

**DIGITAL MUSIC LICENSING AND SECTION 115
OF THE COPYRIGHT ACT**

HEARING
BEFORE THE
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS
FIRST SESSION

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CONTENTS

MARCH 8, 2005

OPENING STATEMENT

	Page
The Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Chairman, Subcommittee on Courts, the Internet, and Intellectual Property	1
The Honorable Howard L. Berman, a Representative in Congress from the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property	2
The Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan	3

WITNESSES

Mr. Wood Newton, Nashville Songwriters Association, International	
Oral Testimony	5
Prepared Statement	7
Mr. David Mark Israelite, President and Chief Executive Officer, National Music Publishers' Association	
Oral Testimony	9
Prepared Statement	10
Mr. Larry Kenswil, President, e-Labs, Universal Music Group	
Oral Testimony	13
Prepared Statement	15
Mr. Jonathan Potter, Executive Director, Digital Media Association (DiMA)	
Oral Testimony	19
Prepared Statement	21

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Prepared Statement of the Honorable Howard Berman, a Representative in Congress From the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property	37
Letter from the The Register of the Copyrights of the United States of America to Representatives Sensenbrenner, Conyers, Smith and Berman	39

DIGITAL MUSIC LICENSING AND SECTION 115 OF THE COPYRIGHT ACT

TUESDAY, MARCH 8, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 4:40 p.m., in Room 2141, Rayburn House Office Building, Hon. Lamar Smith (Chair of the Subcommittee) presiding.

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will come to order. I am going to recognize myself for an opening statement, then the Ranking Member, then, we will look forward to hearing from our witnesses today.

Today, this Subcommittee begins updating compulsory music licenses, focusing on section 115, mechanical licenses. Over the past few years, the growth in the online music business has been phenomenal, demonstrating the strong demand by consumers for legal music. Last year, the iPod had record sales. Music subscription services are increasingly popular. Digital music not only has a future in the music business; it is the future.

Many businesses and the Register of Copyrights have stated that existing law does not accommodate these new business models. Outdated laws written for the piano roll era have hindered and will continue to hinder the growth rate for digital music services. Last March, this Subcommittee held an initial oversight hearing on section 115 in which three of the groups testifying today were represented. Since that hearing, hundreds of millions of digital music downloads have occurred. However, the overwhelming success of one company does not necessarily mean that there are no problems with the law. The solitary success of one company is an indication to some that the digital music market is tilted toward one entity, raising further questions.

The Copyright Office hosted several meetings last fall to identify the problems with existing law and what arguments, if any, if any could be reached to address these problems. A copy of the Register's response, dated September 17, 2004, is available on the testimony table. It appears that there was agreement on what the issues are but little to no agreement on what the solutions are. It is my intent to look into section 115 and other statutes to determine what music license statutes need to be modernized, and I have several goals in mind.

And I might say we eventually might take up not only section 115 but also 112 and 114. The several goals I have in mind are these: first, artists deserve to receive fair compensation. Second, consumers need to know what they are paying for and what restrictions, if any, exist on their use of digital music. Third, businesses need certainty regarding their rights and responsibilities under the law so they can continue to innovate and create new products and business models. Finally, where contractual or royalty disputes arise, there should be a process to settle them quickly and equitably.

Some of the policy issues raised so far involve royalties related to multisession discs, 30-second samples and server copies, the design and operation of a blanket mechanical license, what new or existing organization should operate such a blanket mechanical licensing system, the end of controlled composition clauses.

This is not an exclusive list by any means, and this Subcommittee will undertake a review of all of the issues that require legislative attention. I expect in the months ahead that this Subcommittee will hold additional hearings on related issues such as digital music interoperability and oversight hearings of the existing performing rights organizations to determine how they have functioned. While many have viewed SoundExchange and its royalty collection operations as a success, local television stations continue to battle SESAC over royalties for the music contained in reruns.

I encourage all parties interested in music licensing to promptly put on the record their interests and concerns. Mechanical licensing reform is necessary, and I look forward to beginning that process this afternoon. Also, I would like to invite interested parties to comment in writing on a list of issues that I will identify shortly. In other words, we are serious about legislation.

That concludes my opening statement, and the gentleman from California, Mr. Berman, is recognized for his.

Mr. BERMAN. Well, thank you very much, Mr. Chairman, both for scheduling the hearing on section 115, and I have to agree with you that legislation, I think probably needs to be the end result of what we're doing here. It's been a year since the last hearing on this issue, and I think it is important to assess developments that have occurred in the digital music arena and what strides the parties have made to address the concerns expressed last year.

A primary concern for all those making and distributing music is the threat of piracy. Piracy threatens to harm an industry that is responsible for providing many jobs in my district and throughout the country, from the recording artists, to the backup singers, to sound engineers, musicians, songwriters, lyricists and all the businesses that support these talents.

There are things we can do to restrict piracy. Technology can provide digital rights management technologies. We can strengthen civil and criminal copyright laws. We can address the liabilities of those who are involved in developing peer-to-peer networks which exist primarily for infringing purposes. We can incentivize prosecution of egregious offenders. We can work on our trade laws and on foreign counterfeiting.

All these mechanisms are important aspects in battling piracy, but part of all of this has to be to provide music in a fashion, in

the way people want it, digital and online in any format to anyplace someone wants. I have come to the conclusion that aspects of the section 115 license hinder the development of new services. This, in turn, makes theft of music more attractive and then denies all segments of the music industry and those facilitating legitimate services their rightful compensation.

Last year, the National Music Publishers Association described this issue as the flavor of the month. It has really become the flavor of the next decade. The Washington Post reported that in the next decade, the CD likely would be surpassed as a format of choice. Replacing it will not be a new physical format but a data file. The success of Apple iTunes and the launch of Napster subscription service may not speak to the death of the physical format, but it definitely speaks to its decline. In helping to facilitate movement from the use of CDs to the digital age, we need to ask how the section 115 license would best be reformed.

