

Online Music Licensing: From PROs, AOL and MobiTv to SoundExchange, AT&T and the CRB

By Todd Brabec and Jeffrey Brabec

(Entertainment and Sports Lawyer/October 2011/ a Publication of the American Bar Association Forum on the Entertainment and Sports Industries)

From its inception, music licensing in the digital/online space has been in a continuing state of evolution as to what is licensable, how it is to be licensed, who is to collect and negotiate fees, and what is the value of music in all of the new configurations. Although certain primary rulings in recent online music licensing litigation could be overturned or modified, and new legislation could always be passed, the world of online music licensing as it relates to the performance right, the mechanical right, and the sound recording right, seems to be settling. Though a concrete direction in a world of constantly changing business models and technological innovation is difficult, overall ground rules as well as precedent appear to be taking hold, resulting in a more stable environment for music creators, copyright owners, and music users.

Most countries exist in a world requiring two copyrights for music transactions – the copyright governing the underlying musical composition (the song) and the copyright governing the sound recording (the record). The scope of rights involved in each of these separate copyrights are primarily the jurisdiction of national legislatures with the meaning and scope of these rights normally handled by each countries' judiciary-whether it be courts, tribunals, copyright boards, or other designated bodies. Negotiated voluntary agreements between the users of music (*e.g.*, webcasters, broadcast television, cable, radio, satellite) and large entities organized to negotiate and collect for multiple copyright owners (*e.g.*, performing right organizations, mechanical right organizations, sound recording organizations) or individual copyright owners themselves play a major role in deciding what the license fees should be as well as what the scope of the license is in any media.

In situations where voluntary license agreements cannot be reached by the parties, federal rate courts (*e.g.* ASCAP and BMI in the U.S.), Copyright Tribunals (*e.g.* PRS for Music in the U.K., APRA and AMCOS in Australia and New Zealand) or Copyright Boards (SOCAN, CMRRA and SODRAC in Canada; songwriters, music publishers, record labels, websites, artists, etc. in the U.S.) decide the issues and determine rates.

At the time consumers were just beginning to use the Internet, the global music business had a long history of established rules and negotiations governing licensing and the establishment of rates. Though many of these license negotiations were restricted in the sense of territory and term, among other items, many were not (*i.e.*, grant of the worldwide distribution right in feature film licenses).

In the area of the song, integrating the internet into licenses by copyright owners (music publishers normally) was significantly easier to accomplish than integrating master recordings. In the U.S., Copyright Royalty Judges already had a history of dealing with the setting of rates in many areas and the 2008 CRB hearing regarding the "mechanical rate," showed that the setting of rates in the online world was not only doable but also a reality.

In October of 2008, U.S. Copyright Royalty Judges, ruling on "In the Matter of Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding," set the physical and download statutory license rate to be paid to songwriters and music publishers for the period 2008-2012 at the larger of 9.1 cents or 1.75 cents per minute of playing time, with the ringtone rate at 24 cents. In addition, a late payment fee of 1.5% per month was put into effect. Both the ringtone rate as well as the late payment fee were appealed. The June 2010 decision by the U.S. Court of Appeals for the D.C. Circuit affirmed both. The Royalty Judge's decision was interesting as it incorporated a private settlement between the parties regarding the rates for limited downloads and interactive streaming (on demand streams). This settlement took into account a service's revenue, applicable service type minimums, PRO royalties (ASCAP, BMI, and SESAC) and a per subscriber fee to arrive at a per-work royalty allocation.

On the record side, there is not a long history of collective licensing efforts. A copyright for sound recordings came into effect in 1972 in the U.S.—long after the 1909 Copyright Law and exclusive rights

for musical compositions. The first recognition of a performance right in sound recordings came in 1995, and then again 1998 via the Digital Performance Right in Sound Recording Act and the Digital Millennium Copyright Act. The right was a limited one applying primarily to websites, satellites, and cable and not to terrestrial broadcasting. The industry's approach has primarily been to sue infringers in the online world—an approach that is not popular with consumers. Not only were the labels slow to appreciate the fact that the physical world of sales was quickly disappearing, but also, they did not have the history of different types of licensing negotiations and alternatives that the "song" copyright community had experienced over many years.

In recent years, U.S. Copyright Royalty Board decisions have been of help in determining the online value of sound recordings. The webcaster decisions alone have established industry-wide fees and rates for non-interactive websites as well as a compulsory license in the field. Rates are either per song/per listener, a percentage of revenue, or a percentage of expenses coupled with minimums. For the period of 2011-2015, the Copyright Royalty Board rates for FCC broadcaster simulcasts, commercial webcasters, and commercial and non-commercial educational webcasters are either a "per performance" rate with minimums per station, or channel or a minimum only, depending on the number of aggregate tuning hours streamed.

