Before the
UNITED STATES COPYRIGHT OFFICE
LIBRARY OF CONGRESS

In the Matter of	)	
Mechanical and Digital Phonorecord Delivery Compulsory License	)	Docket No. RM 2000-7 May 23, 2001

Reply Comments of National Association of Recording Merchandisers and Video Software Dealers Association

Neither the administrative recognition of a "Limited Download" nor the bootstrapping of such a concept into a "rental" are authorized by the Copyright Act. To do so now would unlawfully expand copyright to include a right over entirely private performances for which copyright owners have no rights, and would deny to artists the reproduction royalties due to them under law.

The National Association of Recording Merchandisers ("NARM") and the Video Software Dealers Association ("VSDA") submit these reply comments, pursuant to the Copyright Office's March 9, 2001 Notice of Inquiry ("NOI"), 66 Fed. Reg. 14,099, regarding the Mechanical and Digital Phonorecord Delivery Compulsory License. NARM is the trade association for this nation's music retailers, rack jobbers and distributors, who have a vital interest in preserving appropriate financial incentives and rewards for creative artists. VSDA is the trade association for home video retailers, and its members have substantial experience in the true rental of copies of copyrighted works. NARM and VSDA members share a vital interest in

preserving vibrant retail competition in copyrighted works, and in carrying out Congress' intent that such competition be free from control or restraint by the copyright owner.[1]

The Recording Industry Association of America's comments (hereafter "RIAA Comments") ask the Copyright Office to (a) administratively expand the plain meaning of the term "rental," and (b) ignore the plain language of Section 115, which requires that any rental royalty be in addition to the reproduction and distribution royalty. The Copyright Office should bend neither reality nor the law in such a manner.

A Limited Download Cannot Be A Rental

The RIAA seeks to use technological controls to limit the length of time or number of times that the owner of a phonorecord made through a lawful digital phonorecord delivery ("DPD") may listen to it.[2] It would call this concept a "Limited Download" and ask that it be treated as though it were a rental. RIAA's proposed new business model cannot, however, alter existing property rights or find legitimacy within the Copyright Act.

In the first place, the term "rental" has never been used to refer to payments made for the use or possession of one's own property. By definition, rent is the fee paid by one who is not the owner for the right to use the property for the rental period. *See* Black's Law Dictionary, 5th Ed. The Limited Download, in contrast, would wrest from the owner and possessor of the property

[1] Although these Reply Comments are limited to a discussion of the implications of treating a Limited Download as though it were a rental, NARM and VSDA agree with the position taken, and legal analysis made, by the Consumer Electronics Association and Clear Channel Communications, Inc., in their April 23 Comments with respect to other issues raised in the NOI.

[2] The RIAA has acknowledged that the owner of a DPD is the owner of a lawfully made phonorecord, and that, therefore, Section 109 applies. *See, e.g., Joint Reply Comments of Copyright Industry Organizations Report to Congress Pursuant to Section 104 of the Digital Millennium Copyright Act,* dated September 5, 2000, submitted by the American Film Marketing Association, the Association of American Publishers, the Business Software Alliance, the Interactive Digital Software Association, the Motion Picture Association of America, the National Music Publishers' Association and the Recording Industry Association of America, p. 6; *Hearing Before the Copyright Office and the National Telecommunications and Information Administration on a Joint Study on 17 U.S.C. Section 109 and 117* (November 29, 2000) (statement of Cary Sherman on behalf of the Recording Industry Association of America, Inc., p. 298). As discussed below, a Limited Download, by its very nature, would impair the statutory right of the owner of a phonorecord made through a lawful DPD to sell, lend or give away that copy.

the ability to use it once a technological block is activated. If an automobile company were to manufacture its cars with a device that allowed it to control access to the vehicle after it had been sold, the mere fact that it could require payment of a monthly access fee from the new owner does not convert the transaction into a lease. Even if the purchase price of the vehicle were lowered dramatically, taking into account that the owner will only be able to drive it for a limited time until additional access fees are due, the fact remains that the owner continues to own the vehicle regardless whether the automobile company grants access.

