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Sparing Internet Radio from the Real Threat of the Hypothetical Marketplace

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Sparing Internet Radio from the Real Threat of the Hypothetical Marketplace

*Mark D. Robertson**

TABLE OF CONTENTS

I.	THE COPYRIGHT ROYALTY BOARD’S APPLICATION OF THE WILLING BUYER/WILLING SELLER STANDARD AND THE RESULTING ROYALTY RATES.....	545
II.	THE SINGLE HYPOTHETICAL MARKETPLACE STANDARD LEADS TO DISRUPTIVE, COST-PROHIBITIVE ROYALTIES THAT UNDERMINE COPYRIGHT LAW’S PURPOSE.....	546
	<i>A. Webcasters May Be Victims of Their Own Success</i>	546
	<i>B. The New Royalty Rates Punish Authors of Creative Works and the Consuming Public</i>	547
III.	IN THE INTEREST OF ADVANCING COPYRIGHT POLICY, THE CRB MUST APPLY A STANDARD THAT EXPRESSLY ACCOUNTS FOR WEBCASTERS’ VARIED FINANCIAL REALITIES	548
	<i>A. Webcaster Revenue Substantially Attributable to Streaming of Copyrighted Works</i>	549
	<i>B. Webcasters’ Business Models and Commercial Motives</i>	549
	<i>C. Volume of Use of Copyrighted Works and the Scope of the Audience</i>	550
	<i>D. The Existing Statutory Factors</i>	550
	<i>E. Determining Royalty Rates for the Hypothetical Marketplaces in Accord with the Objectives of Copyright Law</i>	550
IV.	CONCLUSION.....	551

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In early 2007, the newly minted Copyright Royalty Board (CRB) handed down its first ruling, which set royalty rates for the digital performance of sound recordings.¹ The CRB's ruling ignited a firestorm of concern among Internet radio broadcasters (webcasters) and their listeners.² For some webcasters, the change to royalty rates constituted a 300–1200% increase over what was due under the previous scheme.³ This massive increase in royalties is attributable to the willing buyer/willing seller standard that the CRB is statutorily required to employ.⁴ This standard directs the CRB to construct one hypothetical marketplace and establish rates to which most buyers and sellers in the marketplace would agree.⁵

The resulting royalties will put many webcasters out of business and hinder the growth of a new, evolving industry.⁶ This effect runs counter to the purpose of copyright law, which is to encourage creative output for the public good by awarding temporary monopoly rights to those who produce creative works.⁷ For this reason, 17 U.S.C. § 114(f)(2)(B) must be amended to direct the CRB to apply the willing buyer/willing seller standard in a manner that adequately accounts for the varied financial realities facing webcasters and honors the overarching policy of copyright law.

This article argues for a standard that expressly directs the CRB to construct a hypothetical marketplace for each actual marketplace. Part I discusses the CRB's application of the willing buyer/willing seller standard. Part II analyzes the shortcomings of the current standard and proposes a revised standard that accounts for the economic realities of the webcasting industry while honoring the objectives of copyright law.

1. See Susan Butler, *Inside the Copyright Royalty Board: Chief Judge James Sledge Explains the CRB Process*, BILLBOARD, Oct. 20, 2007, at 28.

2. See Shaun Assael, *Online and on the Edge*, N.Y. TIMES, Sept. 23, 2007, at 2(32); Robert Levine, *A Fee Per Song Can Ruin Us, Internet Radio Companies Say*, N.Y. TIMES, Mar. 19, 2007, at C4.

3. Jay Inslee, Rep., *Lawmakers Hope to Prevent Demise of Internet Radio* (Apr. 26, 2007), http://www.house.gov/inslee/issues/technology/saving_internet_radio.html.

4. See 17 U.S.C. § 114(f)(2)(B) (2000 & Supp. V 2005); Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084, 24,086 (Copyright Royalty Bd. May 1, 2007) (final rule and order).

5. See 17 U.S.C. § 114(f)(2)(B); Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. at 24,086.

6. See Inslee, *supra* note 3.

7. See *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975); *Bond v. Blum*, 317 F.3d 385, 393 (4th Cir. 2003).

I. THE COPYRIGHT ROYALTY BOARD'S APPLICATION OF THE WILLING BUYER/WILLING SELLER STANDARD AND THE RESULTING ROYALTY RATES

When webcasters and copyright owners fail to agree on a negotiated royalty rate, § 114(f)(2)(B) directs the CRB to “establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.”⁸ The CRB must base “its decision on economic, competitive and programming information presented by the parties.”⁹ Additional considerations include the extent to which the copyrighted use will drive or interfere with record sales and the relative roles of the copyright licensor and licensee in bringing the copyrighted work to the public.¹⁰ The latter factors, while specifically set out in subsections of the statute, do not warrant greater weight.¹¹

