LAST CALL AT THE OASIS: MODIFYING THE NONINTERACTIVE WEBCAST ROYALTY SYSTEM TO SUPPORT SUSTAINABILITY

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I. Introduction

I have never paid for a song in my life. Internet users now expect access to any song that comes to mind, when it comes to mind—in some sense equivocating the concept of ownership to that of access. In 2013, one third of Americans used online radio on a weekly basis, an 11 percent rise since 2011. Further, the average amount of time spent per week listening to online radio has nearly doubled since 2008. Classified as a noninteractive service under the Digital Millennium Copyright Act, internet radio has found itself in the middle of a music industry conflict for profits. However, consumer trends indicate that internet radio is here to stay, and a fair compromise needs to be reached with sound recording copyright holders. This essay proposes a tiered system of royalty payments for noninteractive digital music services that allows for both small webcaster growth and an increase in artist royalty payments.

II. A History of Transmission Based Royalties

A. Copyright in Musical Compositions

The Copyright Clause of the Constitution grants Congress the right to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” In 1897, Congress extended copyright protection to written musical compositions incentivizing authors to create such works for the public benefit. The Copyright Act of 1909 granted authors a number of exclusive rights in their musical works, including the right of public performance. It was not until 1971 that Congress granted copyright protection to sound

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2 Id.
4 U.S. Const. art. I, §8, cl. 8.
6 See Id. §106(4).
recordings of musical compositions. Notably, the Copyright Act does not include an exclusive right to the public performance of sound recordings. Thus, while radio broadcasters have to pay performance royalties to songwriters as owners of musical composition copyrights, these broadcasters have never had to pay royalties for use of the actual sound recording.

B. The Digital Audio Transmission Right

The first instances of Internet radio occurred when terrestrial radio stations began to stream content online in 1994. Only a year later, Congress passed the Digital Performance Right in Sound Recordings Act ("DPRSRA"), granting copyright holders the exclusive right "to perform the copyrighted work publicly by means of a digital audio transmission." The Senate Committee on the Judiciary enacted these changes in order to protect those who "depend upon revenues derived from traditional record sales," expressing a distinct concern with the development of services that allow a listener to request and hear a specific song at any time. This goal was achieved by the creation of a three-tier system dividing streaming services based on the determination that they are: (1) interactive, subscription services, (2) noninteractive services, or (3) nonsubscription, noninteractive transmissions. Depending on the classification a particular service receives, a different mechanism applies for determining royalties. Under this framework, copyright holders were given protection for the use of their work on interactive and digital subscription services but not when their work was transmitted by

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8 Id.
14 Bonneville Intern. Corp. v. Peters, 153 F. Supp. 2d 763, 767 (E.D. Penn. 2001) (explaining that the categorization of digital transmissions was based “on their likelihood to affect record sales.”).
15 17 U.S.C. §114(e)(1); Digital Performance Right in Sound Recordings Act, §3. (According to the DPRSRA, an “interactive” service is one that enables a member of the public to receive, on request, a transmission of a particular sound recording chosen by or on behalf of the recipient. The ability of individuals to request that particular sound recordings be performed for reception by the public at large does not make a service interactive.).
16 See H.R. Rep. No. 104-274, at 14 (1995) (Services within this tier were altogether exempt from the DPRSRA, and included radio broadcasts that were available free of charge.).
17 See Neil S. Tyler, Music Piracy and Diminishing Revenues: How Compulsory Licensing for Interactive Webcasters Can Lead the Recording Industry Back to Prominence, 161 U. PA. L. REV. 2101, 2120 (2013) (The first category requires authorization from and payment to the copyright owner for each offered sound recording. The second category subjects services to a compulsory license, and the third category is exempted from paying sound recording copyright owner for use of the sound recording.).
terrestrial or Internet radio stations that were non-interactive and available without a subscription.18

Recognizing the inadequacy of protection provided by the DPRSRA, Congress further amended these licensing regulations with the passage of the Digital Millennium Copyright Act (“DMCA”) in 1998.19 Further limiting royalty payment exceptions to only “nonsubscription broadcast transmission[s],”20 these changes meant that webcasts now had to pay performance royalties— including transmissions by terrestrial radio stations via the Internet.21 Thus, while interactive services must negotiate royalty rates with the sound recording copyright holders, noninteractive services simply owe a congressionally established compulsory license provided that they adhere to a number of requirements.22

An important determination to be made for an internet radio service, then, is whether or not it is “interactive”— a central issue in Arista Records, LLC v. Launch Media, Inc.24 LAUNCHcast was an internet radio website that allowed users to create “stations” that play music within a particular genre or similar to a particular artist or song that the user selects.25 It was alleged that that this use was “interactive” and thus an infringement because Launch Media paid the statutory royalties available to noninteractive services.26 In making its determination, the court focused on whether the webcast provided users with such predictability or control that it “offered listeners the ability to select music in such a way that they would forego purchasing records.”27 Ultimately, it was concluded that LAUNCHcast was not an interactive service,28 meaning that it and similar services were subject to statutory royalties instead of having to negotiate royalties with copyright holders directly.29

