



Internet Radio and Copyright Royalties: Reforming a Broken System

Daniel Castro

May 2007

In recent weeks, an increasingly agitated community of music aficionados has been mounting a vocal campaign to save Internet radio. On March 2, 2007, the Copyright Royalty Board (CRB) announced its decision to increase the rates of the statutory license¹ for sound recordings paid by Internet radio stations. Webcasters² immediately cried foul and stated that these fees would force most webcasters to cease broadcasting. While some of their comments have certainly been hyperbole, if the new rates take effect they will have a deleterious effect on Internet radio.

There are two core problems with the current system. First, the current system fails to produce competitive rates for the statutory license. In the absence of a competitive market the recording industry is able to pursue monopolistic pricing. SoundExchange, a performance rights organization, negotiates a single royalty rate with webcasters for all music on behalf of the recording industry. Since SoundExchange has a monopoly on sound recordings, it exerts too much market power to be a fair negotiator. In addition, the current system does not allow record labels and artists to set competitive prices for their music. Instead of allowing the market to create competitive pricing, the government has imposed a single royalty rate for all music. Finally, in their most recent ruling the CRB established rates for all non-interactive webcasters based on contracts between large interactive webcasters and the recording industry. The decision did not account for price adjustments that the recording industry and small, non-interactive webcasters would negotiate.

Second, the system discriminates against Internet radio. Although Internet radio and terrestrial radio are competing technologies, Congress has exempted terrestrial radio from paying royalties on sound recordings. The entire premise that Internet radio should pay an additional royalty violates a core governing principle of the new economy that policies be technology-neutral. Ultimately, the system is broken because no judgment from the CRB proceedings would have produced the optimal outcome: a system where copyright owners can set competitive prices for their recordings and get compensated fairly regardless of the technology used to broadcast their music.

Congress needs to enact legislation to reform the current system. **First, Congress should grant the same performance copyright to all broadcast technologies.** If terrestrial radio is exempt from the sound recording performance copyright, then Internet radio should also be exempt. If Congress wants to impose this royalty then both should pay. **Second, Congress should modify the statutory license to allow copyright owners to specify separate royalty rates for each sound recording.** This change will promote more competitive pricing and ensure the market can respond to foreign competition. **Third, Congress should allow copyright owners to assign separate royalty rates to small and noncommercial webcaster groups.** These policies will promote innovation, consumer choice and international competition. As a result, consumers will enjoy more listening options and copyright owners will receive fair compensation for their works.

Background

To the casual listener, few differences exist between Internet radio and terrestrial (AM/FM) radio. Both forms of radio are essentially a non-interactive service where many listeners receive programming from a single broadcaster. As with terrestrial radio, Internet radio consists of a broadcast of audio entertainment comprised of music, news, comedy, and/or sports. Internet radio comes in two formats: terrestrial radio programming rebroadcast on the Internet and audio programming available exclusively online. Internet radio offers many benefits over terrestrial radio such as more diverse playlists, greater exposure for independent artists and a more efficient cost-structure. Moreover, unlike terrestrial radio broadcasters who can only reach listeners in a specific geographical region, Internet radio broadcasters can reach anyone in the world with an Internet connection. As a result, Internet radio serves niche markets and offers listeners more diverse programming. For example, Radio Paradise, a popular Internet radio station, offers a commercial-free broadcast of eclectic rock. The husband and wife owners do not accept any advertising and instead rely entirely on listener support to cover their operational costs and salaries.

In contrast, while Internet radio has vastly expanded the choices for listeners, terrestrial radio has gone in the other direction. The Telecommunications Act of 1996 eliminated restrictions on the number of terrestrial radio stations that a company could own nationally. As a result, listeners have witnessed a vast consolidation in radio station ownership. For example, between 1996 and 2002 Clear Channel Communications grew from 40 stations to 1,240 stations. As of 2006, the top four media companies had 48 percent of terrestrial radio listeners. Consolidation has resulted in programming with less variety. For example, a 2006 study found that radio has become so homogenized that 15 formats made up 76 percent of programming in commercial terrestrial radio.³ Furthermore, even radio stations with different formats overlap up to 80 percent in terms of the songs played on these stations.⁴ In contrast, Internet radio thrives on diversity as reflected in the radio play time

given to independent labels. The American Association of Independent Music (A2IM) reported that while independent labels account for only 10 percent of terrestrial radio play, they account for 37 percent of non-terrestrial radio play.⁵ Internet radio offers a crucial and growing source of revenue and exposure for independent artists.

