplace we must replicate. The same infirmities greatly limit the usefulness of these agreements in determining ephemeral royalty rates. Nevertheless, the Panel considers it appropriate to look at these 26 agreements in order to see if they reveal a clear and consistent pattern. Regrettably, examination of the RIAA's initial 26 license agreements reveals an inconsistent, rather than a consistent, pattern.

Overall, the 26 agreements fall into four categories. Two set ephemeral rates as a percentage of gross revenue. One provides for a flat dollar amount payment. The largest single group indicating any rate (eight in number) provides for an ephemeral rate as a percentage of the performance rate amount. And a fourth group (of fifteen) is silent regarding ephemeral copies and provides no express ephemeral rate.

Percentage of Overall Revenue. Two of the initial 26 negotiated agreements [redacted] calculated ephemeral rates based on overall revenue ([redacted] in the first and [redacted] for a combined performance/ephemeral rate in the second). See RIAA Exs. [redacted]. Compared to the other 24 agreements, these two are the least probative because their percentage-of-overall-revenue basis was used only twice and is not now urged by any party as a formula for the webcasting ephemeral rate to be set by this Panel.

Flat fee. This second type of ephemeral rate agreement (with Yahoo!) resulted in the largest ephemeral royalty amount paid under any of the 26 agreements and was related to the largest number of performances. The Yahoo! agreement is calculated on the basis of a flat fee, with a payment of [redacted] for the initial time period (through 12-31-00) and an additional [redacted] for each 12-month renewal. See RIAA Ex. 75 DR at

§§ 3.1, 3.4. The total [redacted] ephemeral royalty amount paid, when divided by Yahoo!'s total non-ephemeral performance royalty payment of [redacted] million, Panel Rebuttal Hearing Ex. 1 (Mandelbrot W.R.T. 7), results in an effective royalty rate of 8.8% paid under this agreement. As the agreement which represents both the ephemeral royalty for the largest number of performances and the largest ephemeral amount paid, this Yahoo! ephemeral rate, like its per performance rate, is entitled to considerable weight.

<u>Percentage of Performance Royalty Amount</u>. The third category of ephemeral royalty rates is found in eight agreements, which provide for express ephemeral rates of, or calculable to be, 10%. The first of these ([redacted]) occurred in August 2000, contemporaneously with the Yahoo! agreement; the remainder occurred over the next eight months. The three which can be *calculated* to be 10% are [redacted], and [redacted]. *See also* RIAA Exs. [redacted]

<u>Absence of Indication</u>. Having concluded that the soundest basis for determining what willing buyers would pay willing sellers for an ephemeral rate would be to look at the 26 actual marketplace agreements, the Panel is faced with the anomaly that the majority (fifteen) of these 26 do not state any ephemeral royalty rate.[69] Based upon a careful examination of the agreements themselves, as discussed previously in Section V. G., the Panel concludes that the reason for this silence is that these agreements do not, in

[69] Clearly, the RIAA characterization that "Nearly all of the RIAA license agreements include the 10% surcharge for the making of ephemeral recordings under the Section 112(e) compulsory license," RIAA PFFCL ¶245, is decidedly wide of the mark.

fact, convey ephemeral rights to the licensees. Unlike the Yahoo! agreement and others which are typically labeled "WEBCASTING PERFORMANCE *AND EPHEMERAL* LICENSE AGREEMENT" (emphasis added), the fifteen silent agreements are labeled only "WEBCASTER PERFORMANCE LICENSE." *See, e.g.,* RIAA Exs. 60 DR-73 DR. Similarly, while the Yahoo! agreement and others grant an express ephemeral license (see, e.g., RIAA Ex. 75 at §2.1.2), the fifteen silent agreements lack this provision. What all 26 do have in common, however, is an express provision which states that [redacted] See, e.g., RIAA Ex. 75 DR at §2.2.3). Thus, both types of agreements are clear, internally consistent, and unambiguous on their face. The ones labeled as granting ephemeral licenses do so expressly, while the ones labeled simply as performance licenses are limited to that right. Because these fifteen do not provide any ephemeral royalty rate, they provide the Panel no guidance on what the ephemeral royalty rate should be.

However, because they do constitute a significant portion of the marketplace evidence, the Panel sought to analyze how they came about. Four different reasons could explain the unexpected state of affairs. First, at least some of the licensees may have believed that their agreements included ephemeral rights. For example, Mr. Heilbronn of Lomasoft, although he did not negotiate the agreement himself, was not a lawyer, and did not head his company at the time, testified to his understanding that his [redacted] royalty rate [redacted] Tr. 13106-07 (Heilbronn). The Panel believes that he was mistaken.

A second possible explanation is that these services could have been sufficiently small to enable them to operate using only the single free statutory ephemeral copy. Tr. 9769-80 (Marks); Tr. 14970 (Garrett). While some evidence indicates that some of these were smaller, single-channel, or never-launched webcasters, the record does not establish any specificity and suggests, at best, various contradictory inferences. Tr. 14974-88 (Garrett).

A third possible explanation is that ephemeral rates are generally so much smaller than performance rates that they were treated almost as an afterthought, possibly on the order of a sales tax, and accordingly were simply not addressed in some negotiations. For example, the record reveals that in the Yahoo! case, after eleven months of extensive negotiation, multiple term sheets, and near closure on many issues -- and six days before Mr. Marks reported to the RIAA Negotiating Committee that "we have a deal" (RIAA Ex. 137 DR at N14561 (6/29/00)) -- the ephemeral rate was still "to be agreed upon." *Id.* at N11828 (Term Sheet, 6/23/00). In the negotiation, in the last six days, an ephemeral rate agreement was reached (*id.* at N14561), although it may not have been in other negotiations.

A fourth possible explanation is that initially RIAA did not press the issue so long as it received what it regarded as a "satisfactory" performance royalty rate. In each of the first fifteen agreements, RIAA negotiated either 15% of revenue or about 0.4¢ per performance. *See* RIAA Exs. 60 DR-73 DR. While negotiating the [redacted] and Yahoo!), as it became clear that any agreement reached with Yahoo! would be closer to one-half the previous amounts, lead negotiator Marks asked the Negotiating Committee [redacted]

[redacted] RIAA Ex. 137 DR at N14548 (3/29/00). In the context of a non-"satisfactory" rate, the Committee was clear that [redacted] RIAA Ex. 137 DR at N14557 ([redacted], 3/31/00); and at N14555 ([redacted], 3/28/00). In virtually all the agreements thereafter, they did.

