Statement of

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Chairman Berman, Ranking Member Coble, and Members of the Subcommittee, thank you for inviting me to testify before you today on Section 115 of the Copyright Act and how best to reform it. Section 115 provides a compulsory license for the making and distribution of physical phonorecords and digital phonorecord deliveries. This Subcommittee has had a number of hearings over the past three years concerning Section 115 to identify its problems and explore potential solutions. During this time, industry groups that were originally divided about the need for reform have now all agreed that reform is necessary, although they have never been able to agree on how to accomplish this goal.

Let me say at the beginning of my testimony that I believe that reform of the digital music licensing system is the most important music issue currently before Congress. It is an important issue not only to digital music services who want to offer robust music services utilizing thousands of legal copies of musical works, but it is also important to the songwriters and copyright owners who deserve compensation when others use their works. If music licensing reform is successful, consumers will be able to access more legal music online, through

a variety of competing services, and be less tempted by piratical services that today can already offer every song ever written for free.

History of Section 115

Almost a century ago, Congress added to the Copyright Act the right for copyright owners to make and distribute, or authorize others to make and distribute, mechanical reproductions (known today as phonorecords) of their musical compositions. Due to its concern about potential monopolistic behavior, Congress also created a compulsory license to allow anyone to make and distribute a mechanical reproduction of a musical composition without the consent of the copyright owner provided that the person adhered to the provisions of the license, most notably paying a statutorily established royalty to the copyright owner. Although originally enacted to address the reproduction of musical compositions on perforated player piano rolls, the compulsory license has for most of the past century been used primarily, when used at all, for the making and distribution of physical phonorecords and, more recently, for the digital delivery of music online.

Twice since its inception in 1909, Congress has amended section 115, first in 1976, when Congress enacted the 1976 Copyright Act - a wholesale revision of the copyright law, and again in 1995, with the passage of the Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (1995), to accommodate the delivery of music by means of a digital transmission. The changes adopted in 1976 were implemented to ease the burdens placed on the copyright owners, clarify ambiguous provisions and establish a mechanism to adjust the royalty rates over time, whereas the changes made in 1995 were in response to the emergence of new digital technology that, for the first time, provided a quick and inexpensive way to deliver music directly to the consumer's computer. To accommodate these new delivery methods,

Congress modified section 115 to provide expressly for the reproduction and delivery of a phonorecord by means of a digital transmission. Congress took these steps in order to reaffirm the mechanical rights of songwriters and music publishers in on-line environment.

My Office has also updated the regulations that govern the functioning of the existing statute, most recently in June 2004. Regulatory changes, however, cannot address the inherent problems with the statutory license, and the Section 115 compulsory license remains a dysfunctional option for licensing the reproduction and distribution of musical works. Hence, its primary purpose today is to provide a ceiling for the royalty rate used in privately negotiated licenses.

However, that could change and the Section 115 license could become a useful tool for delivering music in a digital environment, if changes can be made to transform the license from a historical relic into a viable mechanism for licensing music on-line. In order for Section 115 to be workable for songwriters, music publishers, online music companies, and consumers, Congress must take action and make the necessary structural changes.

The Need for reform

Recognizing the importance of enabling legal music services to compete with illegal sources of on-line music, Congress has tried to update our laws to combat illegal sources of music on several occasions and the courts have expanded the theory of secondary liability expressly to cover activities that induce others to infringe.[1] Congress has also held oversight

[1] *MGM Studios, Inc. v. Grokster, Ltd.*, 243 F. Supp. 2d 1073 (C.D.Cal. 2003), aff'd, 380 F. 3d 1154 (9th Cir. 2004), cert. Granted, 545 U.S. 1032 (2004), vacated and remanded by, 545 U.S. 913 (2005).

hearings on how to make legal services more able to compete with illegal sources. A primary focus of Congressional inquiry has been the reform of Section 115.[2]