Internet radio also reduces the inefficiencies found in terrestrial radio. Consider the resources needed for radio stations to supply DJs, broadcasting equipment, office space and radio towers to each of the 275 radio markets in the United States with a population over 100,000. Internet radio can serve all of these markets more efficiently and with fewer stations because of its inexpensive technology and global reach. Instead of identical Top 40 stations in every market, for example, Internet radio can satisfy all of these markets with fewer stations at a lower cost. Furthermore, it offers listeners stations with more musical variety. Internet radio takes advantage of the digital economy to provide listeners mass customization, instead of the mass production of terrestrial radio.⁶

Americans have eagerly embraced Internet radio. Bridge Ratings found that 72 million Americans listen to Internet radio every month. Internet radio listenership continues to grow and is projected to reach 148 million listeners nationwide by 2010 (see Table 1). In addition, Internet radio has more than five times the number of listeners of satellite radio.⁷

Table 1: Current and projected Internet radio usage⁸

Year	Internet Radio Usage*	Percent Increase
2005	45	-
2006	57	26%
2007	72	27%
2008	91	27%
2009	116	27%
2010	148	61%

* Weekly number of listeners, in millions

Reliable estimates of the number of Internet radio stations are difficult to find. BRS Media, Inc. tallied approximately 5,000 Internet radio stations⁹; however, this number does not appear to reflect many of the large Internet-only webcasters that stream on multiple channels. For example, AccuRadio and AOL Radio broadcast over 300 and 200 stations, respectively.

Internet radio is one of many types of online music services. Innovation and competition have created alternative online music services, and listeners can now choose between services that provide various levels of customization, interactivity and on-demand recordings. As shown in Table 2, these services can be divided into four categories based on their features: non-interactive webcasting, interactive webcasting, limited downloads and permanent downloads. Internet radio falls in the category of non-interactive webcasting, and includes both Internet-only broadcasts and simulcasts of terrestrial radio. Both Internet radio and terrestrial radio share virtually identical features: a continuous, non-interactive stream of audio broadcast to many listeners. To keep the comparison simple, our discussion of Internet radio will only refer to non-interactive radio broadcasts.

recording consists of the actual sounds and the interpretation of the musical composition by the performing artist, and the record label usually holds this copyright. Although few differences exist between terrestrial radio and Internet radio, U.S. law exempts terrestrial radio from paying a performance royalty for sound recordings to the copyright owner. However, all other broadcasters, including Internet radio, satellite radio and other digital music services must pay for this performance right.

Before 1998, both terrestrial and Internet radio broadcasters paid royalties only to the copyright owner of the musical composition; they paid no royalties to the copyright owner of the sound recording. ASCAP, BMI and SESAC, the three performance rights organizations in the United States, collect these royalties for musical compositions. The Digital Performance Right in Sound Recordings Act of 1995 (DPRA) created for copyright owners a new performance right for the digital transmissions of sound recordings. The Act defined three categories of digital transmissions: broadcast transmissions, subscription transmissions (e.g. cable and satellite), and on-demand transmissions (e.g. Napster). First, the Act exempted broadcast transmissions from the performance right which meant that broadcasters did

Table 2: Spectrum of online music services

Non-interactive webcasting	Interactive webcasting	Limited Downloads	Permanent Downloads
Continuous, non-interactive webcasts and simulcasts	Users can interact (skip tracks, pause, fast-forward) and influence output by rating tracks	Users can access specific music on-demand or access "tethered" downloads of certain tracks	Users can permanently download tracks
e.g. - Radio Paradise, WOXY	e.g. - LaunchCast, Pandora	e.g. - Rhapsody, Napster	e.g. - iTunes, eMusic



Copyright Royalties and Broadcasting: A Legislative History

Music recordings have two copyrights: one for the musical composition and one for the sound recording. The musical composition copyright encompasses the notes and lyrics to a song, and the songwriter or music publisher typically owns this copyright. The sound

not have to pay royalties to sound recording copyright owners. The Act did not differentiate between terrestrial radio and Internet radio. Second, the Act subjected subscription transmissions to a statutory license which meant entities needed to obtain the statutory license to provide subscription music services. Third, the Act subjected on-demand transmissions to an exclusive right which gave copyright owners full rights

to negotiate licenses for the on-demand transmission of their work. If Congress wanted to create a performance right for sound recordings, it should have been created for all technologies, rather than singling out digital transmissions and exempting analog transmissions. The method of transmission is irrelevant when deciding whether or not to grant a performance copyright. This legislation, enacted in the same year Netscape launched its IPO, reflects outdated policies that do not appreciate the benefits and efficiency that the digital revolution has contributed to the economy. The decision was perhaps not surprising since the National Association of Broadcasters (NAB), an influential lobby group, opposed applying the performance copyright for sound recordings to terrestrial radio.