4. The Panel's Ephemeral Royalty Determination

In setting an ephemeral royalty rate, the Panel thus has before it the following: two agreements founded on a basis not now advocated by any party, fifteen agreements which did not provide a rate, the largest single agreement at an effective rate of 8.8%, and eight other agreements at a 10% rate (express or calculable). The Panel concludes that the rate most representative of that negotiated in the marketplace between willing buyers and willing sellers, as represented by these 26 agreements, lies within the range between 8.8% and 10% of the performance royalty amount. For all of the reasons discussed in Section V. G. above, the Panel places significant weight on the Yahoo! rate of 8.8% and does not afford great weight to the other 25 agreements. Indeed, even at face value, as explained here, they do not represent evidence which establishes RIAA's proposed rate. Accordingly granting very modest effect to the agreements which have ephemeral rates around 10%, the Panel rounds the 8.8% Yahoo! rate up to 9%. It determines, accordingly, that the §112(e) royalty rate for whatever number of ephemeral copies are necessary for the sole purpose of facilitating performances under §114(f) shall be set at 9% of the amount of performance royalties paid by a licensee.

O. OTHER ISSUES

1. Same Rates for Both License Periods

As previously noted, the purpose of this proceeding is to set rates and terms for two time periods: (1) October 28, 1998 (the effective date of the DMCA) through December 31, 2000; and (2) January 1, 2001 through December 31, 2002. *See* Order of December 4, 2000 at 5. However, the rates and terms proposed by all parties are the same for both periods.[70] The Panel agrees that, based upon the record before us, there is no warrant to set different rates, nor any inflation adjustments.

2. Long Song Surcharge

RIAA proposes a "long song surcharge" for all performances of songs over five minutes in duration. *See* RIAA PFFCL ¶ 210. RIAA asserts that this "provision is in all of the relevant RIAA license agreements with B2C webcasters." *Id*. To the contrary, this provision is [redacted]. Accordingly, we decline to impose this provision.

3. Partial Performances

Webcasters urge the Panel to exclude from payment *partial* performances of a sound recording that do not reach a threshhold duration of thirty seconds. *See* Webcasters' Supplemental Submission of January 18, 2002 at ¶¶ 13-14. Webcasters note

[70] Within the context of its rate proposal, Webcasters did propose a modest inflation adjustment. *See* Services' Proposed Rates and Terms (November 6, 2001) ¶¶ 2(a)(3) and 2(e). However, the record does not support this adjustment. In any event, the Panel readily acknowledges that its rate determinations are not so precisely calculated as to render an inflation adjustment meaningful or necessary. In this regard, we felt quite comfortable rounding our rate determinations to the nearest hundredth of a cent. This rounding likely subsumes any minor inflation adjustments.

that truncated performances can occur as a result of “technology glitches or user activation of song-skip functions.” *Id.* at ¶ 15. This is true, however the record does not support payment exemptions.

Recognizing the potential for technological glitches that cause occasional streaming failures, three of the 26 RIAA agreements provide exemptions for performances under 10 seconds in duration (two of the three apply only in the introductory periods). *See* RIAA Exhibits [redacted] at § 1.6 [redacted] at § 3.1.1 [redacted] at §1.6 [redacted]. Indeed, streaming failures are also accommodated in the benchmark Yahoo! agreement which provides:

> [redacted]

RIAA Exhibit 75 DR at § 3.2.1 (emphasis added).

However, the Panel has already partially accounted for this provision in our calculation of the per-performance rates. In our calculations, we used the [redacted] blended rate as an end point to determine the final IO and RR rates. The [redacted] blended rate constitutes the precise per-performance rate negotiated by the parties for the first [redacted] performances. These [redacted] performances included the “free” [redacted] performances. Accordingly, this provision has been partially accounted for because it was part of our calculations to find each mid-point, or arithmetic mean, that constitutes the final IO and RR rates. And only a “partial” accounting is appropriate because RIAA agreed to this accommodation in the initial period *only* – as it did in two of the other three agreements that made accommodations for technological glitches.

Respecting Webcasters' second argument, we find no justification for excluding short performances merely because the listener elected to skip a sound recording. The functionality of certain services that allow listeners to skip unwanted performances provides a benefit to webcasters.[71] Although the record does not support a higher performance rate for services that provide this functionality,[72] neither does the record support penalizing the copyright owners for this benefit to webcasters – a benefit that allows webcasters to offer a more satisfying experience to their listeners. None of the 26 agreements provides an exemption for skipped songs and no exemption is warranted.

Finally, we find that tracking and reporting partial performances would not significantly burden the services. *See* Tr. 13789 (Marks) ("Every webcaster that we've done a deal with has agreed to do so [report actual performances], generally speaking, and they do it in different ways."). *See also* Tr. 11800, 11817 (Kessler) (currently available software allows the generation of a performance report that "truly is the push of a button").

Accordingly, the Panel declines to exempt partial performances from payment obligations established herein. *See*, however, Panel discussion below regarding "incidental performances" and the definition of a "performance."

[71] *See e.g.*, Tr. 7412 (Roy) ("… consumers really like this functionality. They like to be able to skip songs they don't like. That's one of the things they don't like about terrestrial radio. And they tend to stay on the services longer.…")

[72] *See* our Section V.J.2., *supra*.

4. Incidental Performances

Webcasters also argue that "incidental performances" should be exempted from payment. *See* Webcasters' Supplemental Submission of January 18, 2002 at ¶¶ 13, 17. The Panel agrees. The benchmark Yahoo! agreement explicitly excludes [redacted] from [redacted] *See* RIAA Exhibit 75 DR at §§ 1.3, 1.10. We accordingly adopt this provision which excludes transmissions or retransmissions that make no more than incidental use of sound recordings, including but not limited to, certain performances of brief musical transitions, brief performances during news, talk and sports programming, commercial jingles, and certain background music. *See id*.

5. Performances of Sound Recordings Already Licensed

All parties agree that performances of sound recordings by webcasters that have already secured a license for that performance should be exempt from payment under the statutory licenses. *See* Webcasters' Supplemental Submission of January 18, 2002 at ¶ 19; RIAA's Comments of January 18, 2002 at 8-9. The Panel agrees.