After webcasters and copyright owners failed to negotiate binding rates, the CRB began its rate determination procedure.¹² To apply the willing buyer/willing seller standard, the CRB first constructed the hypothetical marketplace in which the “buyers” and “sellers” would arrive at a negotiated price for the “product.”¹³ The CRB defined the “buyers” as the services (webcasters) in a market where no compulsory license exists.¹⁴ The CRB defined “sellers” as record companies under no compulsion to sell their product and the “product” as a blanket license for the sellers’ complete repertoire.¹⁵ Notably, the CRB acknowledged there would be “significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors” in the hypothetical marketplace created.¹⁶ However, the ultimate resolution of these “significant” differences was the establishment of rates to which most buyers and sellers would agree.¹⁷ The CRB offered as justification for this homogenous treatment of the services’

8. 17 U.S.C. § 114(f)(2)(B).

9. *Id.*

10. *Id.* § 114(f)(2)(B)(i)–(ii).

11. Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084, 24,087 (Copyright Royalty Bd. May 1, 2007) (final rule and order).

12. *Id.* at 24,084.

13. *Id.* at 24,087.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

broad interests the observation that “the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant.”¹⁸

The result is a rate scheme that does not adequately account for the disparate, nuanced financial realities of an evolving industry. Instead, all webcasters are subject to the same per-performance royalty metric,¹⁹ and many will crumble under the weight of the rate increase.²⁰

II. THE SINGLE HYPOTHETICAL MARKETPLACE STANDARD LEADS TO DISRUPTIVE, COST-PROHIBITIVE ROYALTIES THAT UNDERMINE COPYRIGHT LAW’S PURPOSE

A. Webcasters May Be Victims of Their Own Success

A rate determination method that drives successful members of the effected class out of business patently runs counter to copyright law objectives.²¹ The effect will limit public access to creative works and stifle the creative spirit of an evolving industry. Pandora’s dilemma illustrates this point.

At the heart of Pandora’s webcasting service is the Music Genome Project.²² Company analysts break down songs to their foundational melodic, rhythmic, and harmonic components.²³ These characteristics are then entered into a database from which the company’s software creates personalized stations tailored to individual listeners by matching the characteristics of that listener’s musical preferences to its library of musical “elements.”²⁴ After years of fighting to create a profitable innovation-based business, Pandora is finally poised to turn a profit.²⁵ However, the new royalty rates will swallow seventy percent of Pandora’s income,²⁶ and it will become a victim of its own success.

18. *Id.* at 24,089 n.8.

19. *Id.* at 24,095.

20. *See* Levine, *supra* note 2.

21. *See* Press Release, SaveNetRadio Coalition, Proposal Would Decimate Internet Radio Industry (May 22, 2007), http://www.savenetradio.org/press_room/press_releases/070522-rejection.pdf.

22. Pandora, About Pandora, <http://pandora.com/corporate/index.shtml> (last visited Mar. 9, 2008).

23. William Brand, *Pandora.com in Oakland a Top Internet Radio Station*, INSIDE BAY AREA, Sept. 23, 2007, http://www.insidebayarea.com/search/ci_6977336.

24. *Id.*

25. *Id.*

26. *Id.*

It is not the purpose of copyright law to erase successful, innovative businesses from the commercial landscape. To the contrary, § 801(b)(1)(D) states that rates should be determined in a manner that “minimize[s] any disruptive impact on the structure of the industries involved.”²⁷ Plainly, the opposite has occurred here, and the willing buyer/willing seller standard failed to yield a hypothetical marketplace reflective of copyright law objectives.

B. The New Royalty Rates Punish Authors of Creative Works and the Consuming Public

The Internet provides artists with direct artist-to-consumer distribution in a way unavailable to most artists through traditional media outlets.²⁸ This is particularly true for musicians whose music does not fit within genres that dominate terrestrial radio, such as the band Milkshake.²⁹

Milkshake creates children’s music.³⁰ Where terrestrial radio play is not an option, the Internet provides the most democratic of channels of distribution for the band’s music.³¹ Lisa Mathews, a founding member of the band, put it this way: “When it comes to radio, there just aren’t many venues for Children’s Music via the traditional radio stations. Webcasters provide an outlet for kids and parents to hear new music—music that is pretty much ignored by traditional radio. For me the value is undeniable.”³²

As the royalty rate increase drives webcasters out of business, the industry will be reduced to fewer distribution options for artists like Milkshake. Webcasting, as a business, will be viable only for a limited class of webcasters. This, in turn, will constrict artists’ access to streaming opportunities and lead to a reduction in the amount and variety of creative works available to the public. Again, this runs

27. 17 U.S.C. § 801(b)(1)(D) (2000 & Supp. V 2005).