Initially the DPRA did not impose a sound recording performance copyright on Internet radio or terrestrial radio. However, in 1998 a provision of the Digital Millennium Copyright Act (DMCA) amended the copyright law to include webcasting as a separate category subject to the statutory license. The law continued to exempt terrestrial radio, including digital terrestrial radio (HD radio), from this statutory license even though both Internet radio and HD radio involve the digital transmission of music.¹⁰ This exception violates a core governing principle of the new economy that public policy should be technology-neutral and appears reactionary considering that the new technology offered benefits over the old technology. Rather than applying this copyright to all transmissions, Congress opted to apply it to Internet radio, a nascent technology with little representation in Washington.

Musicians also receive royalties from the manufacturers of hardware used to record digital audio. In the late 1980s, Sony developed Digital Audio Tape (DAT), one of the first consumer-grade digital audio recording and playback mediums, as a successor to analog cassette tapes. To prevent illegal copying, the recording industry lobbied for the passage of the Audio Home Recording Act of 1992 (AHRA) which required one of the first instances of digital rights management (DRM). Specifically, it required that all digital audio recording devices use the Serial Copy Management System

(SCMS) which prevents DAT recorders from making serial copies of a recording. SCMS allows an unlimited number of first generation copies but prohibits any second generation copies. The AHRA also required that these manufacturers pay a royalty on all digital audio recording devices and digital audio recording media. For example, manufacturers such as Pioneer and Samsung must pay royalties for the sales of their satellite radio receivers which are capable of recording audio. The Copyright Office collects these royalties and distributes two-thirds of the money to the sound recording copyright owners and the remaining one-third to the musical works copyright owners.¹¹

Statutory Licenses, SoundExchange and the CRB

The DMCA created a statutory license for the performance of sound recordings for webcasters. A statutory (or compulsory) license provides all entities who meet certain conditions the right to use a copyrighted work if they obtain the statutory license. For instance, in the case of sound recordings, any webcaster may broadcast music if they pay the statutory royalty fee and meet the terms of the statutory license. These terms mandate that a webcaster identify the song, artist and title of every song and not announce the scheduled playlist. In addition, in any three hour period the webcaster must not broadcast more than three songs from a particular album, including no more than two consecutively, or four songs by a particular artist or from a boxed set, including no more than three consecutively.¹²

With a statutory license the webcaster does not need to negotiate a license with the copyright holder, and the copyright holder cannot deny the webcaster the right to broadcast his or her work. Internet radio broadcasters pay the statutory license fees to SoundExchange, a non-profit industry group, who then redistributes the money to the copyright owners, featured artists and non-featured artists (such as non-featured musicians and vocalists). The Copyright Arbitration Royalty Panel (CARP) originally administered the statutory license; however, the Copyright Royalty and Distribution

Reform Act of 2004 replaced CARP with a system of three judges on the Copyright Royalty Board (CRB). Copyright owners and webcasters can set the rate for the license through voluntary negotiations, or if they fail to reach an agreement, they present their case to the CRB who then determines the rates and terms for the statutory license.¹³

Statutory licenses offer economic benefits to all parties. For example, these licenses eliminate the burden on entities who wish to use protected works because they do not have to obtain a separate license from each copyright owner. Locating copyright owners can be costly and burdensome, especially for orphaned works. Similarly, copyright owners do not have to negotiate separate licenses with every buyer but they can still receive royalty payments for the use of their work. These benefits both promote market entry and encourage competition. Buyers and sellers also benefit from the efficiency of allowing a single entity to collect and distribute the royalty fees.