6. Definition of a Performance

Consistent with the Panel's determinations above, and the applicable provisions of the Yahoo! agreement, we define a "performance" as:

> Each instance in which any portion of a sound recording is publicly performed to a listener via a Web Site transmission or retransmission (*e.g.* the delivery of any portion of a single track from a compact disc to one listener) but excluding the following:
>
> (1) A performance of a sound recording that does not require a license (*e.g.*, the sound recording is not copyrighted);
> (2) A performance of a sound recording for which the service has previously obtained a license from the copyright owner of such sound recording; and

> (3) An *incidental* performance that *both* (i) makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events *and* (ii) other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

See RIAA Exhibit 75 DR at §§ 1.3, 1.10; Webcasters' Supplemental Submission of January 18, 2002 at ¶ 19; RIAA's Comments of January 18, 2002 at 8-9.

7. Calculating Number of Performances

As previously explained, the per-performance fee metric is preferred because, among other reasons, it provides a fee structure directly tied to the intensity of sound recording usage. *See* Section V.B., *supra*. However, as RIAA apparently concedes (*cf*. RIAA PFFCL, Appendix C at ¶ 4), some services may not currently possess the proper software, or technical expertise, to track or calculate accurately their performances of sound recordings. Accordingly, as RIAA proposes *(see id*), statutory licensees should be permitted to make a reasonable estimate of the number of their performances until such time as they can reasonably be expected to acquire the software and expertise.[73]

[73] RIAA proposes to permit estimation of performances prior to January 1, 2000 only. *See* RIAA PFFCL, Appendix C at ¶ 4. However, we view this deadline (which precedes by almost five months the expected date of the Librarian's decision in this matter) as inequitable and unworkable. The Panel believes services should be accorded more reasonable notice to acquire the requisite software and technical expertise to begin accurately tracking performances. And although the record does not support any particular timeframe, we view 30 days as reasonable. *Cf. Recording Industry of America v. Library of Congress*, 176 F.3d 528, 536 (1999) (there are "some circumstances in which the Librarian's Decision must, for want of concrete data, be based principally on sound judgment … [so long as the matter in dispute has been] properly raised before the arbitration panel so that the parties have a fair opportunity to address it, and so that the Librarian has the benefit of the parties' views before reaching a judgment"). In the instant proceeding, the matter was raised during the hearing, and again in the RIAA PFFCL. The Services have had ample opportunity to respond.

Accordingly, the Panel accepts RIAA's proposal and permits estimation of the total number of performances by a service as follows:

> For the period up to the effective date of the rates and terms prescribed herein, and for 30 days thereafter, the statutory licensee may estimate its total number of performances if the actual number is not available. Such estimation shall be based on multiplying the licensee's total number of Aggregate Tuning Hours by 15 performances per hour (1 performance per hour in the case of retransmissions of AM and FM radio stations reasonably classified as news, business, talk or sports stations, and 12 performances per hour in the case of all other AM and FM radio stations).

8. Discount for Promotion and Security

In response to inquiries from the Panel during the hearing, RIAA proposes that a performance rate discount of 25% be allowed to any service that includes certain promotional and security features not otherwise required by Sections 114 and 112. *See* RIAA PFFCL ¶¶ 240-43. These include a "buy button" or other link to retail web sites that offer sales of CDs, certain promotional announcements, listener surveys, and limitations on the streaming technology used. *See id*. Some of these considerations are consistent with those offered in many of the RIAA licensees. *See* RIAA Exhibits 60 DR through 84 DR.

The Panel would encourage RIAA and webcasters relying upon the statutory licenses to consider voluntary agreements that would effectuate such discounts. In the final analysis, however, the Panel concludes that it should not mandate these discounts because they entail matters beyond the statutory license and, arguably, beyond the Panel's authority. Moreover, the Panel is aware of no record evidence to support any particular discount rate.

VI. ROYALTY RATES FOR BUSINESS ESTABLISHMENT SERVICES

A. NATURE OF THE SERVICE

In addition to webcasters and broadcasters, the record before us shows that certain organizations offer an entirely different type of music service, namely, the compilation and delivery of background and foreground music to be played in business establishments for the listening enjoyment of customers of those establishments. Pursuant to the "Business Establishment Exemption" found in 17 U.S.C. § 114(d)(1)(C)(iv), organizations which make digital transmissions in the course of such services are exempt from any performance royalty so long as they comply with the requirements of the DMCA. However, pursuant to § 17 U.S.C. § 112(e), those organizations are required to pay a royalty for the right to make multiple ephemeral copies in the operation of such services. RIAA's petition to set the royalty rate for such ephemeral copies has been assigned to this CARP panel for determination.

Unlike webcasting, Business Establishment (also called "background") music service is a form of business which has been in operation for decades. AEI Music Network, Inc. ("AEI") began distributing original artist recordings for use in business establishments in 1971. *See* Knittel W.D.T. 4. Other companies, including DMX Music, Inc. ("DMX"), Muzak, Inc. ("Muzak"), PlayNetwork, Inc., and Radio Programming and Management, Inc., have also offered background music services to business establishments for years. *See, e.g.*, RIAA Exhibits [redacted]. More recently, Music Choice and musicmusicmusic have sought to offer these services, (*see* RIAA Exhibit 60-A DR; Tr. 14,746), and other entities have expressed interest in entering the business as well. Tr. 2259 (Pipitone). In response to the Librarian's invitation, three companies--AEI, DMX, and Music Choice--filed notices of intent to participate in this CARP proceeding. Music Choice subsequently withdrew its notice, but AEI and DMX both filed direct cases in April 2001. In May 2001, these latter companies merged to become DMX/AEI Music ("DMX/AEI"), and that merged entity has continued as an active party in the proceedings.

Again unlike webcasting, the Business Establishment music business has large numbers of paying customers and substantial revenues. DMX/AEI provides music to about [redacted] businesses and generates revenues of over [redacted] per year from this service. *See* Knittel W.D.T. 4; Tr. 8492 (Knittel). As one would expect from a successful business such as this, there have been technological advances over time in the way in which such companies deliver their product.

Originally, AEI and DMX prepared musical programs on tapes and CDs to be played "on-premises" in specialized equipment at their clients' establishments. Later, this on-premise service was improved. AEI and DMX provided their customers with a proprietary hard disk based device which could play music programs that were placed on an internal hard drive. *See* Knittel W.D.T. 8-9. In 1999, DMX and AEI established "digital repositories" of numerous sound recordings, which could be utilized in all the different models of their services. Tr. 8409, 8413, 8416-17 (Knittel); Talley W.D.T. 3-4.

DMX/AEI and RIAA agree that the "on-premises" services are not subject to the § 112(e) license at issue. Thus, the rates set in this proceeding do not apply to those services. Instead, DMX, AEI, and other background music services have obtained from copyright owners voluntary licensing agreements to utilize sound recordings in the operation of those services.

