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United States Government Accountability Office
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The Honorable Arlen Specter
Chairman
Subcommittee on Crime and Drugs
Committee on the Judiciary
United States Senate

Subject: *In a Previous Rate-Setting Proceeding for Some Sound Recordings, the Standard Addressing the Disruptive Impact on the Industries Contributed to a Lower Copyright Royalty Rate, but the Effect of Its Proposed Removal Is Unclear*

Dear Mr. Chairman:

Every day, thousands of AM/FM radio stations, as well as satellite radio, cable radio, and Webcasters, use sound recordings to provide music to their listeners. As a form of intellectual property, sound recordings are protected by copyright law. The copyright holder (e.g., a record company or performer) may use a license to grant third parties permission to use sound recordings, in return for compensation and compliance with other conditions of the license. Congress established a statutory copyright regime, including a statutory license, which among other things, avoids the potential problems associated with thousands of music service providers seeking licenses from many copyright holders. Under this regime, a party may invoke a statutory license to allow it to use sound recordings under certain conditions and according to specific requirements, in exchange for payment of a set royalty amount.

Since 1976, the Copyright Royalty Tribunal, Copyright Arbitration Royalty Panels, and Copyright Royalty Judges have been responsible, successively, for recommending or setting rates, terms, and conditions for statutory licenses. In the Copyright Act of 1976, Congress established the Copyright Royalty Tribunal.¹ The Copyright Royalty Tribunal operated until 1993, when Congress abolished it and authorized the Librarian of Congress, upon the recommendation of the Register of Copyrights, to appoint and convene Copyright Arbitration Royalty Panels.² The Copyright Arbitration Royalty Panel system consisted of ad hoc arbitration panels; each Copyright Arbitration Royalty Panel was selected for a particular proceeding. Finally,

¹Pub. L. 94-553 (1976), adopting as positive law 17 U.S.C. § 801(a).

²The Copyright Royalty Tribunal Reform Act of 1993, Pub. L. 103-198 (1993).

in the Copyright Royalty and Distribution Reform Act of 2004, Congress replaced the Copyright Arbitration Royalty Panel system with the Copyright Royalty Judges.³ The three Copyright Royalty Judges are housed in the Copyright Royalty Board, an establishment created within the Library of Congress. The Copyright Royalty Judges are now responsible for establishing and adjusting the rates and terms of statutory licenses, among other things.

When establishing or adjusting royalty rates for statutory licenses, the Copyright Royalty Judges gather evidence and hear relevant testimony, and consider standards codified in law. The judges may consult the Register of Copyrights, whose timely decision on questions of copyright law is binding on the judges. The Copyright Royalty Judges establish or adjust royalty rates for statutory licenses using one of two standards:

- *Willing buyer-willing seller.*⁴ Under this standard, the Copyright Royalty Judges establish rates that most clearly represent the fees that would have been negotiated in the marketplace. The Copyright Royalty Judges base their decision on economic, competitive, and programming information presented by the parties. In establishing such rates and terms, the Copyright Royalty Judges may also consider the rates and terms from voluntary license agreements.
- *Section 801(b)(1).* Under the standards established in 17 U.S.C. § 801(b)(1), the Copyright Royalty Judges adjust rates and terms of royalty payments to achieve reasonable rates in accord with the following objectives: (A) to maximize the availability of creative works to the public; (B) to afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions; (C) to reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

Congress is considering legislation that would alter copyright law as it pertains to sound recordings. Specifically, the proposed Performance Rights Act⁵ would extend the coverage of copyright law and the statutory licensing provisions to apply to the

³Pub. L. 108-419, § 3 (2004).

⁴17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B).

⁵S. 379, 111th Cong. (2009).

use of sound recordings by AM/FM radio stations;⁶ currently, copyright protection does not extend to the performance of sound recordings played over AM/FM radio stations and therefore a license and royalty payment are not required. Further, the proposed act would alter the standard under which the Copyright Royalty Judges determine statutory license royalties. Under the proposed act, AM/FM radio stations and Webcasters would be brought under the section 801(b)(1) standards and the section 801(b)(1)(D) standard—which addresses the disruptive impact on the industries involved—would no longer be considered for setting any rates for certain licenses.

As requested, this report examines how the section 801(b)(1)(D) standard has been applied in previous rate setting proceedings. To address this objective, we reviewed relevant literature, as well as legislation pertinent to the establishment of the Copyright Royalty Judges and their responsibilities. We also reviewed previous rate-setting proceedings and spoke with relevant government stakeholders, including the Chief Copyright Royalty Judge and representatives from the U.S. Copyright Office of the Library of Congress. We conducted our work from March 2010 through August 2010 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions.

In a Previous Rate-Setting Proceeding, the Section 801(b)(1)(D) Standard Contributed to a Lower Royalty Rate, but the Effect of Its Proposed Removal on Future Proceedings Is Unclear

The Copyright Royalty Tribunal (Tribunal) and a Copyright Arbitration Royalty Panel (Panel) applied the section 801(b)(1) standards three times. The Tribunal applied the section 801(b)(1) standard twice in 1981. In both cases, the Tribunal first determined a royalty rate and then applied the section 801(b)(1) standards. In the first decision, the Tribunal determined the rate was consistent with each standard, commenting only briefly on each,⁷ and in the second decision, it applied the evidence to each of the four standards, sections 801(b)(1)(A)-(D), and made no adjustment to the rate.⁸ In 1997, the Librarian of Congress convened a Panel that made a royalty determination for subscription services for digital performances of sound recordings. While the Panel applied the section 801(b)(1) standards, it relied heavily on a benchmark rate submitted as part of the evidence gathering process to establish the

⁶The House has a companion bill—H.R. 848, 111th Cong., as marked by the House Committee on the Judiciary (2009).