The last time we addressed this issue, we were at least united on a core principle, the prevention of piracy. Each party here has a vested interest in preventing the theft of intellectual property that continues to this day. Each party also has an interest in being available to deliver as much music as possible to maximize revenues or royalties. However, other than piracy and the need to provide access to music, the parties have presented divergent views about change to section 115. Furthermore, subsequent digital music licensing hearings on the application of the section 114 license elicited many differing opinions as well.

I'm going to skip over some of the history here and basically go to my thought. We have a good example of private parties resolving a way to deal with physical reproduction issues, and that example is the EMI Music Publishing and Sony-BMG deal last year. In that vein, I'd like to throw out an idea that all of the interested parties, including the performance rights organizations, come together and negotiate changes to section 115 that would facilitate both the copyright and consumer interests, and if by a time certain, the community has not been able to come to an agreement, then, working closely with the Copyright Office, we would in a bipartisan way consider creating our own changes.

The focus needs to remain on providing rightful compensation to those who provide the music, and facilitating the performance and distribution of music in the ways that consumers want. Our efforts must continue to focus on preventing piracy and help facilitate legitimate digital online services. I look forward to hearing from the witnesses about how changes to section 115 would help in achieving our goal.

Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Berman.

I would like to recognize the presence of the Ranking Member of the Judiciary Committee, who is here today, and ask him if he has any comments he would like to make.

Mr. CONYERS. Just a few, Mr. Chairman, and I thank you for inviting me to participate in this discussion. I'm impressed with both your statements, particularly my colleague, Mr. Berman. He didn't say anything that sent me off my chair, not that he does regularly, but I find his statement very good.

Within a few years, copyright holders have gone from being victims to embracing the Internet market with their works. Copyright owners, including recording companies, songwriters, responded to consumer demands by working with Internet sites like iTunes to provide digital content to consumers. In essence, they're taking advantage of the very technology that threatens their livelihood.

Despite the turnaround, though, we're still hearing that music is still not widely available online and that the reason is the difficulty in getting licenses from music publishers over the musical compositions. Companies seeking the licenses claim the procedures are outdated and the laws not clear on which online music services require the licenses. There are even suggestions that Congress should alter the licensing scheme into a blanket license so that the users of compositions pay royalties into a pool, and the Copyright Office divvy up the money amongst publishers.

But this Member at this point in time would be concerned with proposals that limit the ability of songwriters and publishers to negotiate licenses for their compositions. Despite the fact that they actually create and write the songs that we listen to, songwriters and publishers receive what appear to be the lowest royalties in the music industry. Publishers should not be penalized for protecting their property rights the same way every other industry has done.

The record companies have sued individuals for copyright infringement, and file sharing companies have sued record companies and others for copyright violations. So simple economics dictate that it is in the publishers' self-interest to license their work to anyone who can protect it from piracy and who can pay the royalties, so simply put, publishers and songwriters have no incentive to keep music off the Internet, but limiting their rights even further could create disincentives.

I am concerned about one question that's going to, I hope, be dealt with: if the blanket license and designated agent proposals are established, do you mind dealing directly with publishers instead of going through the record labels? DiMA pays royalties to RIAA and probably would be fine with paying publishers directly if all the other issues are resolved, and so, I welcome the witnesses and look forward to this interesting discussion.

Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Conyers.

Our first witness is Wood Newton. Born and raised in Hampton, Arkansas, population 1,600, his songs echo his roots. Wood is a plain-spoken musical spokesman whose compositions reflect the heart and soul of typical Americans. Wood graduated from the University of Arkansas with a degree in business administration in 1970. Some of the other artists who have recorded Wood's songs include Anne Murray, Willie Nelson, Gary Stewart, B.J. Thomas, Rita Coolidge, and Marty Robbins.

In addition to his writing and production work, Wood is actively involved in songwriter advocacy, serving as a Washington, D.C. liaison for the Nashville Songwriters Association, International, with more than 100 chapters throughout the United States and abroad. Let me say to those who are in the room although Wood Newton has a written testimony, which he will deliver shortly, after we fin-

ish our hearing today, he is going to sing a song that is also very pertinent to the subject matter at hand, and in fact, the title of the song, I believe, is called article I, section 8, which you will appreciate is related to intellectual property. And so, when we finish, don't run out. Stay around. We're going to enjoy that song.

Our next witness, David Mark Israelite, is the newly appointed president and chief executive officer of the National Music Publishers Association. Founded in 1917, the National Music Publishers Association represents American music publishers and their songwriter partners. From 2001 through early 2005, Israelite served as deputy chief of staff and counselor to the Attorney General of the United States. In March 2004, the Attorney General appointed Israelite chair of the Department's Task Force on Intellectual Property. As chairman of the task force, Israelite led a team of higher-ranking officials in examining all aspects of how the Department of Justice handled intellectual property issues and implemented proposals developed by the task force.

Israelite earned his juris doctorate from the University of Missouri in 1994 and received an M.A. with a double major in political science and communications from William Jewell College in 1990.

Our third witness is Larry Kenswil, president of Universal E-Labs, a division of Vivendi Universal Music Group. E-Labs is dedicated to exploring, developing, and evolving global business and new technology strategies to expand the role of music in consumers' lives. Mr. Kenswil has headed E-Labs from its founding in 1999. Previously, he was UMG's executive vice-president, business and legal affairs.

Mr. Kenswil sits on the board of directors of the Recording Industry Association of America. Mr. Kenswil holds a B.A. from Cornell University, an M.S. from Boston University and a J.D. from Georgetown University.

Our final witness is Jonathan Potter, who is the executive director of the Digital Media Association. Today, DiMA represents the leading companies providing online audio and video content. Additionally, Mr. Potter was instrumental in creating the European Digital Media Association. Mr. Potter is a graduate of the New York University School of Law and the University of Rochester.

Welcome to you all. Without objection, your entire written testimony will be made a part of the record, and Mr. Newton, we will begin with you.

**TESTIMONY OF WOOD NEWTON, NASHVILLE SONGWRITERS
ASSOCIATION, INTERNATIONAL**

Mr. NEWTON. Mr. Chairman, Mr. Berman, and Subcommittee Members, I want to thank you all for this important opportunity to speak on behalf of all professional working songwriters in America.