The need for reform became crystal clear during a hearing on March 11, 2004, before this Subcommittee.[3] Interested parties testified about the difficulties they have encountered in licensing the use of nondramatic musical works under the antiquated statutory scheme. They voiced complaints about the notice requirements, lack of clarity over what activities are covered by the license, which rights are implicated, and problems with use of a per-unit penny-rate royalty. A key issue identified by the music services involved the use of business models, e.g., streaming, that required the user to pay one agent for the publishers and songwriters to clear the reproduction and distribution rights (often referred to as the mechanical right) and then to pay a second agent for the same copyright owners to clear the public performance right for use of the same musical works. While it was widely recognized that the performance right could be cleared easily with blanket performance licenses from the three performing rights societies, it became

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[2] *See Oversight Hearing on "Copyright Office Views on Music Licensing Reform": Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the House Comm. on the Judiciary*, 109th Cong. (2005)(statement of Marybeth Peters, Register of Copyrights) (available at http://www.copyright.gov/docs/regstat062105.html). *See also Music Licensing Reform: Hearing Before the Subcomm. On Intellectual Property of the Senate Comm. on the Judiciary*, 109th Cong. (2005) (statement of Marybeth Peters, Register of Copyrights) (available at http://www.copyright.gov/docs/regstat071205.html), *Section 115 Reform Act (SIRA) of 2006: Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the House Comm. on the Judiciary*, 109th Cong. (2005)(statement of Marybeth Peters, Register of Copyrights) (available at http://www.copyrigth.gov/doc/regstat051606.html).

[3] *Section 115 of the Copyright Act: In Need of an Update?: Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the House Comm. on the Judiciary*, 108th Cong. (2004)(statement of Marybeth Peters, Register of Copyrights) (available at http://www.copyright.gov/docs/regstat031104.html). The difficulties involved in licensing musical works have been apparent since before the hearing in 2004. For example, in December 2001, I testified before you on a report I had delivered to you pursuant to Section 104 of the Digital Millennium Copyright Act, Pub. L. 105-304 (1998), in which I addressed some of the issues involved in music licensing that you and I have been grappling with over the subsequent years. *Digital Millennium Copyright Act Section 104 Report: Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the House Comm. on the Judiciary*, 107th Cong. (2001)(statement of Marybeth Peters, Register of Copyrights) (available at http://www.copyright.gov/docs/regstat121201.html). *See also Digital Millennium Copyright Act Section 104 Report* (2001) (available at http://www.copyright.gov/reports/studies/dmca/dmca_study.html).

apparent that no similar mechanism existed to clear the reproduction and distribution rights with equal ease.

Recognizing the need to explore these issues further, the leadership of this Committee asked me in July of 2004 to bring together representatives of the National Music Publishers' Association, Inc. ("NMPA") and its subsidiary The Harry Fox Agency, Inc. ("HFA"); the Recording Industry Association of America ("RIAA"), and the Digital Music Association ("DiMA") to see if agreement could be reached on a general framework of reform. Although the parties willingly participated and agreed to consider a blanket licensing approach, reaching consensus on the details proved impossible.

Subsequently, at the request of this Subcommittee, I prepared model legislation for reform of Section 115 that was centered around the creation of Music Rights Organizations ("MROs"). The hallmark of the proposal was the creation of licensing organizations that would offer blanket licenses covering both the mechanical and the performance rights needed to transmit digitally the musical works in the MRO's repertoire. Essentially, the MROs would offer "one-stop shopping" to the extent the licensee could get a single license covering a multitude of musical works even when the performance, reproduction and distribution all take place in the course of a single transmission.

The proposal, however, was not embraced by the affected parties. Instead, they returned to the drawing board and, in late 2005 and early 2006, they participated in a broader series of discussions on how to reform Section 115 hosted by the Subcommittee. From these discussions, a number of issues were resolved through various compromises that resulted in the introduction of H.R. 5553, the Section 115 Reform Act of 2006 ("SIRA") on June 8, 2006 by Mr. Smith and Mr. Berman. This legislation was marked up in this Subcommittee on the same date, and was

incorporated into a larger package of bills that was originally scheduled for full Committee markup last September.

Key Issues

In reviewing the possible options for reform of Section 115, there are four key issues that must be addressed in any legislation: 1) Scope of the license and clarification of rights; 2) Collection and distribution of royalty fees; 3) Efficiency of the licensing process; and 4) Rate setting procedures.