Unfortunately, the current implementation of the statutory license for sound recordings fails because it results in monopolistic pricing. Since the statutory license only permits one price, SoundExchange uses its market power to negotiate as a monopoly and to demand a per-performance fee that maximizes its revenue. It is not surprising then that webcasters and SoundExchange have been unable to agree on terms and that the CRB has been forced to determine the royalty rate. In choosing the statutory license rates, the CRB attempted to determine what rates a “willing buyer and a willing seller” would negotiate in a hypothetical market with no statutory license.¹⁴ The CRB decided that the rates from agreements between the major record labels and large interactive webcasters served as an appropriate benchmark for the hypothetical market. However, this benchmark reflects a market where the major record labels have substantial market power and lose little if a single webcaster does not purchase their music. On the other hand, a webcaster suffers substantially if it cannot broadcast music from a major record label since these labels control significant quantities of sound recording copyrights. As a result,

the market power of the record labels creates uncompetitive prices in the benchmark market. The CRB dismissed these concerns about unfair market power because “the law does not require a perfectly competitive target market”.¹⁵ While a perfectly competitive market is not the correct benchmark, a modestly competitive market is, and we do not have that today. Congress should end monopolistic pricing by eliminating a single rate for the statutory license which would allow competitive pricing for sound recordings.

New Rates and Terms Determined by the CRB

On March 2, 2007, the CRB issued a new ruling on the rates and terms for the statutory license of sound recordings for webcasters for the 2006-2010 licensing period. For webcasters operating under the statutory license, the new fee schedule mandated by the CRB represents a significant increase. As shown in Table 3, webcasters must pay these rates retroactively to 2006, and rates will increase through 2010. In addition, the CRB set a \$500 annual minimum fee per channel for broadcasters. The CRB based the new statutory license royalties on analysis of seventeen contracts between interactive webcasters and the recording industry. The ruling did not include substantial analysis of the rates small webcasters would pay in the hypothetical market. Instead, the ruling eliminated the previous option which allowed small webcasters to pay a percentage of their revenue in lieu of a per-performance royalty fee.

Table 3: Performance royalty fee schedule for commercial webcasters as determined by the CRB¹⁶

Year	Fee Per Performance	Percent Increase
2006	\$0.0008	-
2007	\$0.0011	38%
2008	\$0.0014	27%
2009	\$0.0018	29%
2010	\$0.0019	6%

In addition, the CRB ruled that noncommercial webcasters will pay a flat fee of \$500 annually. This fee constitutes full payment for the license for the first

159,140 aggregate tuning hours (ATH) per month. For any broadcasts in excess of this amount, the CRB ruled that noncommercial webcasters would pay at the same rate as the commercial webcasters. Aggregate tuning hours refers to the total number of hours of programming transmitted to each listener within a certain time period. For example, if 10 listeners streamed music for 2 hours, the webcaster would report 20 ATH. The CRB reviewed a 2004 survey of National Public Radio (NPR) stations and determined that 159,140 ATH represented the average number of monthly aggregate tuning hours for a station. The CRB ignored the fact that the same survey stated that 79 percent of these stations could not compute their monthly ATH thus rendering this form of accounting burdensome for the vast majority of these stations.¹⁷ Under the new terms, noncommercial webcasters must now track both their ATH and the total number of performances over the ATH threshold.

The CRB deviated from previous agreements and decided to not include separate royalty rates for small webcasters. Prior to 2006, small webcasters paid a different rate than other webcasters. As directed by law, the Librarian of Congress issued the first rates and terms for the statutory license for all webcasters on June 20, 2002 after SoundExchange and the webcasters were unable to make an agreement. The rates established for the statutory license applied retroactively to 1998 and exceeded the ability of many small webcasters to pay. In response, Congress passed the Small Webcasters Settlement Act of 2002 which allowed certain webcasters additional time to negotiate an alternative agreement. These webcasters entered into an agreement with the recording industry that allowed them to pay a royalty equal to 8 percent of their gross revenues or 5 percent of their expenses, whichever was greater, for the 1998-2002 licensing period. For the 2003-2005 licensing period, these rates increased to “the greater of 10 percent of the first \$250,000 in gross revenues and 12 percent of any gross revenues in excess of \$250,000 during the applicable year, or 7 percent of the webcaster’s expenses during the applicable year.”¹⁸ Small webcasters could opt to pay these rates rather than the significantly higher per-performance fee.