This view also finds support in the argument made by the Motion Picture Association of America just yesterday, in testimony before Congress. Addressing the question of whether the delivery of content of e-commerce networks should be considered trade in goods or trade in services, or both, MPAA's Vice President for Trade & Federal Affairs gave the following example:

> If a consumer were to place a telephone order for a DVD of the film "Finding Forrester" and have a copy of that DVD delivered to his house on a UPS truck, that is a "goods" transaction. Likewise, if the same consumer ordering a copy of the same DVD on his/her computer and had the same content delivered digitally and downloaded from his computer to a write-able DVD – that is still a "goods" transaction. The only difference is that a digital network instead of a delivery van provided the transportation from the retailer to the consumer.

Testimony of Bonnie J.K. Richardson before the House Commerce Committee Subcommittee on Commerce, Trade and Consumer Protection, May 22, 2001, prepared statement at 12. Taking this illustration to the next step, one could develop the following analogous example: If, after the consumer watched the UPS-delivered DVD, the studio sent an agent to the consumer's home to disable the consumer's DVD so that the same consumer could not play it again, the agent should be prosecuted for destruction of property. Likewise, if the same studio placed computer programming code into the metadata payload accompanying the digital delivery, and it was set to

prevent the consumer from watching the movie more than once, the value of the consumer's property would be damaged just as much. The only difference is that the disablement of the consumer's property was accomplished by a digitally delivered technology instead of a human agent.

Just as the Motion Picture Association of America maintains that the digital delivery does not change the character of what is in substance still a "goods" transaction, so, also, NARM and VSDA maintain that a sound recording delivered as a DPD is not substantively different from one delivered as a packaged product. The record company has no greater right to control the owner's use of one over the other.

As certainly as Congress intended the rental provision to "cover transactions which common sense indicates are equivalent to rentals," H.R. Rep. No. 987, 98th Cong., 2d Sess. 4 (1984), so, too, must it have intended that transactions which common sense indicates are not equivalent to rentals not be treated as such. It would come as a shock to the average consumer that their computer's hard drive or CD-RW upon which they lawfully fixed the DPD was somehow only being rented from the record company during the time period in which the record company chose to allow them to play the download. Certainly, the record company that authorized the DPD does not own the tangible medium upon which it is fixed. (*See* Section 202.) The Copyright Office should not contemplate the creation of a new rule to overturn the obvious intent of the consumer in agreeing to a DPD.

> It seems well settled that calling such a transaction a 'lease' does not make it such, if in fact it is something else. To determine just what it is the courts will look to see what the parties intended it to be. . . . [T]he test should not be what the parties call the transaction nor even what they may mistakenly believe to be the name of such transaction. What the parties believe the legal effect of such a transaction to be should be the criterion. If the parties enter into a transaction which they honestly believe to be a lease but which in actuality has all the elements of a contract of sale, it is a contract of

> sale and not a lease no matter what they call it not how they treat it on their books. We must look, therefore, to the intent of the parties in terms of what they intended to happen.

Oesterreich v. Commissioner of Internal Revenue, 226 F.2d 798, 801-02 (9th Cir. 1955). For these reasons, it is manifestly clear that a Limited Download cannot be transformed into a rental by merely calling it that, nor does a Limited Download bear any of the most basic elements of a rental transaction. To be sure, Congress may have the authority amend Section 106 to add an exclusive right in a Limited Download,[3] but the Copyright Office certainly does not have the authority to do so.

Section 115 Contemplates a Rental Royalty Over and Above the Royalty for Reproduction and Distribution

Even assuming, *arguendo*, that a Limited Download could be treated as though it were a rental for purposes of the compulsory license under Section 115(c)(4), that section clearly envisions that any rental royalty be in addition to the reproduction and distribution royalty under Section 115(c)(2). Although Section 115(c)(4) states that the grant of a compulsory license under Section 115 "includes the right of the maker of a phonorecord . . . to distribute or authorize the distribution of such phonorecord by rental, lease, or lending (or by acts or practices in the nature of rental, lease, or lending)," clause (4) goes on to state: "In addition to any royalty payable under clause (2) and chapter 8 of this title, a royalty shall be payable by the compulsory