C. Compulsory Licensing for Noninteractive Services

More recently, however, the primary conflict between webcasters and copyright holders has not been whether a compulsory license applies, but rather what the

18 Mary Ann Lane, “Interactive Services” and the Future of Internet Radio Broadcasts, 62 ALA. L. REV. 459, 464 (2011) (“This arrangement reflected the idea that traditional radio broadcasting promotes interest in individual music artists and helps record sales, but failed to address the rapidly growing area of Internet radio and webcasting.”).
21 Emily D. Harwood, Staying Afloat in the Internet Stream: How to Keep Web Radio from Drowning in Digital Copyright Royalties, 56 FED. COMM. L.J. 673, 681 (2004) (“nonbroadcast transmissions previously exempted from the DPRSRA were now subject to royalty requirements.”).
22 See generally Bonneville, 153 F. Supp. 2d at 490.
25 Id. at 150.
26 Id.
27 Id. at 157.
28 Id. at 164.
29 Id. (The court noted that the interactivity determination for internet audio services is a fact intensive determination to be made on a case-by-case basis).
congressionally prescribed royalty rate should be. 30 Both the DPRSRA and DMCA included a voluntary negotiation period between copyright holders and webcasters to determine the compulsory license, and granted arbitration power to a Copyright Arbitration Royalty Panel (“CARP”) in the event that an agreement could not be reached. 31 After the parties were unable to settle on a statutory license the CARP released royalty rate determinations requiring webcasters to pay royalties on a per-performance basis. 32 This royalty rate, however, was necessarily unsustainable by smaller webcasters as it was based solely on the voluntary transaction between Yahoo! and the RIAA. 33 Realizing the dramatic affect such rates could have on their livelihood, small webcasters appealed to Congress for help. Assistance came in the form of the Small Webcaster Settlement Act of 2002, allowing for additional negotiation time, and ultimately resulting in the short-term establishment of royalty rates based on the webcasters’ gross revenue. 34

This revenue based royalty payment system expired in 2005, and as these negotiated terms came to an end, “the brawl began anew.” 35 Once again the Copyright Royalty Board (the CARP’s successor) set per-performance royalty rates that threatened the existence of webcasters both large and small. 36 Congress, as before, increased the negotiation time for webcasters and copyright owners by passing the Small Webcaster Settlement Act of 2008. 37 A settlement was reached, establishing the royalty rates that apply through 2015. 38

D. The Internet Radio Fairness Act

Under the tripartite structure of the DMCA, it would seem advantageous for an Internet radio provider to qualify for the noninteractive compulsory license and thus avoid the high costs of negotiating directly with sound recording copyright owners. 39 However, even Pandora, one of the most successful internet radio services to date, has paid over fifty percent of its revenue to royalties for the past three years. 40 This seemingly

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30 See Tyler, supra note 17, at 2127. (“[T]he establishment of the current compulsory license for noninteractive webcasters may have been the longest and most bitterly battled of all the compulsory licenses established under the Copyright Act.”).
32 Id.
33 See Tyler supra note 17, at 2129. (smaller webcasters did not have the same business structure, resources, or capabilities as Yahoo! and thus could not pay the same royalty rates while turning a profit.)
34 Notification of Agreement Under the Small Webcaster Settlement Act of 2002, 67 Fed. Reg. 78,510 78,511 (Dec. 24, 2002). (stating “the royalty rate shall be 10 percent of the eligible small webcaster's 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, whichever is greater.”)
35 See Day, supra note 31, at 189.
39 See Tyler, supra note 17, at 2122.
40 Jasmine A. Braxton, Lost in Translation: The Obstacles of Streaming Digital Media and the Future of Transnational Licensing, 36 HASTINGS COMM. & ENT. L.J. 193, 200 (2014) (“Pandora paid out royalties of
unsustainable business model led to the introduction of the Internet Radio Fairness Act (“IRFA”) into the House of Representatives in September 2012. The IRFA aimed to change how noninteractive services pay royalties, moving from the “willing buyer, willing seller” model to a percentage of the company’s income. Opponents of the bill (comprised mostly of artists and labels) argued that the royalty rates are already too low and that Pandora is simply employing an ineffective business model. Unsurprisingly, no agreement was reached by the end of the 112th Congress; in the words of the Recording Academy President and CEO Neil Portnow, the “IRFA is officially defeated.”