In its recent ruling, the CRB eliminated the separate status for small webcasters with the rationale that allowing “inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners.”¹⁹ This statement ignores the fact that many industries, from software developers to airlines to pharmaceutical companies, employ discriminatory pricing that benefits both themselves and consumers. While Congress made clear that the Small Webcasters Settlement Act could not be used as precedent in future judgments, the resulting agreement shows that unique circumstances exist that warrant a special status for small webcasters. Rates based only on contracts between large interactive webcasters and major record labels ignore discounts that small webcasters might negotiate. Without a statutory license, record labels would negotiate individual contracts and engage in price discrimination to maximize revenue. Independent record labels might also offer their music at lower rates as an incentive for radio stations to broadcast their music. However, since the CRB set only one rate for all webcasters based on rates negotiated between major record labels and large interactive webcasters, they ended tiered pricing for the statutory license. As a result, the statutory license may now cost small webcasters more than they would negotiate in the market. Unfortunately, the costs of individually negotiating a license with each copyright holder make this option prohibitively expensive. Without an affordable statutory license, many webcasters state they can no longer afford to remain in business.

During the CRB proceedings, SoundExchange argued that webcasters should pay various additional royalties depending on the technology used to stream music. For example, in their arguments SoundExchange claimed that webcasters should pay additional royalties to stream music to wireless computers and to make ephemeral, or temporary, copies of sound recordings. Webcasters often need to make ephemeral copies of a recording to broadcast a song. For instance, a broadcaster may create multiple copies of a song at different bit-rates to

Table 4: Distribution of performance royalties by broadcast medium

Broadcast Medium	Musical Composition Performance Royalty	Sound Recording Performance Royalty		
	Songwriter or Publisher	Featured Artist	Non-featured Artists	SRCO* or Record Label
Terrestrial radio stations	Royalties paid directly to ASCAP/BMI/SESAC	Nothing	Nothing	Nothing
Internet radio stations	Royalties paid directly to ASCAP/BMI/SESAC	45 percent of royalties paid to SoundExchange	5 percent of royalties paid to SoundExchange	50 percent of royalties paid to SoundExchange
Satellite radio stations	Royalties paid directly to ASCAP/BMI/SESAC	45 percent of royalties paid to SoundExchange	5 percent of royalties paid to SoundExchange	50 percent of royalties paid to SoundExchange

* Sound Recording Copyright Owner

stream to a listener based on the speed of their connection. Previously, webcasters had to pay an additional license fee for these ephemeral copies. The recent CRB proceedings showed that current contracts between interactive webcasters and the recording industry bundle this right with the license for the digital performance of the sound recordings. Neither of these actions have any intrinsic value, but charging an additional royalty would needlessly prohibit the use of certain technology. The CRB correctly rejected these arguments, and Congress should include both of these rights at no additional cost in future legislation.

Finally, the CRB did not consider the international implications of their decision. With terrestrial radio, international royalty rates for music have no impact on the domestic market because radio broadcasting is confined to domestic companies. For example, a radio station in China could not compete with a New York radio station simply because they cannot reach this audience. However, one of the benefits of Internet radio is that there are no technical restrictions to keep American audiences from listening to foreign webcasters or foreign audiences from listening to American webcasters. As a result, American Internet radio stations compete with foreign webcasters, meaning that just like industries such as automobiles and software, they can lose or gain market share against

foreign competitors. In a digital economy sound recording performance royalties in the United States must be less than or equal to international royalties, otherwise the disparate fees will create an incentive for American webcasters to move overseas or for American audiences to listen to foreign broadcasts.

Arguments Made by the Music Industry

In the face of criticism of the CRB decision the music industry in general, and Sound Exchange in particular, makes a number of arguments as to why the CRB got it right. Perhaps their core argument is that Internet radio should pay these high royalty rates because listeners are substituting online radio for music purchases. This argument fails for several reasons. First, the music industry has not provided any valid data showing a causal relationship between increasing use of online radio and decreasing sales of music. The music industry has provided many statistics showing decreases in CD sales, but this merely reflects a change in consumer habits. After all, sales of vinyl records and cassette tapes have been declining for years. Second, this argument ignores the major cause of decreased CD sales which is the rampant practice of file sharing among listeners. Even after the emergence of easy-to-use digital download services like iTunes, many consumers

still illegally download music files from peer-to-peer networks or exchange them with their friends.