[3] We suspect that if Congress were to consider creating a copyright in something akin to a Limited Download, it would likely also take into consideration the need to preserve true consumer choice in the matter by making certain that the principles of Section 109 would govern. When Congress first codified the first sale doctrine in Section 27 of the Copyright Act of 1909, the House Committee on Patents stated: "Your committee feel that it would be most unwise to permit the copyright proprietor to exercise any control whatever over the article which is the subject of copyright after said proprietor has made the first sale." H.R. REP. NO. 2222, 60th Cong., 2d Sess. (1909). (The current codification, Section 109 of the 1976 Act, no longer requires a first sale, but mere title to a lawfully made copy by someone other than the copyright owner.) Simply put, consumers and the Constitution's purpose for copyright law (the promotion of science and the useful arts) are better served if copyright owners are denied control over retail distribution and lawful consumer use. As discussed below, any Limited Download should be a choice bargained for as against competing independent retailers rather than forced upon the consumer as the single choice of the copyright owner.

licensee for every act of distribution of a phonorecord by or in the nature of rental, lease, or lending, by or under the authority of the compulsory licensee." (Emphasis added.)

Moreover, if the Copyright Office were to adopt the petitioner RIAA's proposal, it would wreak havoc for copyright owners and businesses involved in the digital delivery of books and motion pictures. It stands to reason that if RIAA member companies can escape having to pay the reproduction royalty due under Section 115(2) by engaging in the delivery of Limited Downloads (perhaps more accurately referred to as a "virtual rentals"), then anyone else who delivers a digital copy of a work would also escape liability for infringement of the reproduction right, provided that access to the reproduction were limited by duration or number of times. Since there is no Section 115(4) equivalent for audiovisual works, this would mean that NARM and VSDA members (and any member of the general public) could begin delivering Limited Downloads of motion pictures without infringing the reproduction right. To say it another way, there is no basis in law for record companies alone to escape liability for copyright infringement by limiting access to a digitally delivered copyrighted work.

NARM and VSDA have no objection to the thoughtful consideration of whether rules should be developed to enable the "virtual rental" of copyrighted works by means of something akin to the Limited Downloads proposed here, but believe it would be imperative that the careful balance of copyright be preserved in the process: Some form of compensation for the author must replace the lost royalty from the right of reproduction, and some limits must be placed upon copyright owners, akin to the first sale doctrine, to insure that anyone who pays the new royalty may be permitted, without the consent of the copyright owner, to engage in those virtual rentals, and thereby insure that consumers will benefit from unrestrained competition. The RIAA petition offers no resolution of either of these important public policy concerns, and only Congress has the authority to do so.

Quite simply, the existing rental royalty contemplated by Congress was a royalty relating to the rental of the actual phonorecord – a tangible medium, whether bought or lawfully made from a DPD – wherein the holder of the copyright in the nondramatic musical work would be paid a royalty for each phonorecord made and distributed, and, if rental were authorized, the holder would be paid an additional royalty based upon a percentage of revenue received by the compulsory licensee for every rental.

There Is No Barrier to True Rental

Following the existing statutory model, each RIAA member company is free to immediately authorize the rental of sound recordings, be they vinyl records, cassettes or CDs. There is nothing new about rental of sound recordings. It is only due to an exception to the first sale doctrine that CDs are not already rented in the United States today. In fact, sound recordings have been rented in Japan for at least twenty years.[4]

As envisioned by Congress, the rental of copies or phonorecords need not impair the copyright owner's fair compensation, even where rentals occur without consent. That has certainly been the case in the video industry where there is no exception to the first sale doctrine as codified in Section 109, such that the owners of lawfully made copies of motion pictures on videocassette or DVD are entitled to rent them without the consent of the copyright owner, and without payment of any additional rental royalty. In that industry, the motion picture studios have several options. They can sell their copies with knowledge that buyers may rent them, or they may lease their copies to retailers (retaining title to them), and enter into revenue sharing agreements to receive a portion of the rental revenue. If they sell them, they will obtain no

