

Draft Regulations Implementing RIAA's Proposed Rates and Terms

**PART 385--RATES AND TERMS FOR USE OF MUSICAL WORKS UNDER
COMPULSORY LICENSE FOR MAKING AND DISTRIBUTING PHONORECORDS**

Sec.

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Authority: 17 U.S.C. 115, 804(b)(4).

§ 385.1 General.

(a) *Scope.* This part 385 establishes rates and terms of royalty payments for making and distributing phonorecords, including by means of digital phonorecord deliveries other than interactive streams and limited downloads, in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance.* Licensees relying upon the compulsory license set forth in 17 U.S.C. 115 shall comply with the requirements of that section, the rates and terms of this part, and any other applicable regulations, except that part ____, and not this part 385, shall apply to the extent that a licensee makes or authorizes interactive streams or limited downloads of musical works. **[Note: Proposed regulations concerning interactive streams and limited downloads are subject to a settlement agreement announced to the Court on May 15, 2008 and expected to be provided to the Court on or after September 15, 2008.]**

§ 385.2 Definitions.

For purposes of this part, the following definitions shall apply:

(a)(1) *All-in wholesale revenue directly attributable to distribution of phonorecords*
means –

(i) when the licensee is not distributing phonorecords directly to end user consumers (e.g., when a record company is selling a physical product to a retailer, or authorizing a digital music service to resell digital phonorecord deliveries), the revenue recognized by the licensee in accordance with Generally Accepted Accounting Principles from the distribution of such phonorecords, and shall be comprised of the following:

(A) in the case of physical products, sales revenue recognized by the licensee directly from distribution of phonorecords, meaning gross sales as reflected on the applicable invoices, less returns and applicable sales discounts; and

(B) in the case of digital phonorecord deliveries, sales, licensing and other revenues received from digital music services attributable to distribution of such digital phonorecord deliveries, as reflected in sales reports and accountings provided to the licensee by such services;

(ii) when the licensee is a record company that is distributing phonorecords directly to end user consumers, the revenue recognized by the licensee in accordance with Generally Accepted Accounting Principles from the distribution of such phonorecords, multiplied by the following applicable percentage:

(A) in the case of revenue from phonorecords distributed by the licensee's physically parting with possession of such phonorecords and phonorecords distributed by means of digital phonorecord delivery as a permanent download, 70%; and

(B) in the case of revenue from ringtones and other phonorecords not identified in clause (A), 50%; and

(iii) when the licensee is a digital music service that has been authorized by a record company to resell digital phonorecord deliveries but that has itself acquired licenses under 17 U.S.C. 115, the amount expended by the service in accordance with Generally Accepted Accounting Principles for the sound recording multiplied by –

(A) in the case of revenue from phonorecords distributed by means of digital phonorecord delivery as a permanent download, and other phonorecords subject to the royalty rate set forth in § 385.3(b), 1.099; and

(B) in the case of revenue from ringtones, 1.176.

(2) For purposes of paragraph (1) –

(i) the licensee's revenues shall include applicable payments to which the licensee is entitled but which are paid to a parent, wholly owned subsidiary or division of licensee;

(ii) the licensee's revenues shall exclude sales and use taxes, shipping, and handling and insurance charges;

(iii) licensees may reserve for returns as provided in § 201.19;

(iv) if, in a single transaction, a licensee receives payment for sound recordings of musical works distributed pursuant to 17 U.S.C. 115 and subject to the rate provided in one of § 385.3(b) and (c), as well as other products or services (e.g., where a phonorecord or online bundle contains material other than sound recordings of musical works, or an online bundle contains both permanent downloads and ringtones), the licensee's revenues from the transaction shall be attributed to the sound recordings of musical works and other products or services in proportion to the licensee's published prices thereof when distributed separately, if any, or otherwise in accordance with a reasonable and non-discriminatory allocation methodology consistently applied; and

(v) if, in a single transaction, a licensee receives payment for sound recordings of multiple unique musical works distributed pursuant to 17 U.S.C. 115 and subject to one of § 385.3(b) and (c) (e.g., the tracks on a CD or a digital album), the applicable revenues shall be allocated equally among such musical works.