1. Scope of the Statutory License and Clarification of the rights

One of the major frustrations facing online music services today, and what I believe to be the most important policy issue that Congress must address, is the lack of clarity regarding which licenses are required for the transmission of music. Let me explain why I believe this to be the case.

Today consumers can listen to music streamed over the Internet or, rather than purchase a physical CD, they can order a digital copy from iTunes or a similar service for about 99¢. While a stream of music can be viewed primarily as a public performance, it is necessary to make server, cache, and other intermediate copies[4] of the sound recording and the musical work[5] embodied therein in order to facilitate the delivery of the performance. Similarly, the purchase of a digital phonorecord delivery of the same recording can be viewed primarily as a mere reproduction and delivery of a copy for private use, but this is not a settled area of the law.

[4] Technically, these are phonorecords rather than copies, *see* 17 U. S.C. § 101 (definitions of "copies" and "phonorecords"), but terms such as "buffer copy" and "server copy" are commonly used to refer to these reproductions.

[5] A "musical work" refers to a composition (e.g., the specification of notes and lyrics, such as a written page of music) while a "sound recording" refers to the fixation of a particular performance of a composition such as on an audio compact disc.

Publishers maintain that any transmission of a sound recording involves a public performance of the musical work embodied therein and the issue is now being considered by the rate court in the Southern District of New York.

But why is this important? If both the mechanical and the performance rights are implicated and the money goes to the same copyright holders, why not make a single payment to one agent for the digital transmission of the work? The answer is that the current music licensing structure does not allow for that option. In the United States, the performance right is licensed by three performing rights organizations: the American Society of Composers, Authors and Publishers ("ASCAP"), Broadcast Music, Inc. ("BMI"), and SESAC, Inc. Collectively, the repertoires administered by these three performing rights organizations account for virtually all musical compositions in the marketplace. However, consent decrees have limited some of these organizations abilities to license both the performance and the mechanical rights. As a result, the mechanical right is licensed under the provisions of the Section 115 statutory license, or directly through the publisher or an agent acting on behalf of the publisher. The largest agent acting in this capacity is The Harry Fox Agency, which has authority to issue mechanical licenses for more than 1.6 million songs on behalf of more than 31,000 publishers worldwide.[6]

The reality of digital transmissions, though, is that in many situations today it is difficult to determine which rights are implicated, and to what extent. Hence, there is a need to clarify the rights involved with different types of digital transmissions in order to determine whether a royalty is owed and at what rate. For example, do the intermediate copies made by routers and computer caches during the delivery of a work to a consumer qualify as "digital phonorecord

[6] HFA Reports 2006 Collections, Susan Butler, N.Y. Billboard Magazine Online (March 16, 2007).

deliveries?" Moreover, would such copies be compensable under a Section 115 license or should such copies be exempted under the law because they have no inherent value except to facilitate the already-licensed transmission of a public performance of a musical work? Finally, clarification of whether the delivery of a reproduction of a musical work for use by the consumer is also a public performance is needed to determine whether a separate license fee must be paid to the performing rights organizations.

As we have seen, licensors have rarely turned down the opportunity in the digital age to seek royalties, even when the basis for their requests is weak at best. Online music companies rightly complain that they need certainty over what rights are implicated and what royalties are payable so that they can operate without fear of being sued for copyright infringement. Although the term "rights clarity" may sound obscure, the issue is at the heart of any music licensing reform effort. Moreover, if the statutory license is to be functional, it is important to identify which reproductions are covered by a Section 115 license and to insure that all necessary reproductions for making a digital transmission can be easily licensed either under Section 115 or under a separate statutory license.

Yet today, music services have forged ahead and have begun offering legitimate music services to everyone's benefit even though the rights questions remain unresolved. In doing so, they are exposed to demands from the agents for both the mechanical and the performance rights and are threatened with lawsuits if they do not acquiesce. And, in fact, music services and the performing rights organizations are engaged in active litigation in the Southern District of New York. In that case, the parties are seeking a determination as to whether a digital phonorecord delivery is also a public performance. Common sense and sound policy counsel that the transmission of a reproduction of a musical work without any rendering of the recording at the

time of delivery should implicate only the reproduction and distribution rights. But the law is ambiguous on this point and the parties are at odds, so they turn to the courts for an answer.