To give you a little snapshot of what it's like to be a professional writer in this country, most of my friends that are not in the music business, they think it's easy. They think these songs just pop into my head, and I get them to an artist, and then, I wait at my mailbox until the millions roll in. But the truth is very different. Most of us in this business spend years and decades before we even have the courage to make the move to one of the major music centers

in America like Nashville or Los Angeles, New York, Detroit, and we risk our young lives to do that.

There are no guarantees, and as we say in Nashville, you've got to be present to win. It's really important. It would be nice if we could just stay home in the security of our family and friends and write these songs and send them to somebody that exploits them, but you've got to be present to win. We take that chance. And once we do get our big break, a lot of times, that is it. Over half of the songwriters who get a top five record never get another one.

I was on the plane ride up here, I was sitting next to a guy who's a Ph.D. in disease control. He works for the State of Tennessee. He is also a guitar picker. So after I recommended a good guitar teacher in Nashville, I asked him the question that I like to ask a lot of people: how much do you think a songwriter makes from each song that goes on a record? And he thought about it for awhile, and he came up with 25 cents.

Now, we would be really happy as songwriters and publishers if that were true, but as you know, the statutory rate is eight and a half cents. And to put that in terms, if you're lucky enough to get on a million-selling record which generates \$15 million at least in revenue for all of those people in that chain, if I co-write that song, and I don't have part of the publishing, my share of that million-performance platinum record is \$20,000. And you know what? If I'm in a publishing deal, then, I don't even see that, because it goes to pay back the money they've been paying me. If I'm very lucky to get a hit on the radio, the performance money can be really good, but last year, there were only 44 top-five country songs in country music, which is the format that most of my music plays in.

Even the very best of us have our good and lean years. I come from farm families, and I compare it to being like a small family farmer without any subsidies. It is really tough. I'll be honest: I was on the phone today talking to my banker, and I am very happy to tell you that he approved a loan for me to stay in business a little longer. So I am a small businessman, and I have had to do other things, like freelance photography and remodel houses and whatever I can to stay in business, and many of us are the same way. So we are truly America's smallest small businessmen.

I was honored to be part of a Grammy-winning album just a few weeks ago: 18 different artists and producers got together and did an album on the songs of Stephen Foster, America's first professional songwriter. So Stephen Foster is on a roll again, or he may be rolling in his grave, because he died with 38 cents in his pocket. He had some good and lean years, but he died with 38 cents in his pocket.

The startling fact is, and I want you to take note of this, is that America has lost more than half of its professional songwriters over the last decade due to the deregulation of radio and corporate mergers and piracy. I have witnessed many good songwriters just give up, and America is the loser in that scenario. If I had represented songwriters in 1909 when Congress formulated the structure of how composers are compensated, I would have asked those lawmakers to consider disclosure requirements on anyone who collects royalties on my behalf.

The system has become so complex, and it is almost impossible for an individual songwriter to ever get a full and accurate accounting of their precious royalty dollars and track those royalties to their source. Songwriter income passes through many hands, and no songwriter should ever have to make the hard decision whether to hire an attorney or an accountant and risk spending more money than they might be owed attempting to trace their payments or to have to perform an audit that would strain professional relationships. I do not believe the 60th Congress ever imagined that I would not have easy access to every record involving my payment history.

Songwriters waited from 1909 to 1978 to have that two-cents maximum wage raised. When you consider inflation, we are earning less today than we did a century ago. As a new payment structure emerges, Congress should favor a system that takes this into account and one that is flexible enough to allow for technology's evolution. If new costs are added to the collection of our royalties by the creation of a new designated collection agency, songwriters should at least be able to bear those costs.

And while we're talking about 100 years between pay raises, I can attest that there are two words that songwriters fear hearing, and that is controlled composition. The practice of asking a songwriter to accept a reduced rate on a song is fundamentally wrong. Controlled composition should end not just for digital music but across the board. After all, the entire music business is built on the back of the songwriter.

For almost a century—

Mr. SMITH. Mr. Newton, we're going to need to conclude your testimony.

Mr. NEWTON. Okay; I can do it real quick here. Thank you very much.

For almost a century, our lawmakers have been wise in preserving our compulsory license system, and generally, it is fair and offers songwriters protection. These new digital rights, there is no collective agency and no obligation to license whatsoever, and so, there is a lot of this up in the air. And we want to be at the table, our songwriters. We are represented well by the Nashville Songwriters Association and the Songwriters Guild of America.

Thank you for letting me speak today on behalf of America's professional songwriters, and I respectfully ask that these remarks be submitted for the record.

[The prepared statement of Mr. Newton follows:]

PREPARED STATEMENT OF WOOD NEWTON

Mr. Chairman, Mr. Berman and Subcommittee Members—

I want to thank you for allowing me this important opportunity to speak on behalf of every working songwriter in America.

First, let me offer a snapshot of what it really means to be a professional songwriter in this country.

Most people, even my own friends, have the mistaken impression that I just put a few words to some chords, take them to a star and go to my mailbox to collect millions of dollars. The truth is very different. Songwriters spend years perfecting their gift and their craft. We proceed, despite even our loved ones wondering why all we want to do is sit around and write songs. At some point in our lives we take a big risk, put everything we own in the car, and head to a city like Nashville, New York, Chicago, Seattle, Austin, Miami, Los Angeles or Detroit, where professional songwriters practice their craft. Even if we were a "big fish" in our little pond back

home—at least people thought we were really good because we were the only songwriter in town—we stop our car, ready to receive praise and hear our songs proclaimed to be “undeniable hits.”

Ten years later, working two part-time jobs with no insurance and accustomed to rejection, someone finally records one of our songs. But, it doesn't make it onto the album. Finally, one day we get our “big break.” It is a statistical fact that most songwriters who get a top five record NEVER get another one. But a few of us persist and get lucky. Every time someone purchases a CD containing my song, I receive 8.5 cents, which I share with my co-writer. Of course, we split that royalty again with the publisher of the song. If I am very lucky my song becomes a “single” and gets played on the radio, and I earn a performance royalty. Last year there were only 44 top five radio songs in country music.