In addition to the CRB rates, SoundExchange, the sole entity designated by the Library of Congress and the Copyright Royalty Board to collect and administer the royalties due from non-interactive webcasting, digital cable and satellite transmissions, and satellite audio services, was given the authority by Congress, via the Webcaster Settlement Acts of 2008 and 2009, to negotiate agreements separate from those set by the CRB giving many licensees a choice of rate structures to choose from. By choosing the SoundExchange rates, which run through 2015 or 2014 depending on the size of the webcaster, one is precluded from choosing any of the CRB set rates. Recent SoundExchange agreements include Sirius XM Radio, College Broadcasters, the Corporation for Public Broadcasting, the National Association of Broadcasters, and certain "Pureplay" webcasters, among others.

SoundExchange distributes the royalties it receives—252 million dollars in 2010—as follows: 50% to sound recording copyright owners, 45% to featured artists, and 2.5% each to non-featured musicians and non-featured vocalists. The latter 5% Digital Performance Royalties Fund is administered by the AF of M and AFTRA.

On the interactive side (in which the user selects the music they hear), individual negotiations prevail as sites must negotiate with the sound recording copyright owner as to what the fees should be. Some examples of the progress in this area are deals involving a percentage of gross revenue from subscribers and advertisers or a percentage of a net figure (gross minus certain expenses) with the resulting figure shared by the label with artists either on a contract royalty percentage basis or a 50/50 license split. Payments to the labels are based on their pro-rata share of activity on each site or by each licensed entity.

In the world of the song/composition performance right in the United States (ASCAP, BMI and SESAC), negotiated industry agreements have been the norm with federal rate court alternatives, mandated by Consent Decrees entered into in 1941 with the government, coming into play only when ASCAP or BMI could not come to an agreement with a music user as to "what a reasonable license fee should be." The Decree also allows any party to apply to the Court—whether or not there were any prior negotiations—and upon such application to be able to perform music for fees to be determined later. This rate court option has been in effect since 1950 with ASCAP and 1994 with BMI. It represents a primary way to resolve disputes and set collective licensing rates when the parties cannot reach an agreement. SESAC, the smallest of the 3 U.S. performance right licensing organizations, is not under a consent decree with the government nor does it have a rate court alternative. These are issues that are currently being discussed as part of a Southern District of New York Sherman Act antitrust action brought by a class of local television commercial broadcast stations entitled *Meredith Corporation v. SESAC*.

In the online world of music licensing, the ASCAP rate court – Southern District Court in New York – has been instrumental in deciding what the license fees should be in the online world as well as what is actually

licensable by U.S. collective licensing organizations. In recent interim and final decisions involving music use by AOL, Yahoo, Real Networks, AT&T, YouTube, Verizon, and others, a percentage of revenue formula is applied taking into account, among other factors, the amount of time music is performed versus the amount of total time spent on the site for all reasons—a business unit's revenue adjusted by a music use adjustment factor multiplied by a court set percentage figure (2.5% in the initial AOL/Real Network/Yahoo decision).

An important issue in the ASCAP rate court cases was whether a retail wireless communications company required a public performance license for musical compositions because it provides ringtones to its customers (In Re Application of Cellco Partnerships, D/B/A Verizon Wireless) and whether the downloading of a digital file embodying a song constituted a public performance within the meaning of the U.S. Copyright Act (17 USC Section 101) (In The Matter of the Application of AOL, Real Networks and Yahoo for the Determination of Reasonable License Fees). Though the reasoning for the two separate decisions was somewhat different, both decisions by two separate Southern District Court of New York federal judges ruled against the existence of a performance right in each situation. There was some language in the 2009 AOL/Yahoo/Real Networks decision and final order which left open the possibility of a performance right in certain situations. However, subject to ASCAP's appeal of this aspect of the decision, the current state of affairs in the U.S. basically denies a performance right both in a download and a ringtone. The court did recognize the fact that a mechanical right is involved in a download of a song and in a ringtone and referred to the Copyright Royalty Board 9.1¢ writer / publisher song download rate and 24¢ ringtone rate as appropriate compensation for these type of uses. These decisions did not deal with the issue of ringbacks as there is not a download involved – the amount of ringback public performance compensation and value though do remain as part of these ongoing cases.

The ramifications of the “no performance right in a download” ruling in these rate court licensing cases goes far beyond U.S. borders as practically every other major country of the world recognizes a performance right in a download. This makes U.S. court decisions 100% contrary to the laws and practices of other country jurisdictions. In many of those countries, the separate mechanical right and performing right (referred to as the reproduction and communication right in some countries) are many times combined in a single joint license which provides the user all of the rights it needs without having to argue the distinctions between the separate rights of copyright.