The music industry also argues that Internet radio should pay more because the value chain goes in one direction. In other words they argue that Internet radio benefits from the ability to play music, while musicians do not receive a promotional benefit. But considering the historical relationship between the music industry and terrestrial radio there seems to be little merit to this argument. Terrestrial radio could not exist without the music provided by the record labels; however, they have managed to avoid paying royalty fees for sound recordings. On the other hand, the record labels depend on terrestrial radio to create hits, promote their music and drive music sales. If copyright owners could establish separate royalty fees for each sound recording, some copyright owners would actually allow radio stations to broadcast their music for free and some would even pay the radio station. Getting your music played on the radio provides a huge boost for an artist. Payola, the illegal practice of radio stations accepting money from the music industry to play songs without proper disclosure, shows the promotional benefits of broadcasting. Congress outlawed this practice in the 1960s amid high-profile accusations that radio disc jockeys accepted bribes to play certain songs. Some record labels cited payola as the reason they were unable to get their music played on the radio. Since then some record labels have started using a third-party loophole to avoid payola laws. Record labels pay independent music promoters, or indies, for every song they can get a radio station to add to their playlist. These indies align themselves with radio stations by offering the station promotional payments. Since the radio stations do not accept money directly from the record labels, they do not need to disclose this money.²⁰ Payola still exists today as shown by the recent \$12.5 million settlement between four major radio stations, including CBS Corp. and Clear Channel Communications, with the Federal Communications Commission (FCC).²¹

Royalty fees for the statutory license should account for the promotional or substitution effect of broadcasting.

Internet radio can help increase music sales by providing listeners playlist histories with direct links to online music stores. For example, in 2006 with an average of 18,000 regular listeners, Radio Paradise generated over \$260,000 in sales of CDs and music DVDs through Amazon and approximately \$28,000 worth of iTunes downloads.²² Playing a song is likely to increase an artist's profile for marketing or branding purposes. In this case, it may be in the interest of the copyright owner to pay the broadcasters to promote their song. Alternatively, if a copyright owner feels the broadcast of a song results in decreased sales of his or her music, the copyright owner would want to set a higher fee for the statutory license. The existence of payola hints at the possibility that radio creates more value for the copyright owner than for the broadcaster, especially when record labels are promoting new music. The statutory license should reflect these promotional benefits. This phenomenon can also be observed in royalty-free music where artists charge no fees for the performance of their sound recordings. Many artists benefit from this strategy. For example, SongPlanet.com has built a business around artists who grant it rights to broadcast their music royalty-free. In exchange, these artists gain a wider audience and can more effectively market their music.

Policy Recommendations for Internet Radio

The U.S. policy on Internet radio has failed for two reasons: it discriminates against non-terrestrial radio and it fails to establish a competitive, market-based rate for the statutory license. Terrestrial radio benefits from being the only technology exempt from a performance copyright for sound recordings. The emergence of digital terrestrial radio (HD radio), and its continued exemption from paying sound recording performance royalties, further illustrates the irrationality of this exemption. Current policy continues to discriminate against non-terrestrial radio by imposing a performance copyright on sound recordings for all non-terrestrial radio broadcasts. Congress should promote technology-neutral policies to ensure a fair and competitive market for all forms of radio. As shown in Table 4, not only does this exemption for terrestrial radio disadvantage

competing technologies, it also results in unfair compensation to the copyright holders. Congress should take an all-or-nothing approach so that terrestrial radio, Internet radio, satellite radio and other digital music services can compete fairly. In other words, everybody should pay or nobody should pay, but the discrepancy should be eliminated.

Recommendation 1: Promote Innovation by Eliminating Technology-Specific Policies

To ensure that Internet radio competes on a level playing field with terrestrial radio, Congress should uniformly apply the performance copyright for sound recordings to all broadcasts. Terrestrial radio should not be the only technology exempt from paying royalties for performances of sound recordings. The sound recording copyright should either be eliminated for all radio or extended to all radio, but Congress should eliminate the disparity between competing technologies.

In addition, **Congress should ensure that the statutory license include the right to make ephemeral copies of sound recordings.** Charging an additional fee for the ephemeral copies discourages broadcasters from using more efficient technology that requires these copies. To encourage innovation, future legislation should ensure that the statutory license includes this right at no additional cost

Recommendation 2: Adopt Competitive Pricing for Statutory License Royalties

If Congress decides to apply the sound recording performance royalty to both Internet radio and terrestrial radio, it should change the way in which royalties are set. Every song is not the same, but by creating a statutory license with a single rate for all music, Congress has essentially eliminated competitive pricing for sound recordings. To correct this but still maintain the benefits of a statutory license, Congress should create a new system where sound recording copyright owners can establish separate royalty rates for each sound recording. **Congress should mandate that SoundExchange, in conjunction with the Library of**

Congress, create a national online catalogue of all sound recordings and allow copyright owners to determine the statutory license rate for each of their works at or below a statutory rate. The database would also allow copyright owners to specify separate royalty rates for commercial webcasters, small webcasters, and noncommercial webcasters. Legislation should cap royalty rates so as to limit a broadcaster's potential liability for broadcasting a song. In addition, Congress should require that SoundExchange not charge royalties for copyright owners who do not choose to specify a fee. This policy would allow only those copyright owners who want to charge royalties to specify a royalty rate. SoundExchange would publish these rates online in an electronically accessible format for webcasters to access. Doing this is likely to enable Internet radio to continue to grow and make American broadcasters more competitive in international markets.