In the meantime, music services operate under the threat of further suits and without any guidance on how to proceed. A far simpler and more direct approach to the problem would be for Congress to amend the law to clarify which rights are implicated in the digital transmission of a musical work. For example, it may well be advisable to amend the law to clarify what constitutes a public performance in the context of digital transmissions, or to provide that when a digital transmission is predominantly a public performance, any reproductions made in the course of transmitting that performance will not give rise to liability. By the same token, it may well be advisable to clarify that when a digital transmission results in the receipt of a copy that may be performed on more than one occasion after its receipt, there is no liability for any public performance that might be embodied in the transmission (because the transmission is a reproduction and distribution for which the copyright owner is being compensated). Alternatively, you should consider creating a licensing structure that covers all the rights involved in the digital transmission of music. While either solution would bring stability to the marketplace and set the stage for the development of more and varied on-line music services, it is critical that the question be addressed as an initial matter before attempting to resolve the other issues associated with music licensing.

2. Collection and Distribution of Royalties

Under the current Section 115 license, licensees must serve notice upon and pay each copyright owner or his or her designated agent directly for the use of his or her musical works. The need for each licensee to identify, serve notice, and pay the individual copyright owners creates major inefficiencies for the licensee especially when the identity of the copyright owner

is not readily known or ascertainable. One way to eliminate these inefficiencies is to specify one or perhaps more agents whose responsibility it would be to collect and distribute royalties. Such a system has already been established under the Section 114 statutory license. Royalties under the Section 114 license, which are owed to the copyright owners of sound recordings rather than that of musical works, are paid to SoundExchange, an agent appointed by the rate setting body to receive the royalties and then disburse them to the copyright owners.

Adoption of this collecting model would, however, give rise to important administrative issues that would need to be addressed. First is the question of administrative costs and what these costs cover. Ideally, an agent should be allowed to deduct only those costs associated with the collection and distribution functions accorded to it by law. Such organizations should not have wide discretion to tap the royalty pools to fund lobbying efforts, lawsuits not directly associated with the collection and distribution of the royalties or tangential licensing practices not associated with the statutory license. Second, the law should include authority for the appointing body to oversee the activities of the agent, including rulemaking authority to establish regulations governing the type and amount of information that must be submitted to determine the extent of use of specific musical works. Third, the law should include guidance on how the royalties will be distributed among the beneficiaries. The agent should not have discretion on how to allocate the funds to copyright owners who have not actively chosen the agent to represent their interests. And finally, provision should be made to govern the retention and use of royalties for works of copyright owners who cannot be identified or located and to insure transparency of all activities.

Should Congress choose to adopt such a licensing scheme, interested parties will have more to say about the organizational structure of the governing board. While this is indeed an

important issue, suffice it to say that the law should require the governing body to include representatives of all stakeholders – that is, music publisherse and songwriters -- in such proportions that a reasonable balance can be maintained among the varied interests of the respective stakeholders.

3. Efficiency of the licensing process

In addition to delineating the rights involved in a digital transmission, creation of a blanket licensing scheme predicated on the filing of a single notice would be a workable model to create efficiencies for all stakeholders. Licensees would be able to minimize their transactions to clear the rights to use the music, copyright owners would receive full compensation for use of their works, and consumers would benefit from the development of new and robust legitimate music services that offer not only current hits but virtually any music that consumers want. I have suggested this approach on a number of occasions and still believe that it is an approach worth pursuing. Users have also suggested amending Section 115 to allow for quarterly payment of royalty fees in place of the current requirement to make monthly payments as a way to streamline the payment process. Given that most licensees in the marketplace appear to operate on a quarterly basis, a simple change to the accounting period would be make the statutory license more workable for those who cannot negotiate licenses in the marketplace. Undoubtedly there are other measures that can be adopted to minimize the costs associated with the administration of a statutory license and careful consideration should be given to any such proposal.

4. Rate setting procedures

Currently, rates set pursuant to Section 115 reflect a unit price for each reproduction and distribution, a pricing structure which suits the making of physical phonorecords. However, it

should be noted that certain music services offer a variety of options for enjoying music at a fixed monthly subscription rate, rather than charging a per stream or per download rate. Such services have stated that it will have difficulty in utilizing a statutory license that requires payment on a per unit rate and would prefer a percentage of revenue option.