For example, PRS for Music in the U.K. issues gross revenue combined performance and mechanical licenses for music downloads (8%), music on demand services (10.5%), webcasts (6.5%), interactive webcasts (8%), and single artist webcasts (10.5%) among others. These licenses also include minimums. In Canada, pursuant to a Copyright Board decision, the total value of the bundle of rights (communication and reproduction) is 12.2% of the price paid by the consumer and or subscribers. The amounts are allocated between SOCAN (the performance rights society) and CSI, a joint venture of CMRRA and SODRAC (the 2 mechanical right societies) and are divided between the societies depending on whether the activity was a permanent download, a limited download, or on demand streaming.

An additional important issue and ruling came via the 2009 AT&T Wireless f/k/a Cingular Wireless ASCAP rate court litigation to determine reasonable fees for a blanket license for the public performance of copyrighted music via wireless and internet transmissions by a cellular telephone communications provider. AT&T had moved for a summary judgement on the issue of whether ringtones and ringback tones constituted fair use within the meaning of the U.S Copyright Act, 17 U.S.C, 101.

In support of its position against previews as a “fair use”, ASCAP set forth numerous examples of other third parties that make previews of music available on the Internet. These included production music libraries, which allow potential users to search their databases via streams, samples, or previews. Also, major music publishers often streamed samples of their catalogue to encourage synch licenses, and songwriters and composers often make their works available on their individual websites for promotional purposes. In addition ASCAP also described the demand for the licensing of “short forms of music” where “in many areas of music licensing, the licensee will specifically seek a license for a limited duration excerpt and that in agreements across different areas of the music business, it is often standard industry practice to

expressly grant the right to make limited use of samples or previews of longer musical compositions for promotional purposes.”

The Court reviewed the factors to be considered as to the use made of a work and concluded that the use of previews was not transformative, that the use is commercial, and that “traditional and reasonable markets existed for the license of preview performances and other short segments of copyrighted music.” Therefore, the court ruled that previews do not constitute fair use and denied the motion in its entirety. The resolution of this issue was important as ringback and ringtone previews were taken into account in both the 2010 AT&T Mobility and 2011 Verizon Wireless ASCAP settlements where a rate of 2% of the price for all ringbacks sold was agreed upon. Excluded were tones directly licensed, or acquired from others who already had a license or where record companies had acquired the performance right.

In May of 2010, a decision was rendered in the ASCAP rate court case involving MobiTv. In May of 2008, ASCAP applied to the Court to set a reasonable rate pursuant to Mobi’s license application to ASCAP with a bench trial being held in April of 2009. The issue involved what is a reasonable fee for the delivery of television and audio programming to mobile telephones. The court determined in this case that a reasonable fee for a “through to the audience” license for Mobi for the years 2003 through 2011 was a revenue based fee multiplied by four specific percentage numbers based upon the type of content. This fee structure was a combination of the 2007 AOL / RealNetworks / Yahoo rate court formula (January, 2009 final order) of 2.5%, the ASCAP/Music Choice 2.5% of gross revenues agreement, and the ASCAP 1990’s post Turner litigation settlements regarding the cable industry where the percentage of revenue fees were based on the music intensity of the programming.

Specifically, the court ruled:

[T]he revenue base upon which the licensing fee will be calculated is (1) for the content that Mobi licenses from content providers, aggregates, and conveys to wireless carriers, the amounts that Mobi pays to the cable television networks or other providers to license the content, plus any revenue from advertising Mobi inserts into that programming; and (2) for the music video channels and any other channel programmed by Mobi, the payments Mobi receives from the wireless carriers for those channels, plus any revenue from advertising that Mobi inserts into that programming. The rate to be applied to that revenue base is 0.1375% for news and sports content; 0.375% for general entertainment; 0.9% for music intensive programming, to include Mobi’s music video channels; and 2.5% for all-audio offerings.

In October of 2010, ASCAP filed an appeal of this decision to the 2nd Circuit Court of Appeals. It is important to note that the MobiTv percentage of revenue figures (Turner/Music Choice) were subsequently agreed upon in both the AT&T Mobility (CV Service) and Verizon Wireless (V Cast and ALLtel Licensed Services) ASCAP final settlement agreements.