28. See Cortney Harding, *The Billboard Q&A: Trent Reznor & Saul Williams*, BILLBOARD, Nov. 10, 2007, at 23 (discussing Reznor’s decision to release his album online in a manner similar to Radiohead).

29. See Press Release, SaveNetRadio Coalition, Wyden-Brownback “Internet Radio Equality Act” Introduced in the Senate: Bipartisan Bill Would Save Internet Radio, (May 10, 2007), http://www.savenetradio.org/press_room/press_releases/070510-wyden-release.pdf.

30. *Id.*

31. See Inslee, *supra* note 3.

32. Press Release, SaveNetRadio Coalition, Wyden-Brownback “Internet Radio Equality Act” Introduced in the Senate, *supra* note 29 (quoting Lisa Mathews, member of the band Milkshake).

afoul of copyright's driving principle—to increase public access to creative works by rewarding authors with royalties.³³

Unfortunately, the willing buyer/willing seller standard yielded royalty rates that will punish successful webcasters,³⁴ limit industry growth,³⁵ and stifle new-media innovation such as the Music Genome Project.³⁶ Moreover, the result will harm those whom the rates are intended to benefit—copyright owners and the public.³⁷

III. IN THE INTEREST OF ADVANCING COPYRIGHT POLICY, THE CRB MUST APPLY A STANDARD THAT EXPRESSLY ACCOUNTS FOR WEBCASTERS' VARIED FINANCIAL REALITIES

The willing buyer/willing seller standard's primary deficiency is its failure to account for individualized financial realities in the marketplace adequately.³⁸ However, this deficiency would be cured if § 114(f)(2)(B) mandated construction of a hypothetical marketplace for each actual market, rather than clumsily corralling all webcasters into one less representative marketplace. Furthermore, delineating market participants in a manner consistent with the financial realities of the marketplace would bring the CRB's rate determination process in line with the fair income for copyright users that § 801(b)(1) calls for,³⁹ and minimize the "disruptive impact on the structure of the industries involved."⁴⁰

Section 114(f)(2)(B) should be amended to direct the CRB to construct as many hypothetical marketplaces as the financial realities of the actual marketplace support. To make this determination, the CRB should consider: (1) the revenue derived from the use of copyrighted works; (2) webcasters' individual business models, including their commercial motives; (3) the level at which individual webcasters reach the public; and (4) the volume of use of copyrighted works. Additionally, the two statutory factors set forth in § 114(f)(2)(B)—whether the use of the copyrighted work stimulates or

33. See *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975).

34. See *Brand*, *supra* note 23.

35. See Press Release, SaveNetRadio Coalition, Proposal Would Decimate Internet Radio Industry, *supra* note 21.

36. See *Brand*, *supra* note 23.

37. See Press Release, SaveNetRadio. Coalition, Wyden-Brownback "Internet Radio Equality Act" Introduced in the Senate, *supra* note 29.

38. See Internet Radio Equality Act, H.R. 2060, 110th Cong. (2007); Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084 (Copyright Royalty Bd. May 1, 2007) (final rule and order).

39. See 17 U.S.C. § 801(b)(1)(B) (2000 & Supp. V 2005).

40. *Id.* § 801(b)(1)(D).

hinders sale of the work, and the relative roles of the copyright owner and user in terms of risk, creative and technological contribution, and investment⁴¹—should be analyzed in conjunction with the previous four factors. These six factors certainly will overlap, and none should be determinative. The CRB should analyze each factor in the context of the others and weight the factors on a case-by-case basis as the CRB deems appropriate.

A. Webcaster Revenue Substantially Attributable to Streaming of Copyrighted Works

Webcasters primarily generate revenue through some combination of subscriptions,⁴² donations,⁴³ and advertising sales.⁴⁴ The CRB must determine to what extent a webcaster's revenue is substantially attributable to the streaming of copyrighted works. In the simplest of cases, webcasters like Atlantic Sound Factory, operated by one person as a hobby, derive revenue only from donations.⁴⁵ These donations are substantially attributable to the streaming service; however, as mentioned below, the profit motive is lacking.⁴⁶ Clearly, as a webcaster's revenue streams increase, the attribution of revenue to the use of copyrighted works will become more sophisticated. For example, Yahoo! is a publicly traded company tallying revenue in the billions of dollars, and Internet streaming constitutes only a portion of that revenue.⁴⁷

B. Webcasters' Business Models and Commercial Motives

This factor would require the CRB to inquire into the webcasters' fundamental commercial purpose. To make this determination, the CRB should consider the business's organizational

41. 17 U.S.C. § 114(f)(2)(B)(i)–(ii) (2000 & Supp. V 2005).