(b) *Interactive stream* has the meaning given in § _____. **[Note: To be provided pursuant to settlement agreement.]**

(c) *Licensee* means a person that has obtained a compulsory license under 17 U.S.C. 115 and its implementing regulations.

(d) *Limited download* has the meaning given in § _____. **[Note: To be provided pursuant to settlement agreement.]**

(e) *Record company* means a person or entity that (i) is a copyright owner of a sound recording of a musical work; (ii) in the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under the common law or statutes of any State, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under Title 17, United States Code; (iii) is an exclusive licensee of the rights to reproduce and distribute a sound recording of a musical work; or (iv) performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the copyright owner of the sound recording.

(f) *Ringtone* means a phonorecord of a partial musical work distributed as a digital phonorecord delivery in a format to be made resident on a telecommunications device for use to announce the reception of an incoming telephone call or other communication or message or to alert the receiver to the fact that there is a communication or message.

§ 385.3 Royalty Rates for Making and Distributing Phonorecords.

(a) *In general.* The royalty payable under 17 U.S.C. 115 for the use of a musical work in a sound recording embodied in any phonorecords of the types specified in § 385.3(b) and (c) is a percentage of the licensee's all-in wholesale revenue directly attributable to distribution of such

phonorecords during the payment period and allocable to that sound recording, as described below in this § 385.3.

(b) *Physical products, permanent downloads and other digital phonorecord deliveries in general (but not ringtones and limited downloads)*. In the case of phonorecords distributed by the licensee's physically parting with possession of such phonorecords, and in the case of phonorecords distributed as digital phonorecord deliveries, except as provided in § 385.3(c) and (d), the royalty rate referred to in § 385.3(a) is 9%.

(c) *Ringtones*. In the case of ringtones, the royalty rate referred to in § 385.3(a) is 15%.

(d) *Interactive streams and limited downloads*. In the case of interactive streams and limited downloads, the applicable royalty rates and terms are set forth in part ___. **[Note: To be provided pursuant to settlement agreement.]**

§ 385.4 Terms for Making and Distributing Phonorecords.

(a) *Clarification of Covered Reproductions*. A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary to engage in activities covered by the compulsory license, including –

(1) the making of reproductions by and for end users;

(2) reproductions made on servers under the authority of the licensee; and

(3) incidental reproductions made under the authority of the licensee in the normal course of engaging in such activities, including cached, network, and buffer reproductions.

(b) *Accounting for Digital Phonorecord Deliveries*. Notwithstanding § 201.19(a)(6),¹ when a digital phonorecord delivery is not distributed to the end user consumer directly by the licensee, the digital phonorecord delivery shall be treated as made, distributed, voluntarily distributed, relinquished from possession and permanently parted with in the accounting period in which it is reported to the licensee.

(c) *Signing Statements of Account*. Notwithstanding § 201.19(e)(6) and (f)(6)(i), monthly and annual statements of account shall be valid if signed by any duly authorized agent of the licensee.

¹ RIAA has indicated its view that Section 115 should be interpreted to grant this Court only limited authority to supplant the Copyright Office's payment regulations. As discussed in RIAA's Conclusions of Law, RIAA does not believe that this Court has the authority to adopt the term set forth in subsection (b), and so RIAA does not propose it here. Nonetheless, RIAA sets forth this term in case the Court concludes that, as a matter of law – and contrary to RIAA's view – it does have authority to adopt this term. If this Court concludes that it lacks jurisdiction over this issue, then RIAA withdraws the term set forth in subsection (b).

(d) *Audit.* Notwithstanding § 201.19(f)(6)(ii), an audit performed in the ordinary course of business according to generally accepted auditing standards by an independent and qualified auditor shall serve as an acceptable verification procedure with respect to the information that is within the scope of the audit.

§ 385.5 Transition Period.

(a) *Effective date.* The royalty rates set forth in this part 385 shall be effective on the first day of the first calendar quarter beginning more than six months after the publication in the Federal Register of the determination of the Copyright Royalty Judges adopting this part.

(b) *Transition.* In the case of any product the first phonorecords of which were distributed to the public prior to the date identified in subsection (a), the licensee shall have the option to pay royalties for any phonorecords distributed during the 12 months following the date identified in subsection (a) at the rates set forth in § 385.3 or at the statutory rate in effect immediately prior to such date, as set forth in part 255.