Songwriters hope that through the course of their career they will have three or four good years. There are long dry spells in between, but we keep writing songs anyway. Throughout my nearly 30 years as a professional songwriter I have had four or five good runs that helped carry me through those lean times. I also remodeled houses, worked as a freelance photographer and in assorted other jobs. Songwriting is a profession where no matter how hard you work there is a constant reality that your last recorded song may be your last recorded song—ever.

Page 2

Please don't mistake me. I will always write songs. Regardless. I personally feel that being able to write songs professionally is a God-given privilege. Later, I am going to play a song I co-wrote with one of our founding fathers, James Madison. Our composition is titled “Article One, Section Eight.” Madison authored that section of the Constitution, which gives authors and composers the right to be compensated for their works.

My first job, as a “paperboy,” shares many characteristics with being a professional songwriter. I am my own secretary, accountant, mailroom and song-plugger. I am America's smallest small business.

Stephen Foster was America's first professional songwriter. He died with 38 cents in his pocket.

Sadly, he might not fare much better today. The startling fact is, and I beseech you to take note, America has lost more than HALF of its professional songwriters over the last decade. Due to the deregulation of radio, corporate mergers and piracy, I have witnessed many gifted composers just give up. And America is the loser.

Mr. Chairman, had I represented songwriters in 1909 when Congress formulated the structure of how composers are compensated, I would have asked those lawmakers to consider disclosure requirements on anyone who collects royalties on my behalf. The system has become so complex that it is almost impossible for an individual songwriter to ever get a full and accurate accounting of their precious royalty dollars and track those royalties to their source. Songwriter income passes through many hands, and no songwriter should ever have to make the hard decision whether to hire an attorney or accountant and risk spending more money than they might be owed attempting to trace their payments, or have to perform an audit that will strain professional relationships. I don't believe that the 60th Congress ever imagined that I would not have easy access to every record involving my payment history.

Songwriters waited from 1909 until 1978 to have their two-cent “maximum wage” raised. If you consider inflation, we are earning less today than we did a century ago. As a new payment structure emerges, Congress should favor a system that takes this into account, and one that is flexible enough to allow for technology's evolution. If new costs are added to the collection of our royalties by the creation of a new designated collection agent, songwriters should at least be able to bear those costs.

And while we are talking about 100 years between pay raises, I can attest that there are two words songwriters fear hearing: “controlled composition.” The practice of asking a songwriter to accept a reduced rate on a song is fundamentally wrong. Controlled composition should end, not just for digital music, but across the board. After all, the entire music industry is built on the back of the songwriter.

Page 3

For almost a century, our lawmakers have been wise in preserving the “Compulsory License” system. Generally, it is fair and offers songwriters protection. However, when it comes to the rights of reproduction and distribution for masters for interactive digital transmissions, there is no compulsory license, no collective agency, and no obligation to license whatsoever. Some record labels have negotiated licenses with subscription services that call for payment of 40% to 50% of their gross revenues for master rights. What is that going to leave the songwriter? It is MY song, yet I have not seen a penny from subscription services. In what other occupa-

tion could someone sell a product based on my creation without me first agreeing on the compensation scheme? Congress, in 1909, was concerned that the right to make mechanical reproductions of musical works might become a monopoly controlled by a single company. With that in mind, I do not believe their intent was to have such reproduction rights controlled by one facet of the industry.

Many of the parties involved in collecting my royalties are discussing these issues with the Nashville Songwriters Association International and the Songwriter's Guild of America. I understand that we need to let this process work. My purpose is not to assign blame. The system has just evolved this way. But as you consider changes to copyright law, now and in the future, please remember that it all begins with a song.

The title of my song today is "Article One, Section Eight." Its message is that, of all the parties involved in this important debate, only authors are mentioned in our Constitution. And our founding fathers gave the rights exclusively to the author!

Thank you for letting me speak today on behalf of America's professional songwriters. I respectfully ask that these remarks be submitted for the record.

Mr. SMITH. Okay; thank you, Mr. Newton.

Mr. Israelite.

TESTIMONY OF DAVID MARK ISRAELITE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL MUSIC PUBLISHERS' ASSOCIATION

Mr. ISRAELITE. Good afternoon, Mr. Chairman, Mr. Berman, Members of the Subcommittee. My name is David Israelite. I am the president and CEO of the National Music Publishers' Association, and I thank you for inviting me to testify today about digital music licensing and section 115.

While I am still in my first month of this new position, for the last year, as you mentioned, Mr. Chairman, I had the honor of serving as chairman of the Justice Department's Task Force on Intellectual Property, and in that position, I worked closely with this Committee and gained a profound understanding of the importance of protecting this nation's valuable intellectual resources. I thank this Committee and its staff for its important work in protecting intellectual property and look forward to continuing our work together in this endeavor.

I also had the privilege of working with members of the recording industry, the Digital Media Association and songwriters, and I am hopeful that our previous experience of working together to combat theft of intellectual property can help us to work together in the future to meet the new challenges and opportunities of the information age.

For more than 80 years, the NMPA has been the principal trade association representing the interests of music publishers and their songwriter partners in the United States. I am here today not just as a new face working out of new headquarters in Washington, D.C. I am here representing a new organization with fresh ideas about how to approach the challenges that face the music industry.

I am pleased to report that in the last few weeks, NMPA has already begun new discussions with the Digital Media Association, the recording industry and others. We have common goals. While the emergence of digital technology provides an exciting new medium for the distribution of music, it also allows for unauthorized peer-to-peer trafficking of copyrighted works. Let me be clear: most peer-to-peer systems are not used to share files. They are used to steal. The success of Apple's iTunes service and other lawful online music services has finally begun to fulfill the promise that the

Internet offers as a legitimate marketplace for music. NMPA and its members are excited about these new services, and we strongly support their efforts.

Music publishers and songwriters have made significant contributions and taken great risks to support legitimate music services since their inception by licensing music on a use now and pay later basis.

In 2001, the NMPA and its subsidiary, the Harry Fox Agency, entered into a historic agreement with the recording industry to assist the launch of new subscription services by creating a framework for mechanical licensing, despite the fact that applicable royalty rates had not been determined.