Most recently, certain of the background music organizations have developed a so-called "broadcast model" of their service.[74] The model employed by DMX/AEI is described in detail in the written and oral testimony of Barry Knittel and Douglas Talley of DMX/AEI. In essence, the model involves digital transmission of musical programs to customers over cable and/or satellite facilities. In the course of operating this service, literally millions of ephemeral recordings are made at various stages of the process, including composing the digital repository, programming, quality control, "client computers," and transmissions. Tr. 8632-8639, 8658-59 (Talley). In particular, "cache" ephemerals are made when content is temporarily stored on a client server for transmission to a cable affiliate or satellite. *Id.* And "buffer" ephemerals, which are ubiquitous in the use of digital technology, are made at numerous stages throughout the operation of the service. *Id.*

The parties agree that it is only this "broadcast" model of background music service which is encompassed in the present proceeding and for which this Panel must set a royalty rate. *See* Tr. 9567 (Berz); 9576, 9581-82 (Garrett).

[74] For example, Muzak, the nation's largest background music service with annual revenues of approximately $87 million, operates a broadcast model of its service. *In re Determination of Statutory License Terms and Rates for Certain Digital Subscription Transmissions of Sound Recordings*, No. 96-5 CARP DSTRA (Library of Congress November 12, 1997), Report of the Copyright Arbitration Royalty Panel ¶¶ 68-69. Musicmusicmusic is also licensed to operate a broadcast service. *See* RIAA Exhibit 60-A DR.

B. RATE PROPOSALS OF THE PARTIES

1. DMX/AEI's Rate Proposal

DMX/AEI proposes that the Panel set a royalty of $10,000 per year per company for the making of buffer and cache copies to facilitate the digital transmission of sound recordings in broadcast services, prorated for the period between October 28, 1998 and December 31, 1998. *See* DMX/AEI PFFCL ¶44.

While recognizing that, "as a theoretical matter the potential scope of ephemeral recording rights available to the background music industry may be broader," DMX/AEI asserts that the Panel should set a royalty only for the use of cache and buffer ephemerals, since its existing voluntary licenses allegedly give it the right to use its digital repository in operation of the broadcast service, as well as the on-premises services. DMX/AEI PFFCL ¶ 10.

DMX/AEI argues that the Panel would be entirely justified in setting this royalty rate at zero. *See* DMX/AEI PFFCL ¶¶ 42-44. It contends that, in exempting DMCA-compliant background music services from any performance royalty, Congress concluded that operation of such services would likely have a positive effect on the revenue of copyright owners, and envisioned only a modest ephemeral royalty if there were evidence of any significant "leakage" (ephemeral copies being used to generate records for sale), which there is not. DMX/AEI PFFCL ¶¶ 46-50. It points out that the Copyright Office has criticized the §112(e) statutory license as an "aberration" which should be repealed in favor of an ephemeral recording exemption which would exempt buffer copies from any royalty obligation. DMX/AEI PFFCL ¶¶ 51-53. Finally, DMX/AEI argues that, because they have no "independent economic value" other than facilitating performances, its ephemeral copies should have a royalty, at most, which is consistent with those set in RIAA license agreements for webcasters. Its fee proposal of $10,000 per company (i.e., $20,000 for the merged DMX/AEI) is allegedly quite compatible with the Yahoo! agreement, which sets a royalty of $50,000 per year for a much broader range of ephemeral rights than DMX/AEI will require. *See* DMX/AEI PFFCL ¶¶ 54-56.

2. RIAA's Rate Proposal

RIAA proposes that the Section 112(e) ephemeral license for broadcast background music service be set at 10% of the gross revenue from such service, with a minimum fee of $50,000 per year. *See* RIAA PFFCL ¶ 627. RIAA denies that DMX/AEI's existing licenses permit use of its non-DMCA-compliant digital repository in the broadcast service. Thus, asserts RIAA, DMX/AEI will likely be required to utilize in this service a DMCA-complaint database, which will entail creation of ephemeral recordings beyond the cache and buffer copies for which DMX/AEI wants the Panel to set a royalty. *See* RIAA Reply to DMX/AEI PFFCL ¶¶ 8 - 12.

Moreover, RIAA argues, even if DMX/AEI were to prevail in its contention that its presently licensed database can also be utilized in its broadcast service, the Panel should not tailor the royalty to the individual circumstances of one company. Rather, it should establish a blanket royalty which would permit any applicant, including those which may not have seperately licensed databases, to utilize ephemeral recordings throughout the operation of their service, regardless of the particular technology they choose to employ. *Id*.

Further, RIAA contends, Congress was certainly aware that, notwithstanding the absence of a performance royalty, background music companies have for years paid substantial royalties to make the sound recording reproductions necessary to operate their on-premises services, and there is no reason to believe that Congress intended to disturb this "traditional stream of revenue" by creation of the § 112(e) license. *Id.*

RIAA notes that the Copyright Office's comment about the aberrational nature of the ephemeral license was made in connection with webcasting, not background music, and, in any event, Congress has not accepted the Copyright Office's view on this matter. *Id.* at 11-12.

Finally, RIAA asserts that the appropriate benchmarks for a royalty for the background services are not recent licensee agreements from the very different world of webcasting, but rather agreements which have been utilized for years to license sound recording use by background services. *Id.* at 13-20.

C. WHAT IS THE ROYALTY FOR?

A threshold dispute that the Panel needs to resolve in order to set a royalty in this area is the question of what we are setting a royalty for. As noted above, DMX/AEI argues that we should only set the royalty for the use of cache and buffer copies because, it asserts, its existing licenses already give it the right to use its non-DMCA complaint database in the broadcast service. RIAA disputes that the existing licenses give DMX/AEI this right and argues that we should set the royalty for all ephemeral recordings utilized in a broadcast service, which will likely involve -- at least for some applicants - - ephemerals in DMCA-complaint databases, as well as cache and buffer ephemerals. Resolution of this threshhold matter is complicated by the fact that the dispute about the reach of DMX/AEI's existing licenses is a matter for determination by the courts, not this Panel, and no court has yet addressed the issue.