E. Free Market Royalty Act

Introduced to the House of Representatives last September, the Free Market Royalty Act (“FMRA”) seeks to eliminate the distinction between digital and terrestrial transmissions of sound recordings and remove the compulsory licensing system currently in place for royalties. The passage of this bill would end the longstanding agreement between agreement between terrestrial radio and the record industry. Supporters of the bill claim that the terrestrial radio exception to the sound recording royalty is unfair while broadcasters claim that many stations could not pay the royalties, or would switch to a spoken-word format in order to avoid the increased costs. Clear Channel, a large terrestrial radio conglomerate, has made private agreements to pay a performance royalty payment with several record labels. However, given the size of Clear Channel this willingness is likely not representative of terrestrial broadcasters generally. While this method would certainly provide sound recording copyright holders a short-term stream of income—as 82 percent of Americans listen to terrestrial radio weekly—the sustainability of such royalties seems questionable at best. This act also assumes that webcasters will successfully negotiate with the copyright owners, an assumption that has generally proven untrue for the past decade. Given the history of limited compromise between the radio industry and sound recording copyright owners, the conclusion that a fair settlement will take place seems speculative at best.

sixty percent, fifty percent, and fifty-four percent of its revenue in fiscal years 2010, 2011, and 2012 respectively.).


42 Carr, supra note 3.


46 See Braxton, supra note 40, at 196. (“The recording industry recognized a mutual benefit in radio broadcasts; their music would receive free advertising and lead consumers to purchase music, while radio broadcasters would gain a listening audience.”).


48 Id.

49 See Edison Research, supra note 1.
III. Current Trends of Internet Radio

As is evident, the compulsory licensing rates currently in place for noninteractive internet radio services are not satisfactory for any party involved. Further, the application of a per-play royalty payment has received heavy criticism for being prohibitively expensive.\(^50\) While revenue based models have been proposed as a solution to this issue, such royalty payments allow small webcasters with little revenue to use a disproportionate amount of intellectual property in regard to the compensation offered.\(^51\)

A compromise, then, must lie in the balancing of recording industry interests and internet radio service interests.

The music industry’s resistance to lowering royalty rates for internet radio is somewhat surprising considering the affect such services have on music piracy. According to the NPD Group’s 2012 study, nearly half of the 40 percent of consumers who had stopped pirating music in the last year cited free, legal music streaming services as their reason for doing so.\(^52\)

Looking to other markets, studies have linked Spotify (an interactive streaming music service) to a 25 percent decrease in music piracy since 2009.\(^53\)

Similarly, in the film industry it has been suggested that increasing Netflix (a television/movie streaming service) subscriptions corresponds with lowered film piracy rates.\(^54\)

While little data is available to show a direct link to the emergence of free or inexpensive legal media and lowered piracy rates, it seems abundantly clear that access to inexpensive alternatives has led to fewer incidents of online piracy.\(^55\)

Apart from the subsidiary benefit of curbing music piracy, music streaming is beginning to show itself as a viable long-term income stream for the music industry.\(^56\)

SoundExchange, the nonprofit organization responsible for collecting and distributing digital performance royalties, has posted increased annual payouts for the past decade, and shows no signs of slowing.\(^57\)

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51 Duvall, *supra* note 36, at 273. (A revenue based model would allow for extensive use of intellectual property with little or no compensation is contrary to Congress’s intention in enacting the DMCA).


54 *George Wong, Netflix is Doing Its Job to Reduce Piracy in North America*, UBERGIZMO, May 17, 2011, http://www.uberzgismo.com/2011/05/netflix-reduce-piracy-north-americal/. (it is worth noting that this data is correlative at best, as tracking piracy rates with Netflix membership seems near impossible.).

55 See Guerrero, *supra* note 53.

56 *Ari Herstand, Streaming Will Soon Be More Profitable Than Sales*, DIGITAL MUSIC NEWS, Dec. 30, 2013, http://www.digitalmusicnews.com/permalink/2013/12/30/streaming-more-profitable-than-sales. (Sweden’s music market has grown 13.8% in the past year as compared to a global 0.2% increase since 1999 – the shift is being attributed to the 91% figure of digital music sales coming from streaming in the country.).

for noninteractive music streaming, quickly followed by Beats, which plans to release a similar service early next year.\footnote{Joan E. Solsman, Will Streaming Music Services Ever Make Money? 2014 May Tell, CNET, Dec. 30, 2013, http://news.cnet.com/8301-1023_3-57615822-93/will-streaming-music-services-ever-make-money-2014-may-tell/} With so many new services hopping on the streaming audio train, it is of little surprise that one study predicts that digital content will comprise more than 80 percent of the growth in consumer spending on entertainment and media in the next four years.\footnote{Id. (PricewaterhouseCoopers estimates that between 2013 and 2017, digital content will account for 40 percent of the music market and 87 percent of the growth in consumer spending on entertainment and media.).} With the rapid shift from ownership to streaming, the music industry needs to adapt to new methods of reaching consumers in order to stay profitable.