The parties agreed to make bulk licenses available immediately with the understanding that royalties would be paid at a future date when rates are determined. Similar agreements were made with independent subscription services. These agreements paved the way for the launch of online music services offering a broad catalogue of music. And while the recording industry and individual companies have deposited advances on these future royalties, songwriters and publishers have not yet been paid, despite the fact that their music has been licensed for over 3 years.

Publishers and songwriters did this to make these new services work, and we are prepared to do more. NMPA's members and the Fox Agency's affiliates have issued over 2.85 million licenses to over 200 different licensees for the delivery of digital music works. These licenses represent the vast majority of musical works for which there is any meaningful level of consumer demand.

There are still challenges, and the system can work better, but the NMPA stands ready to consider new and innovative approaches to meet these challenges of the new environment in which we operate, and we look forward to working with this Committee and the entire music industry to do so.

Thank you very much.

[The prepared statement of Mr. Israelite follows:]

PREPARED STATEMENT OF DAVID M. ISRAELITE

Good afternoon, Mr. Chairman, Mr. Berman and Members of the Subcommittee. I am David M. Israelite, President and Chief Executive Officer of the National Music Publishers' Association ("NMPA"). I thank you for inviting me to testify today about possible statutory changes concerning digital phonorecord delivery ("DPD") licenses.

As many of you know, I recently served as Deputy Chief of Staff and Counselor to the Attorney General of the United States, and as Chairman of the Justice Department's Intellectual Property Task Force. In that position, I worked closely with many members of this Committee and gained a profound understanding of the importance of protecting the nation's valuable intellectual resources. I thank this Committee for its important work in helping to protect our nation's intellectual property. I also had the opportunity to work with the other members of the panel today—all of whom play an important role in protecting music from theft. I am hopeful that our experience of working together to combat theft of intellectual property can help us work together to find solutions to many of the problems that have plagued the music industry for decades and to meet the new challenges and opportunities of the information age.

In my new role as President and CEO of NMPA, the principal trade association representing the interests of music publishers and their songwriter partners in the United States, I intend to work diligently to find those solutions and meet those challenges. For more than eighty years, NMPA has served as the leading voice of the American music publishing industry—from large corporations to self-published songwriters—before Congress, the administration and in the courts. The approxi-

mately 600 music publisher members of NMPA, along with their subsidiaries and affiliates, own or administer the great majority of the musical compositions licensed for manufacture and distribution as phonorecords in the United States. It is important to distinguish the copyright in these musical compositions, which form the foundation of today's music industry, from the copyright to the sound recording of an artist's rendering of those compositions. Both ingredients—the “musical work” and the “sound recording”—are essential to make music as the public knows it.

I am pleased to report that NMPA has been engaged in discussions with the Digital Media Association (“DiMA”) and the Recording Industry Association of America (“RIAA”) regarding the licensing of DPDs by online subscription services in an effort to formulate solutions that we hope will ensure the availability of all songs for licensing by subscription services and guarantee a level playing field for the determination of rates.

NMPA'S ROLE IN SUPPORTING NEW DIGITAL MUSIC SERVICES

Nearly a century ago, a new technology emerged that changed the music industry forever. That new technology was the piano roll—essentially long perforated sheets that operated a player piano's keys. To make sure that musical compositions were widely available for reproduction as piano rolls and in other media and technologies, Congress enacted the mechanical compulsory license in 1909. This statutory mechanism allows users of nondramatic musical works to invoke the compulsory license and reproduce and distribute such works at a royalty set by the statute, as long as the terms and conditions of section 115 are followed.

Following the enactment of the 1909 Act, a collective society of musical composition copyright owners developed to offer one-stop shopping for obtaining compulsory licenses. Founded in 1927, that society, The Harry Fox Agency, Inc. (“HFA”), is a subsidiary and the licensing affiliate of the NMPA. It provides an information source, clearinghouse and monitoring service for licensing musical copyrights, and acts as licensing agent for more than 27,000 music publishers, which in turn represent the interests of more than 160,000 songwriters.

Today the emergence of new technologies once again is set to change the music industry forever. The most significant change is the ability to distribute phonorecords electronically over the Internet. While this development provides an exciting new medium for the distribution of music, it also allows for unauthorized “peer-to-peer” trafficking of copyrighted musical works for which no royalties are received by songwriters and music publishers. Although illegal “peer-to-peer” services continue to dominate Internet delivery of music, the success of Apple's iTunes service—and other lawful online music services—has finally begun to fulfill the promise that the Internet offers as a legitimate marketplace for music. NMPA and its members are excited about these new services and strongly support their efforts.

In order to combat the theft of music and ensure the lawful availability of musical works online, NMPA's members have generously underwritten legitimate music services since their inception by licensing on a “use now, pay later” basis. In the fall of 2001, NMPA and HFA entered into an historic agreement with the Recording Industry Association of America (“RIAA”) to assist the launch of new subscription services by creating a framework for mechanical licensing of such services to offer tethered downloads and on-demand streams despite the fact that agreement had yet to be reached as to the applicable royalty rates. In that agreement, the parties agreed to make licenses available immediately on a bulk basis with the understanding that licensees will pay royalties at a future date when rates are determined, either by agreement or arbitration. The parties further agreed to clarify the scope of rights licensed in order to avoid disputes—and potential litigation—in favor of jump-starting new businesses. To that effect, the parties stipulated that on-demand streams and limited downloads involve a mechanical, and that pure “radio-style” streaming does not involve a mechanical. In the wake of that historic agreement, NMPA and HFA entered into similar agreements with independent subscription services on essentially the same terms. These agreements paved the way for the launch of a wide array of subscription services offering a broad repertoire of music to online subscribers.

Indeed, NMPA's members have every economic incentive to issue as many licenses to new, legitimate Internet music services as possible. It is only through such license agreements that our members are compensated. For this reason, the songwriting and music publishing communities have consistently worked with new businesses to promote broad public access to their works on fair and reasonable terms. Time and again, when called upon to help jump-start new distribution channels for their music, songwriters and music publishers have risen to the challenge.