[4] The Compact Disc & Video Rental Commerce Trade Association of Japan (CDV-Japan) values CD rentals as a promotional vehicle to boost CD sales. Domestic CDs may be rented within a few weeks after they are released, whereas foreign record companies may prevent rental for up to a year, and regularly do so. CDV-J contends that the rental of domestic CDs shortly after they are released has contributed to the rapid increase in sales market share for domestic CDs during the 1990's.

additional revenue from the rentals, but they may price them according to whether they expect to derive more revenue from a low price and high volume (for example, pricing them at a wholesale price near $15, referred to in the video industry as a "sell-through price"), or near $70 (referred to in the industry as the "rental price"). Retailers are free to rent them or sell them regardless which price is paid. At the sell-through price, specialty retailers will require less total revenue to break even, but will see rental transactions diminish due to sales (including sales through non-specialty retailers). At the rental price, retailers are still free to sell them, but few consumers will be willing to pay the high retail price. (It is generally the practice to re-release a rental-priced video at the sell-through price after a period of time.) In either case, the copyright owner cannot control whether they are rented or sold, but can simply price them based upon its own calculation whether it can derive more revenue through low prices and higher volume, or through very high prices at lower volume.

In the case of revenue sharing, the copyright owner retains title, and generates revenue as a percentage of each rental transaction. Because the copyright owner retains title, it is free to make the authority to rent the copy contingent upon the revenue per rental it seeks from the retailer. No matter which business models are used, it is a fact that the motion picture studios have, in recent years, derived more revenue from the home video market (the lion's share of which comes from unauthorized – but perfectly lawful – rentals) than all other sources of domestic revenue combined.

In the case of phonorecords, Congress gave the copyright owner the right to prohibit or authorize rentals and, because of Section 115(c)(4), the record company obtains a compulsory license to do so, provided a statutory rental royalty is paid to the holder of the copyright in the nondramatic musical work. Such provision is unnecessary for books and movies simply because

the book publisher or the motion picture studio will typically control all of the copyright authority in the work.

If the record companies were to authorize rental, they would have two options. First, they could do as the motion picture studios have done, and enter into revenue sharing agreements wherein they retain title to the CD, and the retailer pays a percentage of each rental transaction. A percentage of that revenue, in turn, would be paid to the compulsory licensor as determined in a CARP, in addition to the compulsory license under clause (2).

Second, unlike the motion picture studios, the record companies could sell the CD at the regular wholesale price for sales only, and then authorize retailers to rent them in exchange for a fixed payment or percentage of revenue for each rental transaction. In that case, the retailer could choose to sell or rent the CD, but if rented, an additional payment would be made to the record company. In like manner, the record company would pay the compulsory license due under clause (2) for each CD made and distributed, and in addition pay the compulsory license due under clause (4) as a proportion of the revenue from each rental transaction.

To summarize, today the RIAA member companies are free to authorize retailers to rent CDs. If they choose to do so, and if they derive any revenue from the rentals, they would be obligated to pay a royalty under clause (2) for the initial reproduction and distribution and, in addition to that royalty, pay the rental royalty under clause (4). Contrary to this Congressional plan, the RIAA asks the Copyright Office for the right to pay a lower rental royalty instead of the reproduction and distribution royalty.

A "Limited Download" Controlled By Copyright Owners Would Give Them Control Of a Right of Private Performance

Copyright owners enjoy an exclusive right of public performance, but do not have an exclusive right of private performance.[5]

> The Copyright Act does not give a copyright holder control over all uses of his copyrighted work. Instead, [Section 106] of the Act enumerates several "rights" that are made "exclusive" to the holder of the copyright. If a person, without authorization from the copyright holder, puts a copyrighted work to a use within the scope of one of these "exclusive rights," he infringes the copyright. If he puts the work to a use not enumerated in [Section 106], he does not infringe.