On reflection, we have concluded that the exact reach of DMX/AEI's existing licenses is irrelevant to our task. The background music license agreements introduced into evidence show that royalty rates have not been based on [redacted]. Thus, for example, Knittel Rebuttal Exhibit 22, [redacted]. Moreover, the royalty rates in DMX and AEI licenses were essentially the same before and after November 1999, when they introduced the new "digital repository" database.[75]

Some background music services may choose to operate broadcast services with DMCA-compliant databases, as musicmusicmusic has done. See RIAA Exhibit 60-A ¶ 2.1(c)(i). Others may conclude that a permanent, non-DMCA-complaint database involves substantial cost savings and thus elect to obtain voluntary licenses for that database. Still others may wish to operate without a database at all, as DMX and AEI did before 1999. *See* Tr. 14,789. Choices about which technology to use involve cost-and-benefit tradeoffs about which neither side presented detailed evidence.

However that choice is made, though, no broadcast service can operate without making millions of ephemeral recordings at many different stages of the process. Thus, after Mr. Talley of DMX explained that he uses the term "ephemeral copies" to include "cache and buffer copies" and nothing more, Tr. 8656, he was asked at what stages ephemeral copies are made in the DMX/AEI broadcast model. He answered, "Every

[75] Compare pre-1999 and post-1999 royalty rates in the respective license agreements and renewals provided as RIAA Exs. 09 DR, 10 DR, 11 DR, 12 DR, and 13 DR.

stage from the transmission to the reception. There are many, many, many places where this happens, where ephemeral copies are made." *Id.*

Over the next ten pages of transcript, Mr. Talley described the "many places" in the broadcast model at which ephemeral copies are made, including, but far from limited to, the digital repository, Tr. 8656-66, after which this colloquy occurred:

> **Q**: Okay. I guess as you said in your broadcast model there are a lot of different ephemeral copies that are made, correct?
>
> **A**: Yes.
>
> **Q:** And if you can't make those ephemeral copies, you can't use this broadcast model, can you?
>
> **A:** That's correct.

Tr. 8667

This testimony effectively refutes, in our view, DMX/AEI's contention that its ephemeral copies have "little or no independent economic value." DMX/AEI Reply to RIAA PFFCL ¶ 6. Without such ephemerals, no broadcast service could be operated, and no revenue could be generated.

We agree with RIAA that, in creating the § 112(e) statutory license, with rates for each type of service "binding on all copyright owners ... and transmitting organizations," 17 U.S.C. § 112(e)(4), Congress intended to create blanket licenses which would afford each licensee all the rights necessary to operate such a service, in this case, the right to make any and all ephemeral copies utilized in a broadcast background music service. We do not believe it appropriate to subdivide this package of rights into multiple mini-licenses for the making of different kinds of ephemeral copies at numerous different stages of the process. Nor does the evidence of the parties permit us to assign separate value and separate royalties to each such sub-license, as DMX/AEI counsel have acknowledged. *See* Tr. 14,762 (Rich).

Accordingly, the Panel concludes that the royalty we must set is for all ephemeral copies which may be utilized in the operation of a broadcast service, and the royalty rate is not dependent on whether or not a particular licensee's model includes a DMCA-complaint database.

D. DETERMINING THE ROYALTY RATE

1. The Views of Congress and the Copyright Office

We do not find persuasive DMX/AEI's argument that Congress envisioned the §112(e) royalty as a *de minimis* payment to guard only against the risk of leakage. Nothing in the statute says so, nor does the legislative history compel that conclusion. Rather, Congress plainly made fair market rate the talisman for this CARP, and we must assume that Congress knew that for years copyright owners have been collecting millions of dollars in royalties from background music companies for use of their sound recordings in those services.[76]

Nor do we think the Copyright Office report cited by DMX/AEI mandates that we set a zero or *de minimis* royalty. DMX/AEI PFFCL ¶ 51. First, the section of the report quoted by DMX/AEI deals with webcasting, not background music. Second, while the views of the Copyright Office on any matter are entitled to great respect, as stated previously, Congress has yet to accept the Office's view on this point. We are bound to apply the Copyright Law as presently enacted.

[76] Mr. Knittel testified that [redacted] pays over [redacted] per year in royalties and fees to copyright owners. Knittel W.D.T. 14.

2. The Statutory Factors

As we explained in Section III above, we believe the statutory command for setting rates under § 112(e) is essentially the same as for setting rates under § 114(f)(2), *i.e*., the determinative question is what price a willing buyer and willing seller would agree to in the marketplace for the license in question. While the economic, competitive, and programming factors described in the statute are relevant, and we have considered them, the net effect of such factors is best gauged by looking at the prices actually negotiated by willing buyers and willing sellers, if such agreements are available.

Thus, with respect to § 112(e)(4)(A), we agree with DMX/AEI that use of sound recordings in background music services has significant promotional value. DMX/AEI PFFCL ¶¶ 32-35. This is true whether the music is delivered via the on-premise model or a broadcast service. This factor has led some small labels and individual artists on occasion to license the use of their sound recordings for little of no royalty payment in hopes of achieving wider public familiarity with their works. *See* Tr. 8380 (Knittel). However, notwithstanding the promotional potential, the major record labels, which hold the vast majority of sound recording copyrights, have insisted on significant royalty payments in exchange for use of their complete repertories, and background music companies have agreed to those payments, as discussed below.

Indeed, background music companies would have little economic incentive to incur the capital costs of establishing a new, broadcast service unless they had concluded that such a service would be more profitable than their existing, successful on-premises services. Given that conclusion, such companies would naturally seek to move as many customers as possible from on-premises to broadcast contracts. In fact, most DMX customers now receive their music through the broadcast service. Talley W.D.T. 3. If the royalty rate for broadcast service is substantially lower than for on-premises service, as DMX/AEI propose, then the shift in customers (and thus revenue) from on-premises to broadcast service will substantially reduce the copyright owners' "traditional stream of revenue" from broadcast music companies, a factor which Congress instructed us, via Section 112(e)(4)(A), to consider in setting the royalty rate.

Similarly, as regards §112(e)(4)(B), background music companies plainly have played a major role with respect to the creative and technology contributions, capital investment, cost, and risk relative to their services (*see, e.g*. evidence cited at DMX/AEI PFFCL ¶¶ 36-41), and copyright owners have played a major role with respect to such factors relative to the copyrighted works. (*See*, e.g., evidence cited at RIAA PFFCL ¶ ¶ 488-89, 493-97.) The weight to be given by willing buyers and willing sellers to such respective factors is, again, best demonstrated by the agreements they have actually reached.