While the influx of new online music companies that want to offer immediately every song ever written has put an enormous strain on the music publishing industry in licensing mechanical rights, music owners have made a Herculean effort to satisfy that demand. As of today, NMPA's members and HFA's affiliates have issued over 2.85 million licenses to 215 different licensees for digital delivery of musical works. These licenses represent the vast majority of musical works for which there is any meaningful level of consumer demand.

We are grateful to Congress for its foresight in preserving the statutory compulsory license for musical compositions over the years, and amending section 115 when necessary to maintain a level playing field for copyright users and rightsholders—all for the ultimate benefit of the listening public. The compulsory license has made it possible over the past century for virtually any performing artist to record our members' musical compositions, while guaranteeing compensation to songwriters for their creative efforts. Consumers have been the winners.

In the original 1909 Act, Congress set the statutory rate for reproducing and distributing musical works at 2 cents per song. Remarkably, this rate did not change for 67 years, until 1976 when Congress added a rate-adjustment mechanism for the statutory rate. Since that time, the statutory rate has increased—usually by industry negotiation—and today stands at 8.5 cents per song. If the mechanical right statutory rate had increased commensurate with the Consumer Price Index, the rate today would be 40 cents per song.

While the 8.5 cents statutory rate acts as a ceiling, it does not act as a floor. Music copyright owners are free to negotiate lower rates with users of copyrighted musical works, and often do. In some instances, contractual provisions such as “controlled composition clauses” in the recording contracts of certain artists require the composers of musical works to accept 75% or less of the statutory rate. As a result, the average actual rate paid for musical works is significantly less than 8.5 cents per song.

Even though mechanical royalties remained frozen for nearly seventy years, NMPA is not looking to recoup those historical losses. Instead, we are simply asking for fair compensation comparable to that received by other music copyright owners.

THE NEED FOR A LEVEL PLAYING FIELD

Online music services have expressed concern regarding the availability of licenses for subscription music services. In order to offer those services, online music services need to obtain multiple rights from multiple copyright owners. From the copyright owners of sound recordings, online services need to obtain rights of reproduction, distribution and public performance with regard to the sound recording masters. From the copyright owners of musical works or their representatives, online services need to obtain the equivalent rights with regard to the underlying musical compositions.

Songwriters and music publishers were the innovators in creating ASCAP as a performing rights organization (“PRO”)—and supporting BMI after it was founded as a competing PRO—and in creating the HFA as a collective mechanical rights agency, for the purpose of facilitating the licensing of musical works. Pursuant to the consent decrees under which they operate, the PROs must license nondramatic public performance rights to any user who requests it, including online music services. Likewise, the compulsory licensing provisions of the Copyright Act require music publishers to license mechanical rights to all users, including online music services.

In the case of master rights, Congress first recognized the efficacy of a compulsory license in 1995, but that compulsory license was limited to the right of public performance, and only for non-interactive digital transmissions. With regard to the rights of reproduction and distribution for masters for interactive digital transmissions, however, there is no compulsory license, no collective agency, and no obligation to license whatsoever.

This legal regime has placed songwriters and music publishers at an inherent disadvantage in negotiating mechanical rates for subscription services. Because of the “use now, pay later” deals that NMPA and HFA have made with RIAA and independent subscription services, the absence of a negotiated rate has not stood in the way of the launch of subscription services offering a broad repertoire of music. Exercising their unfettered right to license their master rights for reproduction and distribution, however, record labels have negotiated licenses with subscription services that call for payment of 40% to 50% of their gross revenues for master rights, while songwriters and music publishers have yet to earn any mechanical royalties from subscription services and the subscription services, in turn, have been unable to

close their books due to uncertainty as to the royalties they owe for musical work rights.

We look forward to working with Congress to find a way to correct this problem—enabling creators to be compensated for the use of their works and subscription services to balance their books and enjoy a fair return on their investment.

CONCLUSION

In sum, we believe that a level playing field is essential in order to ensure the availability of all songs for licensing by subscription services, and to guarantee that songwriters and music publishers obtain fair rates for their creative works.

I thank the Committee for this opportunity and ask that my written remarks be made part of the record.

Mr. SMITH. And thank you, Mr. Israelite.
Mr. Kenswil.

TESTIMONY OF LARRY KENSWIL, PRESIDENT, e-LABS, UNIVERSAL MUSIC GROUP

Mr. KENSWIL. Thank you, Mr. Chairman.

I would like to thank the Subcommittee under your leadership, Mr. Chairman, and Ranking Democratic Member Berman and the rest of the Subcommittee for focusing its attention on the relatively arcane but important subject of mechanical licensing. I would also like to thank you, while I have a chance, for your leadership in adding to section 115 a limited antitrust exemption to facilitate industry negotiations of mechanical royalty rates for physical products.

I am here today to describe some of the new technologies and distribution platforms that Universal is using to give consumers more enjoyable and more convenient ways to access digital music. Unfortunately, I must also tell you about ways that the antiquated structure of section 115, with its one song at a time, one publisher at a time licensing model is frustrating the introduction of these new products.

That structure imposes unreasonable transaction costs on any effort to meet the public's voracious appetite for digital music. The section 115 licensing system is broken. We should all work together to try to fix it.

This is a revolutionary era in the music business. For those of us who embrace change, it is the best time. It used to be the record companies introduced a major new technical format every decade or so, but the formats were merely evolutionary. Now, new formats mean business models, new revenue sources, new abilities for consumers to control their listening and more places and more ways for people to find a broader array of music and music-related products.

At Universal, we are talking to potential business partners every day, and when we see business propositions that make sense, we close deals as fast as we can to get those products and services on the market. So I would like to describe some of the businesses that record companies and their partners are bringing to the market to meet the consumer demand for greater, better, and more flexible access to music.

As we all know, online music services have now come of age. Apple alone has sold over 300 million downloads, and over a million and a quarter households subscribe to music through services such as Napster. Ringtones and other telecommunications products

are one of the hottest things in music. Consumers can play actual recordings of music by the original artists, both for signaling incoming calls and for private listening. But ringers are only the beginning. Mobile services want to offer their customers full song downloads, videos and other music-related products.