While I have testified that the current Section 115 does not specifically require a per unit rate, parties have expressed concern that the rate setting body would continue to set a per unit rate as has been the practice throughout the history of the license. Consequently, it may be advisable to adopt amendments that would clarify that the rate setting body has the flexibility to set a schedule of rates depending upon the services offered by the business and the manner in which it prices its offerings, while ensuring that copyright owners are fairly compensated. In any event, authority to set rates for a modified Section 115 license should remain with the Copyright Royalty Judges, the entity created by Congress to establish rates and terms for the statutory licenses in the copyright law, and they should have some discretion to establish interim rates when new services become operational.

Legislative Options

The fundamental question is how to structure an effective and efficient licensing system. First, because there are inherent difficulties in crafting an entirely new licensing system, you should start by asking what is the minimal amount that needs to be done to alleviate the problems that face the music services under the current licensing structure and focus on making these changes. No doubt interested parties will use this opportunity to approach this Subcommittee and ask that it include a number of issues marginally related to the reform of Section 115. That appears to have been the case last year with respect to the Section 115 Reform Act. However, I

would urge this Subcommittee to focus on a narrow bill that addresses only the most important core issues. Consideration of other issues will only delay this important reform effort.

To reach this objective, I suggest two substantively different options: either create a Section 114 style blanket license or provide for wholesale sublicensing with a safe harbor provision for the sublicensors. Both approaches would create a workable licensing system that would allow music services to make digital transmissions of all available musical works. The first, however, requires a substantial restructuring of the Section 115 license whereas the second sublicensing option requires only minimal modifications to achieve its objective.

Option 1: A Section 114 style licensing system for digital transmissions

Section 115 provides a statutory license to utilize a nondramatic musical work to make and distribute phonorecords of sound recordings, but it does so on a song-by-song basis. Section 114, on the other hand, offers a blanket license covering the public performance right for sound recordings embodied in digital transmissions. Moreover, the Section 114 license is simpler to administer. It requires the filing of a single notice of use with the Copyright Office, and it authorizes the Copyright Royalty Judges ("CRJs") to set rates and terms of payment for use of the license, one of which is the designation of an agent to collect and distribute royalty fees. Rights owners, artists, and online companies have been supportive of this model since the agent designated by the CRJs, SoundExchange, strives to identify and pay all rightholders, and it is my understanding that its actions are generally regarded as transparent.

The problems associated with clearing the mechanical rights for musical works are fundamentally the same as those associated with clearing the performance rights for sound recordings. Hence, adoption of a Section 114 style license for Section 115 would solve most of the difficulties associated with clearing the rights to make and distribute the musical works

needed to facilitate a digital transmission or to make a digital phonorecord delivery. It would provide one-stop shopping to the music services both for the license and for the payment of the royalty fees. In addition, it would eliminate uncertainty with respect to the rates that apply to the use of music, provided that the license allows the CRJs to set rates for new business models as they emerge. The system would also offer substantial advantages to the rightsholders. Under a blanket license system, there are economies of scale that reduce the administrative costs associated with the collection and distribution of the royalties. Moreover, a blanket license increases the possibility that a creator's works will be used because the works are readily available and no special effort is required to locate the rights holder and clear the license.

Option 2: Sublicensing

Currently, record labels may sublicense the mechanical rights to musical works under a privately negotiated license, provided that it is a term of the license, or apparently through Section 115.[7] It appears that this sublicensing can work efficiently since it conveys all of the rights necessary for download services to operate legally. Moreover, record companies have presumably cleared the rights to use the underlying musical work in their sound recordings either through private licenses or use of Section 115. For this reason, it makes sense for music services to look to the record companies to clear the rights to use both the sound recording and the musical work embodied therein.

[7] *See* 17 U.S.C. § 115(c)(3)(I) and S. Rep. 104-128 at 43 (1995). The Senate report language makes clear that the purpose of this provision was to allow record companies to sublicense the mechanical rights. Specifically, it states that "[t]he changes to S. 227 are intended to allow record companies to license not only there own rights, but also, if they choose to do so, the rights of writers and music publishers to authorize digital phonorecord deliveries. If a record company grants a digital transmission service a license under both the record company's rights in a sound recording and the musical work copyright owner's rights, the record company may be liable to the extent determined in accordance with applicable law."