The creation of a national database of sound recordings with corresponding performance royalty fees would allow copyright holders to set music royalty fees at competitive market rates. Broadcasters could make economic decisions to play music based on the published rate, and they would no longer be subject to an artificial royalty fee that values all music equally. Copyright owners would be able to adjust fees to meet their promotional needs and provide reduced pricing for small webcasters and noncommercial webcasters if they desire. A separate fee schedule for these webcasters would allow copyright owners to profit from price discrimination while still allowing all broadcasters to benefit from a statutory license.

Currently, SoundExchange must maintain a database of all sound recordings and their corresponding copyright holders, and they could easily extend this database to include separate statutory rates. Copyright owners must already identify their sound recordings to SoundExchange, so they could also notify SoundExchange of their preferred royalty rate. The Library of Congress should maintain an open version of this database as a valuable public resource. Just as the Library of Congress maintains useful data on published

works such as title, author and subject, it could expand its services to offer similar information on sound recordings. Developers could then use the database to create value-added services for consumers. For instance, a service may expand the database to allow users to tag music with keywords representative of that song. Users could then find music relating to a certain genre, year, band or subject.²³

To keep American Internet radio competitive worldwide, the United States should promote this system internationally. Congress should direct the Office of the United States Trade Representative (USTR) to establish an international framework for sound recording copyrights based on the aforementioned model. An international framework is needed to prevent certain countries from enacting royalty rates below market value, thereby giving their webcasters an unfair advantage. Furthermore, an international agreement would help ensure copyright holders receive fair compensation internationally and allow webcasters to broadcast globally without fear of copyright infringement.

Recommendation 3: Enable Small and Noncommercial Webcasters to Negotiate Separate Royalty Rates

The new statutory rates do not sufficiently address small or noncommercial webcasters (like NPR). **Congress should modify the terms of the statutory license to accommodate these webcasters so they can continue to function and copyright owners can continue to receive royalty payments.** First, Congress should create legislation to create a tiered royalty rate system which would allow copyright owners to assign separate royalty rates to small and noncommercial webcaster groups. Second, legislation should create a standard

definition of a “small webcaster” based on the total number of performances. In the recent ruling, the CRB judges noted that the absence of a standard definition for small webcasters prevented them from distinguishing between small commercial webcasters and all other commercial webcasters. By defining small webcasters based on their total number of performances rather than on revenue, Congress would not allow webcasters who simply do not maximize their revenue to use the small webcaster royalty rate. Third, legislation should reduce the minimum fee for webcasters to no more than \$500 annually per broadcaster, regardless of the number of channels broadcast. The CRB designed the minimum fee to ensure that SoundExchange received enough money per licensee to cover the administrative cost of the license. The current decision to require a \$500 annual fee per channel imposes an unnecessary burden on broadcasters with numerous channels. If broadcasters provide an aggregated report of usage from all channels to SoundExchange, it would be more appropriate to charge a minimum fee per broadcaster rather than per channel. These changes will allow small and noncommercial webcasters to compete and innovate while ensuring that copyright holders receive adequate compensation.

Conclusion

Internet radio offers benefits to listeners, musicians and the economy; however, the recent CRB ruling reflects a broken system that Congress needs to fix. Internet radio represents the future of broadcast music and it is time for Congress to act to ensure its long-term survival. Implementing these changes will ensure that radio technologies can fairly compete, innovation can thrive, copyright owners can receive fair compensation, and Americans can continue to listen to quality music.