⁷Petition for review denied, *Amusement and Music Operators Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144 (7th Cir. 1982).

⁸On review, affirmed in material part, and reversed and remanded in part on other issues, *Recording Industry Ass'n of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981).

value of a performance right that, among other things, did not exist at the time the benchmark came into existence. The Librarian of Congress subsequently reviewed the Panel's rate determination and on recommendation of the Register of Copyrights, rejected the rate, and placing some emphasis on the section 801(b)(1)(D) standard, established a new rate. The Librarian faulted the Panel for its application of the section 801(b)(1)(A) standard and for its failure to reconcile its conclusion with the Tribunal's 1981 decision. Subsequently, a petition for review of the Librarian's decision was denied with respect to these rate-setting issues but granted and remanded on other issues.⁹

The Copyright Royalty Judges (Judges) applied the section 801(b)(1)(D) standard in 2008 during the satellite digital audio radio services (SDARS) rate-setting proceeding, and determined that to avoid disruption of the satellite radio industry, this standard warranted that satellite radio providers pay a lower royalty rate than might be appropriate as the industry is established.¹⁰ The Judges identified a "zone of reasonableness" for the royalty rate; the Judges set the lower bound of the zone of reasonableness at 2.35 percent of gross revenue and the upper bound at 13 percent of gross revenue.¹¹ The Judges subsequently considered the section 801(b)(1) standards. Because of the state of the satellite industry at the time, the Judges determined that the cost of a royalty could have a negative impact on the ability of the satellite radio industry to continue operating. Specifically, the Judges determined that based upon the evidence presented in the proceeding, the satellite radio industry did not have enough of a subscriber base to reach profitability and that adopting the rate at the upper bound might delay the industry becoming profitable and might prevent the industry from making investments in technology that would allow it to continue serving customers. Therefore, the Judges adjusted the royalty down from the upper bound to 6 percent of revenue for 2007 and 2008, with the rate increasing 0.5 percentage points per year thereafter until 2012.¹² Although the decision considered the negative impact on the investment of the satellite radio industry under section 801(b)(1)(D), the judges expressed their belief that it might have been weighed alternatively as a market rate discount or under section 801(b)(1)(C).¹³

⁹*Recording Industry Association of America v. Librarian of Congress*, 176 F.3d 528 (D.C. Cir. 1999).

¹⁰The rate-setting proceeding pertained to both preexisting subscription services and SDARS. See 73 Fed. Reg. 4080 (Jan. 24, 2008). But, the preexisting subscription services rate was settled and published as a Final Rule in December 2007. See 72 Fed. Reg. 71795 (Dec. 19, 2007). Additionally, in 2009, the Judges applied the 801(b)(1)(D) standard during a rate-setting proceeding for the use of the music works. In this proceeding, the Judges found no reason to adjust the rate due to the potential disruption to the relevant industries. See 74 Fed. Reg. 4510 (Jan. 26, 2009).

¹¹The Judges set the lower bound at 2.35 percent of gross revenue—the rate paid by SDARS for the musical work license—and the upper bound at 13 percent of gross revenue—a rate paid by other digital services.

¹²Petition for review denied in part, and granted in part and remanded on other issues, *Sound Exchange, Inc. v. Librarian of Congress*, 571 F.3d 1220 (D.C. Cir. 2009).

¹³73 Fed. Reg. 4080, 4096-4097 (Jan. 24, 2008).

It is unclear how the proposed removal of the fourth standard from the section 801(b)(1) standards would impact future rate-setting proceedings. Government experts with whom we spoke said that the third and fourth standards, sections 801(b)(1)(C) and 801(b)(1)(D) respectively, are closely related and ensure that the industries involved have the ability to continue operating after the imposition of a royalty. As discussed previously, in the SDARS proceeding, the Judges viewed the standards as intertwined. Based on the previous rate-setting decisions, the application of the standards depends upon the evidence and relevant testimony. While the section 801(b)(1) standards may have contributed to a lower royalty rate in proceedings to date, the Chief Judge said that application of standards could act to lower or raise the rate. Therefore, it is difficult to determine how the proposed modified section 801(b)(1) standards might be applied in future rate-setting proceedings or how the removal of the section 801(b)(1)(D) standard might affect the outcome of a proceeding before evidence and testimony are presented at a proceeding before the Judges.

Agency Comments

We provided a draft of this report to the Federal Communications Commission (FCC) and the Copyright Office of the Library of Congress. FCC provided no comments on the draft and the Copyright Office provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the Chairman, FCC; Register of Copyrights, Library of Congress; and interested congressional committees. This report will also be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have questions about this report, please contact me at (202) 512-2834 or goldsteinm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Mike Clements (Assistant Director), Alison Hoenk, Eric Hudson, Bert Japikse, and Jonathon Oldmixon.

Sincerely yours,



Mark L. Goldstein
Director, Physical Infrastructure Issues

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