3. Agreements From Which Marketplace?

DMX/AEI contends that, if we are to derive a royalty from marketplace agreements, we should look to the ephemeral royalty rates reflected in RIAA's agreements with certain webcasting licensees, particularly Yahoo!. However, in the webcasting market, the principal royalty is plainly the § 114(f) performance royalty; the ephemeral royalty is an ancillary royalty which produces only a modest increase in the licensee's overall royalty obligation. With respect to background music companies which are exempt from the § 114(f) royalty obligation, § 112(e) is the only royalty which licensees must pay in order to make use of all sound recordings in the operation of a digital broadcast service.

Moreover, webcasting is an entirely different kind of business than background music. It has different customers, different economics, and different delivery methods.

Webcasting, as noted above, is a new business which has yet to prove profitable on a large scale, whereas the background music business is well established and generates very substantial revenues.

Thus, we believe the appropriate license agreements to use as benchmarks are those by which copyright owners have for years granted background music companies the right to use all of their sound recordings in the operation of their on-premises service. We reject DMX/AEI's contention that these agreements are irrelevant because they involve the licensing of reproduction and distribution rights, rather than the right to make ephemeral copies. It is apparent to us that these licensing agreements (introduced by both RIAA and DMX/AEI) were effectively intended to permit the licensees to utilize sound recordings in operating the background music services in question. The Section 112(e) license here will have the same effect for broadcast services that make digital transmissions of sound recordings.

4. Royalties Evidenced By the Pertinent Agreements

The parties have introduced nearly three dozen license agreements between copyright owners and background music services. No party has contended, nor introduced evidence to show, that these are anything other than what they appear to be, namely, agreements between willing buyers and willing sellers, and we treat them as such. The critical question is what royalties do these agreements establish?

Barry Knittel, formerly President of AEI Music Markets – Worldwide and now DMX/AEI's Senior Vice President of Business Affairs Worldwide, testified that AEI has approximately [redacted] license agreements for North America, which fall into various categories. *See* Tr. 8379-80 (Knittel).

First are licensing agreements which are "strictly promotional" and in which the licensees do not expect a royalty. *See* Tr. 8380 (Knittel). These agreements are usually with individuals who are trying to get their songs played. *See* Tr. 8390 (Knittel). AEI has "very few" of these agreements. *Id*.

Second are agreements in which AEI pays a royalty of [redacted] every time a sound recording is used within one of its programs. *See* Tr. 8380.

Third are "marketing fund license agreements" in which the licensors "share in our profits from music programming and receive certain distributions of royalties from that and other promotional benefits." Tr. 8380. Under such an agreement, the label receives part of the royalty in cash and the balance is placed in an account to be used by AEI for promotion of the label's products in whatever way the label directs. *Id*. at 8384-85. AEI has such agreements with [redacted] *Id*.

Fourth are agreements in which [redacted] receive a percentage of AEI's proceeds in cash rather than have those funds retained by AEI in a promotional account. *See* Tr. 8468-69.

The Panel finds that the third and fourth form of agreement (whose principal difference is whether the royalty is received entirely in cash or partly in the form of promotional services requested by the licensor) comprise the predominant royalty arrangement between AEI and the major labels who license the vast majority of copyrighted sound recordings. *See also* Wilcox W.D.T. 12; Pipitone W.D.T. 3; Tr. 2266 (Pipitone). Similar agreements exist between major labels and other background music services, including [redacted], Muzak ([redacted]), Play Network Inc. ([redacted]), and Radio Programming and Management, Inc. ([redacted].

It is true, as DMX/AEI asserts, that these agreements convey to the licensees some benefits beyond the use of the sound recordings. But they also convey to the licensor benefits beyond the royalty payment. It is clear, however, that "by far the most important rights" conveyed to licensees by these agreements are the rights to copy and distribute (i.e., to use) sound recordings in their background music service (Tr. 8475-76 (Knittel)), and it is thus reasonable to infer that the royalty obligation in these agreements was assumed in exchange for those "far most important" rights.

The royalty obligation in these agreements is generally [redacted] of gross proceeds derived by the background music company from the licensed service. *See*, RIAA Exhibits 9 DR, 10 DR, 11 DR, 12 DR, 13 DR, 14 DR, 26 DR, 27 DR, 28 DR, 60-A DR, 66 DR-X, Knittel Rebuttal Ex. 22; Knittel W.D.T. 14-15. Two agreements (RIAA Exhibits [redacted]) set the percentage for satellite service at [redacted] and for on-premises service at [redacted]; these agreements were negotiated at a time when it was uncertain whether satellite service was subject to a royalty obligation. *See* Pipitone W.D.T. 3-4; Tr. 2268-70 (Pipitone); Marks W.D.T. 31. One of these agreements (RIAA Exhibit 14 DR) has subsequently expired, and the rate for on-premises service has gone back to [redacted]. (RIAA Exhibit 10 DR). Other subsequent agreements (RIAA Exhibit 60-A DR, Knittel Rebuttal Exhibit 22) have set a uniform percentage rate for satellite and on-premises services.

In a few agreements (e.g., [redacted] Knittel Rebuttal Exhibit 22), there are certain deductions from "gross proceeds" before the royalty percentage is applied. In most of these agreements in evidence (RIAA Exs. [redacted]), however, there are no deductions from gross proceeds, and in some (e.g., RIAA Exs. [redacted]), the licensee is obligated to pay [redacted] per recording used in a program, in addition to the stated percentage of gross proceeds.

From the evidence before us, the Panel finds that, among major labels and a variety of background music companies, willing buyers and willing sellers have generally agreed to blanket licenses to use sound recordings in such services in exchange for royalty payments of approximately [redacted] of the gross proceeds of such services. As discussed in Section VI.C. above, there is no evidence that the royalty rate depends on what technology is used to deliver the music. Royalty rates for on-premises services were 10-15% of gross proceeds before 1999, when DMX and AEI did not utilize digital repositories, and 10-15% of gross proceeds after 1999, when they did. *See* note 75 *supra.* Nor is there any persuasive evidence that willing buyers and willing sellers place a significantly different value on a broadcast service which uses a DMCA-compliant database from one which does not. *See, e.g.*, RIAA Exhibit 60-A DR ([redacted] royalty for broadcast service with DMCA-compliant database) and Knittel Rebuttal Exhibit 22 (royalty of [redacted], for broadcast service without DMCA-compliant database).[77]

[77] The [redacted] per program feature is impossible to convert directly into a percent of revenue, but plainly means that the total royalty obligation is greater than [redacted] of gross proceeds.