Endnotes

1. A statutory license is a compulsory license that the sound recording copyright owner must provide to webcasters who meet certain conditions and pay a statutory fee. The webcaster needs this license to broadcast music. We discuss the statutory license in more depth later in the paper.
2. In this paper, we use the terms webcast and broadcast interchangeably for Internet radio.
3. Peter DiCola, "False Premises, False Promises: A Quantitative History of Ownership Consolidation in the Radio Industry," *Future of Music Coalition* (December 2006), <www.futureofmusic.org/research/radiostudy06execsum.cfm>.
4. Peter DiCola, "False Premises, False Promises: A Quantitative History of Ownership Consolidation in the Radio Industry," *Future of Music Coalition* (December 2006), <<http://www.futureofmusic.org/research/radiostudy06execsum.cfm>>.
5. "A2IM Value Proposition," *American Association of Independent Music* (March 2007): 2, <http://www.a2im.org/downloads/Declaration_of_Independents_13.pdf>.
6. Robert D. Atkinson, "Digital Prosperity: Understanding the Economic Benefits of the Information Technology Revolution," (Washington, D.C.: The Information Technology & Innovation Foundation, 2007):52 <http://www.itif.org/files/digital_prosperity.pdf>.
7. "Bridge Ratings Industry Update - Internet Radio," *Bridge Ratings, LLC*. (February 21, 2007), <http://www.bridgeratings.com/press_02.21.07.Internet%20RadioUpd-.htm>.
- ⁸ "Digital Media Growth Projections," *Bridge Ratings, LLC*. (February 19, 2007), <http://www.bridgeratings.com/press_021907-digitalprojectionsupd.htm>.
9. "BRS Media's Christmas.FM now features over 100 Holiday Stations Online," *BRS Media, Inc.* (November 22, 2006), <<http://www.brsmedia.com/press061122.html>>.
10. "The Digital Millennium Copyright Act of 1998: U.S. Copyright Office Summary," U.S. Copyright Office, (December 1998), 15-16 <<http://www.copyright.gov/legislation/dmca.pdf>>.
11. U.S. Copyright Office, "Copyright Law of the United States of America and Related Laws Contained in Title 17 of the United States Code," <<http://www.copyright.gov/title17/92chap10.html>>
12. "Frequently Asked Questions – Webcasting," *Recording Industry Association of America*, <http://www.riaa.com/issues/licensing/webcasting_faq.asp>.
13. "Licensing Information," *U.S. Copyright Office*, <<http://www.copyright.gov/carp/>>.
14. Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, 28 <<http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf>>.
15. Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, 35 <<http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf>>.
16. Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA (<<http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf>>), 46.

-
17. National Public Radio (March 19, 2007). "NPR Files Motion for Rehearing with Copyright Royalty Board." Press release. <<http://www.npr.org/about/press/2007/031907.copyrightroyalty.html>>.
 18. "Rate Information," *SoundExchange*, <<http://www.soundexchange.com/rates.html>>.
 19. Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA (<http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf>), 19.
 20. Eric Boehlert, "Pay for play," Salon.com (March 14, 2001), <<http://archive.salon.com/ent/feature/2001/03/14/payola/index.html>>
 21. Federal Communications Commission (April 13, 2007). "Broadcasters Pay \$12.5 Million to Resolve Possible 'Payola' Violations." Press release. <http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-272304A1.pdf>.
 22. William Goldsmith, e-mail to author, April 13, 2007.
 23. For a complete discussion of this subject, see David Moschella, *Customer-Driven IT: How Users Are Shaping Technology Industry Growth* (Boston: Harvard Business School Press, 2003), 120-124.

About the Author

Daniel Castro is a Senior Analyst with ITIF specializing in issues relating to IT and the digital economy. He has experience in the private, non-profit and government sectors. In addition, Mr. Castro is a Visiting Scientist at the Software Engineering Institute (SEI) in Pittsburgh, Pennsylvania where he has developed virtual training simulations to provide clients with hands-on training of the latest information security tools. Before joining ITIF, Mr. Castro worked as an IT analyst at the Government Accountability Office (GAO) where he audited IT security and management controls at various government agencies. He has a B.S. in Foreign Service from Georgetown University and an M.S. in Information Security Technology and Management from Carnegie Mellon University.

About the Information Technology and Innovation Foundation

The Information Technology and Innovation Foundation (ITIF) is a nonprofit, non-partisan public policy think tank committed to articulating and advancing a pro-productivity, pro-innovation and pro-technology public policy agenda internationally, in Washington and in the states. Through its research, policies proposals, and commentary, ITIF is working to advance and support public policies that boost innovation, e-transformation and productivity.

For more information contact ITIF at 202-449-1351 or at mail@itif.org, or go online to www.innovationpolicy.org

ITIF • 1250 I St. N.W. • Suite 200 • Washington, DC 20005