In September 2010, the Second Circuit Court of Appeals in the ASCAP/Real Networks, Inc./Yahoo! Inc. rate court case (AOL had previously settled with ASCAP) issued the first appellate decision in the string of online music licensing ASCAP rate court cases. The Court reaffirmed the lower court’s decision that a download of a musical work does not constitute a public performance of that work, and further, it vacated the District Court’s assessment of fees (2.5% music use adjustment factor formula) for the ASCAP blanket license and remanded the issue for further proceedings. The case was subsequently settled by the parties prior to any rehearing.

As to the “download issue”, the Court concluded that there was no “contemporaneous perceptibility” necessary, in the Court’s mind, for the existence of a performance right in the transfer of a musical file.

As to the royalty rate formula, the Court of Appeals felt that the District Court “did not adequately support the reasonableness of the 2.5% royalty rate applied to music use.” The Court did not specify a particular method of developing a formula for music use revenue by the District Court in the remand but did suggest a number of considerations and approaches that might be helpful in arriving at an appropriate formula.

Among them were valuing each of a services' different types of music uses separately and then applying a "blended uniform rate and revisiting it periodically" as well as a variation of the BMI license utilizing multiple revenue categories apportioned into "buckets" and applying different revenue percentages to each. The latter is an admittedly complicated and complex way of doing things. The Court also looked at the ASCAP/Turner agreement which involved different revenue rates based on varying music intensity as well as the 2.5% of gross revenue Music Choice/ASCAP negotiated agreement in addition to other past different media agreements by PRO's and music users.

In May of 2011, ASCAP filed in the Supreme Court of the United States a Petition for a Writ of Certiorari as to the question of whether an Internet-based music service "performs...a work publicly" when it transmits a performance of a copyrighted musical work to the public by means of a digital download. ASCAP's position was that the U.S. Court of Appeals for the Second Circuit decision misinterpreted the plain language and legislative history of the Copyright Act, placed the United States in violation of Intellectual Property Treaties and other International Agreements including Berne, WIPO, and NAFTA, among others and significantly reduced the fair compensation to which songwriters and publishers are statutorily entitled. On October 3, 2011, the Supreme Court denied the petition for Cert and let stand the lower court ruling that "there is not a performance right in a download"

It is important to note that there are numerous ASCAP, BMI, and SESAC voluntary negotiated agreements in this area. These agreements include percent of music revenues as well as gross revenues, multiple revenue categories with different rates, different revenue percentages for on demand streaming, Internet radio and audio visual programming, gross revenue attributable to the service calculations, aggregate tuning hours calculations, flat fee deals, lump sum payments for past activity, and different values assigned to a service's different music uses and minimum fees, among others. All three organizations also have standard website agreements that can be accessed via each organization's website.

Where Do We Stand Now

Of the three areas of music licensing under discussion, two of the three (mechanicals and sound recordings) seem clear, with the third (performances) on the road to clarity.

In the mechanical licensing area, rates for physical product, digital downloads, ringtones, interactive streaming, and limited downloads have been set through 2012.

In the area of the limited performance right in sound recordings, CRB rates for cable, satellite, and webcasters are in effect through 2012 or 2015 depending on the category with SoundExchange separate negotiated rates extending through 2015 at the latest with a 2014 date for smaller webcasters. Further, payment formulas are in effect as to distribution of royalties to record labels, featured artists, and non-featured musicians and vocalists. A remaining open question involves whether this limited right will be extended by legislation to terrestrial broadcasting.

The performance area – the world of ASCAP, BMI, and SESAC – remains in a state of flux with multiple different license fees negotiated and standard form formulas in effect in addition to rate court decision formulas. Further, the issue as to whether there is a performance right in a download seems to be settled, at least for the time being, in most instances based on a number of court decisions as well as a denial of Cert by the United States Supreme Court in the Real Networks/Yahoo case.. In addition, settlement agreements with various major players (*e.g.*, AOL, YouTube, AT&T Mobility, Verizon Wireless, Ericsson, Netflix, Hulu, Spotify, Real Networks and Yahoo) have resulted in negotiated rather than court set license fee formulas and fees. Finally, the ability of a copyright owner to withdraw works from a PRO (writer and publisher grants are non-exclusive) and license those works directly to a user is also a factor in the future of licensing in the online world. Major issues remain including the formula for the determination of final fees and the revenue base for those fees as well as the scope, interpretation, and future effect of the "no performance in a download" language of the AOL/Real Networks/Yahoo and Verizon Wireless rate court and Second Circuit Court of Appeals decisions.

As you can see, rate courts, royalty boards, litigation, settlements, consent decrees, legislation, and voluntary agreements all have a role in determining what is actually licensable in the online world as well as what the fees should be. Based on the events of recent years, the path for songwriters, composers, recording artists, copyright owners, and the users of music seems clearer than at any time in the past.

Copyright 2011 Todd Brabec & Jeff Brabec