In view of this evidence, the Panel concludes that, in exchange for a blanket license to utilize all copyright owners' sound recordings in a broadcast service under Section 112(e), background music companies and copyright owners would agree to a royalty of at least 10% of gross proceeds. RIAA has proposed that royalty, which lies at the low end of the [redacted] range described above, partly to give some consideration to the contention of DMX/AEI that its existing voluntary licenses already provide some of the rights (i.e., the digital repository) it needs to operate such a service. Tr. 14658 (Garrett).

One subsidiary question which must be answered in setting such a rate is how to define "gross proceeds." RIAA has proposed an expansive definition drawn from the [redacted]). We reject this proposal for two reasons. First, we believe that this licensee, [redacted], was particularly motivated to accommodate RIAA. Second, the definition in question is found in only one of the other background music license agreements before us. In contrast, [redacted] agreements before us (RIAA DR Exhibits [redacted]) provides, in substantially uniform language, a simpler and less sweeping definition of gross proceeds.[78] This definition, which appears in more of the

---

78 [redacted]

agreements before us than does any other, has apparently been utilized by [redacted] with most of the background music services (AEI, DMX, Muzak, Play Network, Inc. and Radio Programming and Management, Inc.) over a number of years. Thus the record shows that this simple definition has won broad marketplace acceptance. While not detailed, its widespread use suggests that the parties have developed workable understandings for applying it in actual practice. We adopt this definition, as rephrased to fit the Section 112(e) license.[79]

Secton 112(e) requires that the Panel also set a minimum fee for this kind of service. However, the evidence before us is too varied to draw the conclusion that willing buyers and willing sellers consistently agree to minimum fees on the order of $50,000 per year, as requested by RIAA. While several of the agreements (RIAA Exhibits [redacted]) have minimums of that size or larger, one has a much smaller minimum ([redacted]) and several (RIAA Exs. [redacted]) have no minimum payment at all. We conclude that the minimum fee of $500, which we have set to cover the administrative costs of dealing with the webcasting and broadcasting licensees, should apply to the Business Establishment licensees as well.

Accordingly, the Panel determines as follows:

---

[79] Because any one label can only demand royalty payments from the background services for use of its own recordings, a formula must be developed to calculate what portion of total proceeds resulted from use of that label's records. The definition we adopt does so differently for classical recordings and other titles, presumably because the playing time of classical recordings varies widely, whereas that of most other recordings is relatively uniform in length. For the blanket license under 17 U.S.C. § 112 (e), there is no need to distinguish the copyrighted recordings of one label from that of another, but there is a need to distinguish the portion of the background company's programs which utilize copyrighted recordings from the portions which utilize non-copyrighted recordings. The definition we select is easily adapted to that purpose.

1. The Section 112(e) royalty rate for the making of unlimited numbers of ephemeral recordings by background music organizations in the operation of broadcast services pursuant to the Business Establishment exemption contained in 17 U.S.C. § 114 (d)(1)(C)(iv) shall be a sum equal to ten percent (10%) of the licensee's gross proceeds derived from the use of the musical programs which are attributable to copyrighted recordings. The attribution of gross proceeds to copyrighted recordings shall be made on the basis of:

(i) for classical programs, the proportion that the playing time of copyrighted classical titles bears to the total playing time of classical titles; or

(ii) for all other programs, the proportion that the number of copyrighted titles bears to the total number of titles.

2. The minimum fee for each licensee shall be $500 per year.

VII. TERMS FOR SECTION 114(f) AND 112(e) LICENSES

A. THE GOVERNING STANDARD

17 U.S.C. § § 114(f) and 112(e) require that, in addition to determining royalty rates for the statutory licenses created by those sections, the Panel is also required to establish *terms* for such licenses. Section 114(f) explicitly provides that the Panel's determination of such terms is governed by the same standard which controls its rate determinations, i.e.,

> In establishing rates *and terms* for transmissions by eligible non-subscription services and new subscription services, the copyright arbitration royalty panel shall establish rates *and terms* that most clearly represent the rates *and terms* that would have been negotiated in the marketplace between a willing buyer and willing seller.

17 U.S.C. § 114(f)(2)(B) (emphasis added).

While the language of Section 112(e) is less explicit in defining the standard applicable to the Panel's determination of terms under that section, the Librarian has previously ruled that "the standard for setting royalty fees for the Section 112 license is identical to the standard used to set rates for the section 114 license" (Order of July 16, 2001 at 5), and there is no reason to conclude that this identity of standards would not apply to the setting of Section 112 terms as well.

Thus, it is evident that the Panel is bound to adopt those terms which the record shows would have been agreed to by willing buyers and willing sellers in the marketplace. The question of whether such terms represent the optimum alternative from the standpoint of administrative convenience and workability is not part of the governing standard for the Panel, nor is it a matter on which we have either record evidence or institutional expertise. Accordingly, while the Panel would not readily adopt terms which are obviously unworkable, and has not done so here, we must defer to the expertise of the Librarian the final evaluation of the administrative feasibility of terms which willing buyers and willing sellers would agree to in marketplace negotiations.

B. THE RECORD CONCERNING WILLING BUYER/ WILLING SELLER AGREEMENT

During the suspension of proceedings described in Section II.D. *supra*, the parties reached a contingent settlement concerning commercial broadcaster rates and an agreement concerning virtually all terms for webcasters, broadcasters and background music services. While the parties agreed that their rate settlement could not be presented to the Panel until certain conditions were met, there was no such restriction concerning the agreement on terms. Accordingly, on December 20, 2001, the Panel issued an order granting the joint motion of the parties to reopen the record for the purpose of receiving the agreed terms.

Subsequently, complications developed which prevented the Panel from receiving the parties' settlement concerning broadcaster rates. However, the parties continued to maintain general agreement regarding nearly all terms. In a hearing on January 11, 2002, the Panel solicited clarification and supporting authority for certain of the proposed terms.

On February 1, 2002, the Services and the Copyright Owners and Performers filed separate submissions tendering their respective proposals concerning terms. In each case, the actual terms proposed were virtually identical in all respects except for two matters addressed below. In each submission, the proposed term was followed by one or more explanatory comments. Again, in the vast majority of instances, the comments from each side were substantially identical.