42. See Live365.com, VIP Membership Agreement, <https://store.live365.com/orders/orderform-listen.live> (follow "Membership Agreement" hyperlink) (last visited Mar. 9, 2008) (stating Live365.com will remove all advertisements from use of the service for paid VIP Members).

43. See Assael, *supra* note 2.

44. See Miguel Helft, *AOL Moving To Increase Revenue It Gets from Search Ads*, N.Y. TIMES, Apr. 7, 2007, at C2 (discussing AOL's efforts to increase advertising revenue to off-set its decision to waive subscription fees for many services and offer them for free).

45. See Assael, *supra* note 2.

46. *Id.*

47. See Press Release, Yahoo!, Yahoo! Reports Third Quarter 2007 Financial Results (Oct. 16, 2007), http://files.shareholder.com/downloads/YHOO/256133812x0x137473/fa47ff82-92f7-448f-8e28-2a66f8abd5df/YHOO_Q3FY07PRFfinal.pdf.

structures, its commercial motive, whether the business offers other services, the manner in which revenue is generated, and any other relevant considerations. At its core, this factor probes whether the company seeks to profit from the use of copyrighted works.

C. Volume of Use of Copyrighted Works and the Scope of the Audience

As an audience is a prerequisite to use of copyrighted works in this context, these two factors are linked. Together they provide a safeguard for copyright owners. The analysis here would focus on the number of copyrighted works a webcaster streams and the number of listeners that utilize a particular webcaster's streaming service.

A high volume of use of copyrighted works may suggest a significant reliance on streaming as a revenue-generating service. As a webcaster's reliance on the use of copyrighted works for revenue increases, the potential for unfair exploitation rises. In this way, these factors will further inform the CRB's analysis of the webcaster revenue and business model factors. Overall, the volume of use and audience scope factors will favor an equitable balance by precluding large webcasters from availing themselves of rates established for a hypothetical marketplace designed for lower volume webcasters.

D. The Existing Statutory Factors

Finally, the CRB should consider the two statutory factors set forth in § 114(f)(2)(B). First, § 114(f)(2)(B)(i) identifies as a relevant consideration whether streaming will hinder or enhance copyright owners' other revenue sources.⁴⁸ Second, the CRB should consider the § 114(f)(2)(B)(ii) factor: the relative share of the risk, capital investment, cost, and creative and technological contribution of the copyright owner versus the user.⁴⁹ In this analysis, technological innovations akin to the Music Genome Project would warrant consideration.⁵⁰

E. Determining Royalty Rates for the Hypothetical Marketplaces in Accord with the Objectives of Copyright Law

After analyzing the factors set forth above, the CRB should establish the appropriate number of hypothetical marketplaces and

48. 17 U.S.C. § 114(f)(2)(B)(i) (2000 & Supp. V 2005).

49. *Id.* § 114(f)(2)(B)(ii).

50. *See* Pandora, About Pandora, *supra* note 22.

classify webcasters accordingly. At this point, the primary deficiency of the current standard would be cured, and the CRB would create, for each hypothetical market, a rate scheme that the relevant market participants would arrive at on the open market. It is not the purpose of the proposed standard to influence what form the resulting royalty scheme takes. Rather, the extent of the proposed standard's control over the remainder of the process is only to require that the rates be arrived at in accord with, and be reflective of, the objectives set forth in § 801(b)(1)—the CRB must seek a fair return for copyright owners, seek a fair income for copyright users, maximize the public's access, and minimize the effect on the industry.

IV. CONCLUSION

The current manifestation of the willing buyer/willing seller standard has the Internet radio industry operating under the threat of a debilitating royalty increase.⁵¹ This poses a serious risk to the viability of webcasting as an industry, which in turn will decrease public access to creative works and constrict avenues of exposure and royalty revenue for copyright owners. These results are contrary to the purpose of copyright law.⁵²

To bring the royalties in line with this purpose, § 114(f)(2)(B) must be amended to direct the CRB to establish as many hypothetical marketplaces as the financial realities of the actual market dictate. Additionally, the statute should require the CRB to determine the appropriate nature and quantity of hypothetical marketplaces by analyzing the six factors discussed above.

Amending the standard in this way would result in a royalty scheme reflective of copyright law objectives by minimizing the disruptive impact on Internet radio's evolution while enabling a fair return for copyright owners and a fair income for copyright users.⁵³ Similarly, and perhaps most importantly, the public would continue to benefit as diverse webcasters, such as Atlantic Sound Factory and Pandora, continue to give form to Internet radio as an emerging engine of access to creative works.

51. See Inslee, *supra* note 3.

52. See *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975); *Bond v. Blum*, 317 F.3d 385, 393 (4th Cir. 2003).

53. See 17 U.S.C. § 801(b)(1) (2000 & Supp. V 2005).