Fortnightly Corp. v. United Artists Television, Inc., 392 U.S. 390, 393-95 (1968) (footnotes omitted). The concept in copyright law most analogous to a Limited Download is not rental, but private performance. If the RIAA petition were granted in this regard, and a Limited Download controlled by copyright owners (in this case, the record companies) were created, the result would be the creation, in both substance and in effect, of a right of private performance. This is so because, despite the fact that the consumer is undoubtedly the owner of the lawfully made copy, the copyright owners (the record companies) would be given control over completely private performances of the work from those copies.[6] To put it another way, if the record company were to rent a CD directly to a consumer, the record company would have absolutely no right to determine how many times it could be played, or which members of the consumer's family or friends could listen to it. The only restraint upon the right of the consumer to listen to the sound recording at will would be the term of the rental, at which time the physical return of

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[5] Section 106(4). "No license is required by the Copyright Act, for example, to sing a copyrighted lyric in the shower." *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 155 (1975). Of course, those who own the phonorecords should not be relegated to singing in the shower, but may play them in the living room as well. Indeed,

[6] It warrants noting that private performances do not constitute infringement regardless whether the person rendering the private performance owns a copy (or phonorecord) of the work.

the sound recording would obviously prevent it from being performed. In the event that the consumer fails to return the sound recording when due, and continues to perform it when the right of possession has ended, these private performances would still infringe no copyright. The consumer's liability would be for breach of the rental agreement. Accordingly, since the consumer owns the copy made by DPD, there is no obligation to return it, and the freedom to continue privately performing it would attach. For the copyright owner to limit that right of private performance (whether by technological means or purported terms of license) would in effect mean that the copyright owner is reserving for itself the right to authorize private performances of the work from a DPD. Such a result plainly contravenes the clear words and purposes of the Copyright Act.[7]

Expansion of Copyright Owner Control Over Entirely Private Performances Constitutes Misuse of Copyright

Because copyright law does not give any copyright owner the exclusive right of private performance, and because the private enjoyment of a sound recording owned by the consumer (even if the sound recording resides on a computer hard drive as the result of a DPD) is not a public performance, the copyright owner's use of technology to prevent the consumer from performing the sound recording owned by the consumer constitutes a major expansion of copyright power by technological fiat.

Indeed, if the owners of copyrights in sound recordings can gain approval of such conduct, it stands to reason that the owners of copyrights in other works of authorship, such as in print media and audiovisual works, could also claim a right to technologically control (and extract payment for) entirely private performances.

[7] Contrary to the RIAA plan, we should be encouraging use that stops short of infringement rather than attempting to limit it. *Fortnightly*, 392 U.S. at 393, n.8 (citing B. Kaplan, An Unhurried View of Copyright 57 (1967)).

Moreover, such control would be more formidable than the control copyright owners currently have over public performances. For example, when a public performance is licensed for use in a live concert, the copyright owner does not control who can attend the concert or the price of admission. A movie theater, likewise, may be licensed to publicly perform a movie, but one who slips in to watch it without paying violates no right of the copyright owner. The same is true for in-home entertainment. When a pay-per-view service is broadcast over cable television, the copyright owner does not give the consumer a license to watch it; rather, the cable company obtains the license to perform it publicly, and charges a fee to its (not the copyright owner's) subscribers. At no time have copyright owners been given the power to charge for reading a book, watching a movie or listening to a song, nor the power to charge for playing a CD at home, watching a DVD at home, or reading a book aloud. Nor have they ever had authority under the Copyright Act to charge extra for reading a book twice, watching a downloaded movie outside of a 24-hour window, or playing a DPD for more than a month. Yet, this is precisely what the RIAA petition seeks.[8]

As the Supreme Court made clear nearly two decades ago, "the law has never accorded the copyright owner complete control over all possible uses of his work," *Sony Corp. of Am. v. Universal City Studios,* Inc., 464 U.S. 417, 432 (1984). Congress conferred only a limited copyright in those enumerated statutory rights in Section 106 to further the Constitution's purpose. To use that monopoly power, however limited, for the purpose of gaining control over