The Panel has concluded that the nearly identical February 1, 2002 submissions of the parties, which reflect extensive negotiations between all the parties to this case -- including RIAA, AFIM, AFTRA, AFM, DMX/AEI, NRBMLC, five large broadcaster groups, and a dozen webcasting services -- meet the standard of clearly representing the terms that would have been negotiated in the marketplace between a willing buyer and a willing seller. Extensive evidence in support of many of the terms was provided in the written and oral testimony of a number of witnesses, including Barrie Kessler, Executive Director of Internal Operations and Data Management for SoundExchange; Michael Williams, RIAA's Executive Vice President of Finance and Operations; Steven Marks, RIAA's Senior Vice President for Business and Legal Affairs; and Ronald Gertz, President and CEO of Music Reports, Inc. Moreover, we do not see any provisions in these terms which are plainly unworkable, although, as noted, we defer to the Librarian's greater expertise on this matter.[80] Accordingly, the Panel adopts those terms which reflect agreement among the parties.[81]

B. DISPUTED TERMS

The are two respects in which the parties did not reach agreement concerning terms. The Panel must therefore determine how willing buyers and willing sellers would have resolved those matters in their marketplace negotiations.

---

[80] There are some provisions in the terms which cannot be fully settled until the Librarian makes his final determination with respect to the royalty rates at issue and also issues a final order under 17 U.S.C. §§ 114(f)(4)(A) and 112(e)(7)(A) establishing applicable notice and record-keeping requirements for the services involved in this proceeding. Those instances are noted in the Panel's determination of terms set forth in Appendix B hereto.

[81] One term on which all parties agreed was the provision in Paragraph 3(f) that requires Designated Agents to pay directly to performers their share of royalties. All parties seem to recognize, and the Panel concurs, that this is the most efficient, economical, and reliable way to assure that performers receive the royalties to which they are entitled under the statute. The Copyright Office has raised the question of whether, regardless of its desirability, the statute permits such direct payments. The memorandum submitted by AFM and AFTRA makes a strong argument that it does. In the absence of contrary authority, we accept the AFM/AFTRA position and commend it to the Copyright Office for favorable consideration.

1. Definitions of Certain Terms

The Services ask that the Panel include in the terms we adopt the definitions, contained in the parties' joint submission of December 20, 2001, of four terms: "Affiliated," "AM/FM Streaming," "Broadcaster," "Non-Public." Copyright Owners and Performers oppose the adoption of such definitions, noting that they were developed to explain the broadcaster rates settlement which has not been effectuated.

The Panel has concluded that these disputed definitions plainly relate to a broad settlement of broadcaster issues which went well beyond this Panel's jurisdiction, for example, by extending beyond 2002. Because that settlement could not be realized, and has never been presented to the Panel, we do not know the rate structure to which the definitions in question relate. Based on the evidence of record, the Panel has determined to adopt rates as set forth above, which are not tied to the particular definitions the Services ask us to adopt. Accordingly, there is no need to include such definitions in the terms we establish.

However, the Panel has concluded that, in view of the rate structure it has determined to adopt, it should also adopt definitions of some terms that were not included in the parties' February 1, 2002 submissions. Accordingly, on February 6, 2002, the Panel solicited the parties' definitions of certain additional terms, has carefully considered the parties responses` to this order, and has adopted what it deems the most appropriate definitions for those additional terms.

2. Agent for Copyright Owners Who Do Not Designate an Agent

The terms agreed to by all the parties permit copyright owners to designate either

SoundExchange or Royalty Logic Inc. (RLI) as their Designated Agent for the distribution of royalties to the copyright owners who designate them, and the performers entitled to receive royalties from the performance of recordings owned by such copyright owners. The parties, however, are in disagreement concerning who should be the agent for copyright owners who fail to designate an agent, and the performers entitled to receive royalties from the performance of such copyright owners' recordings. The Services propose RLI. Copyright Owners and performers propose SoundExchange.

While there are respectable arguments for either designation, the Panel has concluded that willing buyers and willing sellers would ultimately have agreed upon SoundExchange as the distribution agent for copyright owners who fail to designate one. While the Services would like to see some competition among designated agents, they do not have a vital stake in the matter. Once licensees have paid to the Receiving Agent (whom the Services have agreed should be SoundExchange) the royalties and fees for which they are liable, the distribution of such funds is not a matter in which they have a direct interest.

Copyright owners and performers, on the other hand, have a direct and vital interest in who distributes royalties to them and how that entity operates. AFM and AFTRA, in particular, have expressed a strong preference for SoundExchange because of its non-profit status, its experience with royalty payment, and a recent purported reorganization of SoundExchange which allegedly gives artists substantial control over its operations. Submission of AFM and AFSTRA Regarding Proposed Terms and Eligible Non-Subscription Transmissions And The Making of Ephemeral Reproductions at 15-18.

The Panel believes that, in any marketplace negotiation between willing buyers (i.e., licensees) and willing sellers (i.e., licensors) concerning the process for distributing licensor payments, the licensees, having no direct stake in that aspect, would ultimately have to accede to the strong preference of licensors concerning who should distribute royalties to copyright owners who have not designated a particular agent. Accordingly, we reflect such an agreement, or concession, in the terms we adopt here. The Panel also believes that, as a matter of public policy, when choosing between a for-profit and a not-for-profit entity to serve parties who have not indicated a preference for either one, it is generally more appropriate to select the not-for-profit organization, rather than one whose distributions would be reduced by some degree of profit margin in addition to the administrative cost of collecting and distributing such royalties.

C. THE FORMAT OF APPENDIX B

Set forth in Appendix B hereto are the terms which the Panel has adopted for the Section 114 and 112 statutory licenses in question. The terms themselves appear in regular type. Explanatory comments appear after each term in italics. Comments preceded by a bullet (•) were submitted by all parties. Comments preceded by an asterisk (*) were either written by the Panel or adopted by the Panel from the submission of one side or the other.

VIII. DETERMINATION AND ASSESSMENT OF COSTS

In accordance with the findings and conclusions set forth above, the Panel determines that the compulsory license rates and terms for the digital audio transmission of sound recordings by eligible nonsubscription services pursuant to 17 U.S.C. § 114(f) and the making of ephemeral recordings by transmitting organizations pursuant to 17 U.S.C. § 112(e) for the period October 28, 1998 through December 31, 2002 should be as set forth in Appendix B hereto.

Pursuant to 37 CFR § 251.54(a)(1) and (b), the costs of the arbitrators shall be borne by the parties hereto in accordance with their agreement, namely, one-half by the Copyright Owners and Performers and one-half by the Services.

IX. CERTIFICATION BY THE CHAIRPERSON

Pursuant to 37 CFR § 251.53(b), on this 20th day of February, 2002, the Panel Chairperson hereby certifies the Panel's determinations contained herein.

DATED: FEBRUARY 20, 2002

Eric E. Van Loon
Chairperson

Jeffrey S. Gulin
Arbitrator

Curtis E. von Kann
Arbitrator