Record companies, however, have been unwilling to sublicense all music services because of the exposure they assume under such arrangements. Record companies are concerned that should a sublicensee fail to make timely payments for use of a musical work, the record company may be responsible for those payments. Nevertheless, sublicensing is an efficient way for online music services to obtain all the rights needed to make and distribute phonorecords in today's digital marketplace and some thought should be given to creating incentives for the record companies to increase their willingness to sublicense more services. For example, the sublicensing provision could be amended to create a safe harbor for those companies that sublicense the mechanical rights to a digital music service and the safe harbor should cover sublicenses negotiated in the marketplace as well as those obtained under Section 115. Under such a provision, which would require minimal amendments to existing law, record companies would be responsible for clearing the rights and administering the sublicense, including the collection and distribution of the royalties for the reproduction and distribution of the musical works. However, the record companies would not be legally responsible to copyright owners in the event of a music service's failure to make the required payments. Rather, the music service would retain responsibility for making the appropriate royalty payments in a timely manner and would be the subject of any infringement action arising from an uncompensated use.

Should such an approach be considered, the law would also have to impose certain requirements upon the record company to govern whether (and if so, to what extent) record companies would be permitted to make any deductions for administrative costs involved in sublicensing, and whether the royalties for the statutory license should reflect those costs so that they are borne by the licensees rather than the copyright owners or the record companies.

Each of these two options could resolve one of the two key problems I have identified with music licensing today: the difficulty online music services have in clearing the rights to very very large numbers of musical works in a system which currently requires licensing on a work-by-work basis. However, neither option addresses the other key problem: the sometimes apparently duplicative claims by two different agents of the same copyright owner – that two different licenses–one for public performance and one for reproduction and distribution–must be obtained in order to make a digital transmission of a musical work. I have already suggested some ways to resolve this problem, but further thought needs to be given to how to correct what has become a dysfunctional model for licensing music rights.

Other Options for Consideration

Over the past three years, I have offered and commented on a number of different options in addition to the two identified above, ranging from an outright repeal of Section 115 to the creation of a Music Rights Organization ("MRO") system which would combine all necessary rights for digital transmissions into a single blanket license issued by the entity authorized to license the public performance right of the musical work. However, there was an outcry from all sections of the music industry over the disruption they believed would occur under these two options. Nevertheless, I continue to believe an MRO option is worth considering. While music publishers have historically been well-served by the allocation of licensing authority to performance rights organizations for performance rights and to publishers and other agents for reproduction and distribution rights, that division of labor is archaic, inefficient and unfair (at least to licensee) in this age of digital transmission of music. As the lines between performance and distribution have become blurred, the opportunities for confusion and even abuse have become intolerable. It is noteworthy that music publishing is the only industry in which this has

become a problem, and the reason clearly is that music publishing is the only copyright industry in which such a division of licensing authority has predominated. However, I recognize that the political difficulties that the proposal faced in 2005 are likely to reappear should the Subcommittee revisit my MRO proposal.

Similarly, last year's Section 115 Reform Act tackled most of the difficult core issues associated with music licensing in today's world and offered workable answers, e.g., blanket licensing, coverage of the intermediate copies and hybrid offerings, a rate setting mechanism, and a means to administer the license with the authorization of the creation of designated agents.[8] Nevertheless, controversy over tangential issues and the details concerning implementation resulted in lack of consensus. For this reason, I have suggested a narrower and more focused approach to reforming Section 115 to deal only with the specific problems identified with the functionality of the license.

Regardless of which option you chose to pursue and whether it is one I have identified, Congress must solve the rights clarity issue in order for any legislation to succeed in creating a viable licensing structure for the music industry.

I look forward to working with this Subcommittee to see that Section 115 reform legislation is enacted into law as soon as possible. Thank you again for the opportunity to appear before you today.

[8] It did not, however, address claims by performance rights organizations that the performance right must be licensed by services that offer downloads of music.