### IV. A Solution to the Internet Radio Royalties Issue: The 5-Tier Noninteractive Service Licensing Scheme

It remains unclear whether a per-performance royalty rate can be set that will allow for sustainable noninteractive webcasting (particularly small webcasters) while appeasing copyright holders. Dating back to the CARP rate setting, high royalty payments were viewed as favorable based on the theory that market consolidation would allow a few webcasters to operate at sustainable levels.\footnote{Duval, supra note 36 (the CARP believed that there were too many marginal webcasting entities and set a high royalty rate in hopes of decreasing the variety of music available on the Internet and consolidating the market.).} Particularly illustrative is the fact that Congress has had to allow for additional negotiation time following each declaration of CARP/CRB royalty rates.\footnote{See Day, supra note 31, at 187-91 (outlining Webcaster I and Webcaster II).} Given that webcasting has managed to survive this rate setting process a number of times, it seems logical that copyright law should build on the per-performance royalty rate that has defined internet radio.

The model that this essay proposes is a digital sound recording per-performance royalty rate for noninteractive services that rises with listener hours for each particular webcast. A review of the rate-setting negotiations and congressional acts surrounding them that small webcasters face the most difficulty in coping with the established royalty rates.\footnote{Id.} Along the same vein, these same webcasters lack the bargaining power necessary to negotiate fairly with sound recording copyright holders.\footnote{Tyler, supra note 17, at 2125 (explaining that small webcasters suffer when forced to negotiate with copyright holders, with the gap in bargaining power making successful negotiation nearly impossible.).} An alternative would be to offer these small webcasters a revenue based model until they reach some threshold of listenership – by requiring an eventual shift to the per-performance royalty payout, the system can avoid the disparate property usage to compensation ratio contemplated when avoiding such models.\footnote{See Duvall, supra note 36.}

As a webcaster grows in size, it must adopt a per-performance royalty system (if it did not opt into using such royalty payouts when at smallest tier). Envisioned by this essay is a five-tier system consisting of: small, medium-small, medium, medium-large,
and large, noninteractive webcasters. As a particular webcaster gains (or loses) the listener hours to move from one statutorily set tier to another, the per-performance royalty due would change accordingly. Thus, both copyright holders and the webcasters themselves are incentivized to increase listenership. Copyright holders receive higher royalty payments as webcasters develop audiences, while webcasters benefit from increased ad revenue coming from more web traffic.65

For the system proposed here to be effective, the royalty rates need to be carefully set to avoid crippling internet radio providers while compensating copyright holders fairly. While per-performance royalty rates have yet to find this equilibrium, it seems likely that this is a result of inexperience in this new business enterprise.66 With nearly half of America being regular monthly listeners to internet radio,67 there seems to be an adequate sample size from which to establish preliminary royalty rates by 2015.

Converting free listeners to subscribing members is also instrumental to a healthy symbiosis between internet radio and the music industry. Another tiered system based on the percentage of total unique users is conceivable here. Under such a scheme a webcaster could incrementally increase its per-stream royalty payments when 25 percent of its users are paying subscribers. In return for the increased royalty payments, copyright holders (or SoundExchange) could be required to cover an equal portion (25%) of the webcaster’s bandwidth costs which increase with website traffic. Thus, as subscriber percentage rises webcasters pay more in royalties but less operating expenses. Such compensation would not only incentivize webcasters to convert more free listeners to subscribers, but might also encourage copyright holders to offer exclusive benefits to subscribers of a particular webcast.

V. Conclusion

A new age of music consumption has come, and the average listener has more songs at his disposal than ever thought imaginable. As the speed of access increases and overall internet radio usage multiplies, both labels artists will begin to reap substantial benefits from their sound recording copyrights. By lowering royalty payments for small webcasters, Internet radio can reach a larger and more diversified audience, creating huge opportunities for artists who might have been overshadowed in a record industry dominated by physical album sales. A royalty payment model that incrementally increases per-stream royalties will generate substantial income—particularly as such services continue to grow in popularity—securing the financial future of the modern recording industry.

65 Ciara Byrne, Internet Advertising Worth a Record $7.3 Billion in Q1, 2011, VENTURE BEAT, May 26, 2011. http://venturebeat.com/2011/05/26/internet-advertising-worth-a-record-7-3-billion-in-q1-2011/. (recent developments in tablet and mobile advertising have led to a startling increase in demand for and revenue from digital advertising in the past year.).

66 See Harwood, supra note 21, at 684-88. (original CARP rate based on a single transaction, and further negotiations being based on the negotiated settlement of only a few parties.).

67 Edison Research. supra note 1. (estimating that 45% of American’s listen to internet radio on a monthly basis, up from 27% in 2010.).