[8] The pay-per-view system used for cable broadcasts clearly fits the definition of public performance under Section 101, whereas playing one's own (or rented) video at home does not. Playing one's own (or rented) copy of a movie and watching it on pay-per-view cable may both be done in a place not open to the public and with a gathering of no more than a family and its small circle of friends, so neither would meet the Section 101 definition of public performance under subparagraph (1). The cable broadcast, however, meets the transmission requirements of subparagraph (2), which is an alternate definition. *See, e.g., Columbia Pictures Ind., Inc. v. Professional Real Estate Investors, Inc.*, 866 F.2d 278 (9th Cir. 1989); *Columbia Pictures Ind., Inc. v. Redd Horne, Inc.*, 749 F.2d 154 (3rd Cir. 1984).

distribution of a work after the distribution right has been terminated by law, or to control private use beyond the bounds of the copyright, is an abuse of that copyright. "A copyright owner may not enforce its copyright to . . . use it in any manner violative of the public policy embodied in the grant of a copyright." *Tricom, Inc. v. Electronic Data Systems Corp.*, 902 F. Supp. 741 (E.D. Mich. 1995) (citations omitted). Leveraging copyright power to control behavior which Congress intended remain outside of the copyright owner's control is the type of conduct condemned in *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948); *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942); *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917), and *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970 (4th Cir. 1990). Without regard to whether Section 115 is applicable, the Copyright Office has no authority to enlarge the rights in Section 106 into a technological right of private performance over digitally delivered copies and phonorecords. It should not, therefore, come to the aid of copyright owners seeking a stamp of approval over their self-help use of technology to achieve the same objective.

To return for a moment to the MPAA example of the "Finding Forrester," referenced above, could the consumer first agree with the studio that, in exchange for paying less for the physically delivered DVD, the studio would be authorized to disable or destroy the consumer's property after the consumer watched the movie? And, if so, couldn't it also agree that, in exchange for a lower cost of a Limited Download, it would authorize the studio to use technology to prevent multiple access? Perhaps, but NARM and VSDA maintain that if such agreement were extracted by the copyright owner leveraging its copyright monopoly power, it would offend the public policy that underlies the Copyright Act – to "serve the cause of promoting broad public availability of literature, music and the other arts." *Twentieth Century Music Corp. v. Akin*, 42 U.S. at 156.

If retailers who do not own the copyrights were to offer such restrictive terms, consumers could shop elsewhere for more favorable terms. But given that the copyright owner is the only initial source of the product, consumers would have no real choice. The power of the copyright monopoly would have been employed not to prevent unauthorized reproduction or an unauthorized public performance, but to prevent an unauthorized – but perfectly lawful – private performance. Such an expansion of copyright is forbidden.

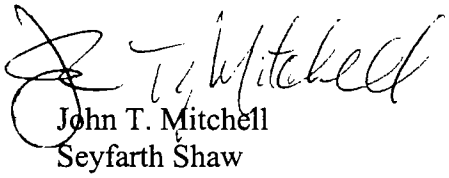
Conclusion

For these reasons, the Copyright Office lacks statutory authority to confer upon copyright owners the ability to control private performances or to deem extra-legal limitations upon the consumer's right to play their sound recording to be in the nature of a lawful rental. The Copyright Office also lacks statutory authority to exempt RIAA members from payment of a reproduction royalty on condition that they limit the consumer's right to play a sound recording. NARM and VSDA believe that it is unlawful for copyright owners to leverage their copyright monopoly power in a manner which impairs both the public's right to benefit from Section 109 and the consumer's right to privately perform its own music collection.

Although it is certainly feasible to create the electronic equivalent of a rental by use of mechanisms that limit the period during which a file can be played, such a model should be structured to carefully exclude copyright-owner control over the terms and conditions of such a Limited Download, and to determine whether or under what circumstances such "virtual" rentals would not infringe the reproduction right. Although NARM and VSDA welcome exploration of the exciting possibilities for distribution of copyrighted works made possible by new technology,

the Copyright Office should defer to Congress on the question of whether such a model will have a place in the Copyright Act.

Respectfully submitted,



John T. Mitchell
Seyfarth Shaw
815 Connecticut Ave., NW, Suite 500
Washington, DC 20006-4004
202-828-3574
202-838-5393 (fax)
jmitchell@dc.seyfarth.com