Proposed Regulations for RIAA's Alternative Rate Request

If the Court were to adopt RIAA's alternative rate proposal, the foregoing proposed regulations should be modified as set forth below.

1. Add the following additional definitions to proposed § 385.2:

() *Per-track wholesale price* means the wholesale price realized from the sale of a phonorecord distributed by the licensee's physically parting with possession of such phonorecord or by means of digital phonorecord delivery as a permanent download divided by the number of sound recordings of musical works embodied therein, except that –

(i) when the licensee is a record company that is distributing phonorecords directly to end user consumers, such wholesale price shall be determined by multiplying the applicable retail price by the applicable percentage set forth in § 385.2(a)(1)(ii)(A) or (B);

(ii) when the licensee is a digital music service that has been authorized by a record company to resell digital phonorecord deliveries but that has itself acquired licenses under 17 U.S.C. 115, such wholesale price shall be determined by multiplying the amount expended by the service in accordance with Generally Accepted Accounting Principles for the sound recording by the applicable factor set forth in § 385.2(a)(1)(iii)(A) or (B);

(iii) if, in a single transaction, a record company receives payment for such phonorecord and other products or services (e.g., where a phonorecord or online bundle contains material other than sound recordings of musical works, or an online bundle contains both permanent downloads and ringtones), such wholesale price shall be determined by allocating the transaction price to the sound recordings of musical works and other products or services in proportion to the published prices thereof when distributed separately, if any, or otherwise in accordance with a reasonable and non-discriminatory allocation methodology consistently applied; and

(iv) in a case in which multiple fixations of the same sound recording are distributed on a physical product or as permanent downloads as part of a single transaction (e.g., a multisession disc, or downloads to a computer and cell phone), the price of the transaction shall be used to determine the per-track wholesale price, but all such fixations together shall be considered the same phonorecord track.

() A *locked content product* is a phonorecord on which the sound recording has been encrypted or otherwise protected by digital rights management, or degraded (e.g., by means of voiceovers) so as not to materially substitute for the sale of a copy of a non-degraded recording, and is either (i) not otherwise accessible to, or playable in a non-degraded form by, the consumer without additional payment and/or authorization, or (ii) accessible or playable in a non-degraded form by a consumer for no more than a limited time period and/or a limited number of "plays"

that is commercially reasonable for the purpose of inducing the consumer to make an additional payment to permanently obtain access to or enable the non-degraded play of the recording.

A locked content product is *unlocked* when a consumer is given permanent access to non-degraded play of the relevant recording.

2. Substitute the following proposed § 385.3:

§ 385.3 Royalty Rates for Making and Distributing Phonorecords.

(a) *Physical products and a la carte permanent downloads.* In the case of a phonorecord distributed by the licensee's physically parting with possession of such phonorecord or by means of digital phonorecord delivery as a permanent download as part of a discrete transaction and not a subscription service, the royalty payable under 17 U.S.C. 115 for the use of a musical work in a sound recording is as follows –

- (1) if the per-track wholesale price is \$1 or more, 9.45¢ per track;
- (2) if the per-track wholesale price is 80¢ or more but less than \$1, 8.1¢ per track;
- (3) if the per-track wholesale price is 60¢ or more but less than 80¢, 6.3¢ per track;
- (4) if the per-track wholesale price is 45¢ or more but less than 60¢, 4.7¢ per track; and
- (5) if the per-track wholesale price is less than 45¢, 3.6¢ per track.

(b) *Ringtones.* In the case of a ringtone, the royalty payable under 17 U.S.C. 115 is 18¢.

(c) *Other general digital phonorecord deliveries.* In the case of phonorecords distributed as digital phonorecord deliveries, except as provided in subsections (a), (b) and (d), the royalty payable under 17 U.S.C. 115 for the use of a musical work in a sound recording is 9% of the licensee's all-in wholesale revenue directly attributable to distribution of such phonorecords during the payment period and allocable to that sound recording.

(d) *Interactive streams and limited downloads.* In the case of interactive streams and limited downloads, the applicable royalty rates and terms are set forth in part ___. **[Note: To be provided pursuant to settlement agreement.]**

(e) *Locked content products.* In the case of a locked content product, the product is considered distributed, and the royalty becomes payable, when the product is unlocked.