Multi-session discs are new products that provide superior audio fidelity, surround sound, greater storage capability, videos and other value-added content as well as improved security to reduce piracy. To enable consumers to play their music on whatever device they own, we are introducing dual disc, which provides a CD on one side and a DVD with advanced resolution audio and video on the other.

Kiosks are yet another way for consumers to access the music they want. Through in-store offerings, such as Starbucks Hear Music Media Bar in Austin, Texas, consumers can listen to songs, create a custom mix, and burn it to a CD. One of our current priorities at UMG is the distribution of music videos by streaming or download services on the Internet, through interactive cable and satellite, video on demand set-top boxes as well as to cell phones and other new receivers. These new services will allow us to create new streams of income for everyone in the music business.

With the proliferation of music formats and business models we are seeing today, section 115 has made it difficult or impossible to launch many new services. The biggest problem is the enormous transaction cost it entails. We have been using the compulsory licensing system for dual disc releases, and we will spend many times on accounting and audit costs what we pay in royalties.

Licensing for new technology and formats is even harder. We have hundreds of thousands of recordings that we want to make available using all kinds of new technologies. We should all want to make it easy for a service to launch with a million tracks or for a large number of physical products to be rereleased in new formats, but every new technology is effectively a new configuration for which our whole catalogue needs to be licensed separately again by countless publishers. Any one of several co-owners both known and unknown of a song can effectively block its use.

Technology entrepreneurs are often shocked to learn that even though our sound recording rights can be licensed readily, they are stymied. For our catalogue to be on their proposed service, either they or we must undertake a massive effort to relicense all the relevant musical work on a work-by-work, copyright owner-by-copyright owner basis and on a configuration-by-configuration basis. It should come as no surprise that startup businesses are not interested in replicating our copyright licensing and royalty accounting departments and information systems. As a result, too many of our potential business partners have thrown up their hands and abandoned their plans.

Section 115 licenses are unique among all the Copyright Act's compulsory licenses in that it is not a blanket license. For example, an Internet Webcaster can perform all commercial sound recordings by filing a single notice. There are other problems: section 115's per unit cent rate does not reflect the economic realities of the new technologies, and we believe that ringtones are covered by the section 115 license, but publishers have disagreed. We think

that multiformat discs, we should only have to pay once per track. Some publishers disagree, and there are countless other questions.

Nobody wants to enhance the availability of music through legitimate new product and service offerings more than Universal. However, a compulsory licensing system designed a century ago for piano rolls and wax cylinders, not ringtones and dual discs doesn't work.

In the past, our collaborative efforts with the publishers have produced some outstanding successes, such as Mr. Israelite has mentioned. We want to work with them again to find a common ground to reform section 115.

Thank you for your time, and we would be happy to take any questions.

[The prepared statement of Mr. Kenswil follows:]

PREPARED STATEMENT OF OF LAWRENCE KENSWIL

My name is Larry Kenswil. I am President of UMG/eLabs, which is Universal Music Group's new media, business development and advanced technology division.

I would like to thank the Subcommittee, under the leadership of Chairman Smith and Ranking Minority Member Berman, for focusing its attention on the arcane but important subject of licensing of musical works under the mechanical compulsory license provided by Section 115 of the Copyright Act. I would also like to thank you for your leadership in the last Congress in adding to Section 115 a limited antitrust exemption to facilitate industry negotiations of mechanical royalty rates for physical products. That modification is important to our efforts to address the kinds of problems I will describe today, even if it is not enough to solve those problems.

The purpose of my testimony today is to describe some of the new technologies and distribution platforms that Universal is using to give consumers more enjoyable and more convenient ways to access digital music. Unfortunately, I regret that I also must tell you about the ways that the antiquated structure of Section 115, with its one-song-at-a-time, one-publisher-at-a-time licensing model, is frustrating the introduction of those new products. That structure imposes insurmountable transaction costs on any effort to meet the public's voracious appetite for digital music. Indeed, the transactional costs of licensing musical compositions are the obstacle to making sound recordings available through new technologies and in new formats. The bottom line is that even though technology companies, record companies and music publishers have a common interest and a great desire to launch new music services, that will is not enough to overcome a licensing system designed almost a century ago for making piano rolls. The Section 115 licensing system is broken. We should all work together to try to fix it by introducing blanket licensing of musical compositions and providing greater royalty rate flexibility so that structural impediments to licensing musical compositions do not continue to deprive consumers of the benefit of new and exciting ways to access music, and everyone in the music value chain can benefit.

BACKGROUND

By way of background, Universal Music Group, or UMG, is the world's leading music company. UMG's artists are among the most popular across all types of music, including George Strait, Shania Twain, Mary J. Blige, Mariah Carey, Toby Keith, Stevie Wonder, Eminem, Sting, Sheryl Crow, U2, and Black Eyed Peas. Our record labels include Decca, Deutsche Grammophon, DreamWorks, Geffen, A&M, Interscope, Island, Def Jam, Philips, Motown and Verve. UMG releases over 2,000 new albums or compilations each year in this country, and UMG has often led the way by making its music available through new technologies and distribution platforms.

It is important to understand that because every musical recording embodies a musical composition, every exploitation of our product requires licensing by a musical work copyright owner. We need to obtain or verify rights to over 30,000 musical works each year just for our new releases in traditional formats. In fact, we requested over 130,000 individual mechanical licenses last year in the United States. Because the statutory process for obtaining licenses and accounting for use under Section 115 is so cumbersome, UMG usually relies on licenses based on Section 115 but obtained directly from copyright owners or The Harry Fox Agency. Those li-

censes are typically issued separately for each “configuration,” such as CD, DVD or download.

The number of licenses we obtain is much larger than the number of songs involved because of so-called “split copyrights.” Few musical works are owned by only one copyright owner. Indeed, it is not uncommon for the rights to a single song to be split among four, five or more different copyright owners. And while they would not need to, most will require that consent and a separate license be obtained from all their co-owners. As a result, it is common to deal with dozens of copyright owners to clear a single album. In addition, while many licensing transactions are straightforward and involve publishers with sophisticated licensing systems and with whom we work well every day, there are tens of thousands of active music publishers, and countless individuals who may own fractional interests in some musical works without being actively engaged in the business. Sometimes it is even hard to find co-owners whose consent we need.

NEW TECHNOLOGIES

This is a revolutionary era in the music business. For those of us who embrace change, it is the best time. It used to be that record companies introduced a major new technical format every decade or so, but the formats were merely evolutionary. The basic business model of selling physical products in bricks and mortar record stores was not much changed from 10-inch 78 RPM shellac, to 12-inch 33 RPM vinyl, to 5-inch polycarbonate CDs played by a laser. But now new formats mean new business models, new revenue sources, new abilities for consumers to control their listening, and more places and more ways for people to find a broader array of music and music-related products. New formats are now revolutionary, not evolutionary, bringing with them great promise, not to mention the challenge of easier piracy. My job is to enhance the new while ensuring a fair return to songwriters, publishers, artists and record companies alike. Technology entrepreneurs and many established companies that haven’t traditionally been in the music business are excited about bringing new musical offerings to the public, and we’re excited to work with them. At Universal we’re talking to potential business partners every day, and when we see business propositions that make sense, we close deals as fast as we can to get those products and services on the market. And I know that other record companies are doing the same.

I’d like to describe some of the businesses that record companies and their business partners are bringing to the market to meet the consumer demand for greater, better, and more flexible access to the music they love.

Online Music Services. Anyone who saw the dueling iTunes and Napster advertisements during the Superbowl knows that legitimate online music services have come of age. Apple has sold over 300 million downloads, and over a million more every day. Over a million and a quarter households subscribe to music through services such as Napster that offer unlimited access to over a million songs. Each service offers opportunities for consumers to “burn” music to a disc or move it to a portable device. And there other services, from customized radio stations uniquely tailored to the individual, to fan sites that expand the artist’s community. New ideas come to us and from us every day.

Ringtones and Other Telecommunications Products. Cell phone ringtones are one of the hottest things in music. Although until recently most cell phones had tinny speakers that could only play the simplest of tunes, the latest phones are powerful music listening devices that, among other things, allow consumers to play actual recordings of music by the original artists to signal incoming calls. Now, consumers can select “ringback tones” that will be heard by people calling them, and “reverse ringback tones” that they can hear while waiting for an outgoing call to go through. This cultural phenomenon has to date been limited to wireless networks, but there are lots of interesting possibilities for people to interact with music on all kinds of telecom devices. One of the biggest potential opportunities lies in the rollout of cellular 3G networks this year. Mobile service providers want to offer their customers full song downloads, videos, and other music related products. We are ready, willing, and able to deliver those products, if we can get the rights to the underlying compositions.

Locked Content. While the name “locked content” isn’t very appealing, new digital rights management technologies give us almost infinite flexibility to put music into the hands of consumers, let them “sample” it before they make a purchase decision, and then allow them to buy what they want, while ensuring that songwriters, publishers and artists are paid. Sometimes this might involve encrypted copies of music preloaded on devices, such as computer hard drives, cell phones or portable music players, that consumers can unlock by making a purchase or subscribing to a serv-

ice. We're also interested in distribution models that would allow a consumer to share an encrypted copy of a recording with a friend, and then allow the friend to listen to it a limited number of times, or over a limited time period, before making a purchase decision.

Multisession Discs. The CD format is now well over 20 years old. New technologies provide superior audio fidelity, including surround sound, greater storage capacity, videos and other value-added content, as well as improved security to reduce the sting of piracy. To realize those advantages, we are experimenting with all kinds of different formats, including SACD and DVD-Audio. To minimize consumer confusion and frustration as the number of available formats multiplies and consumers demand access to music on more and more new devices, we are also introducing DualDisc, which provides a CD on one side and a DVD with advanced resolution audio and video on the other, all designed to maximize playability.

Kiosks. Yet another way for consumers to get access to the music they want is in-store offerings such as Starbucks' Hear Music media bar that allows consumers to listen to songs, create a custom mix, and burn it to CD, all while they enjoy a cup of coffee. We expect kiosks to be rolling out from coffee shops to places as disparate as big-box discount retailers and airport lounges.

Music Videos. One of the things we are most excited about at UMG are new possibilities for distributing music videos through streaming or download services on the internet, through interactive cable and satellite video-on-demand set-top boxes, as well as to cell phones and other new receivers. There is a huge consumer demand for music video content. To date, shelf space and broadcast technology limitations have made it impracticable to meet that demand, but new technologies will allow us to satisfy that demand and create new streams of income for everyone in the music business, which may be critical to offset the harm caused by peer-to-peer infringement.

LICENSING DIFFICULTIES

We at UMG are excited about all of the products I have discussed and working hard to get these offerings into the hands of consumers. As far as rights to sound recordings are concerned, the marketplace is working well; lots of services have been able to obtain rights to the vast majority of sound recording repertoire. I believe that many of our music publisher colleagues are equally excited about these technologies and want to license musical works for these new uses. However, the basic structure of Section 115 is almost a century old, and in Internet time, the revisions the publishers sought in 1995 to graft download licensing onto that basic structure might as well have been made a century ago. With the proliferation of formats and business models we are seeing today, this archaic licensing system has made it difficult or impossible for new technologies to go forward with licenses to any significant portion of the musical works that consumers want.

The biggest problem with Section 115 and the whole licensing system that has grown up around it is the enormous transaction costs it entails. In the case of licensing for traditional channels, we have overcome this by building up over decades copyright licensing and royalty accounting departments and information systems to correlate recordings to musical works and manage publisher splits. But from an industry-wide perspective, this system requires significant and duplicative effort among record companies, musical publishers and licensing agents that unnecessarily takes money out of all our pockets. We would all benefit from a more efficient system for licensing new releases of physical products.

Licensing for new technologies and formats is much harder. We have hundreds of thousands of recordings that we would love to make available using all kinds of new technologies. And I'm sure that in principle our music publisher colleagues would be happy to license the musical works for many of these uses. We should all want to make it easy for a service to launch with a million tracks or for large numbers of physical products to be re-released in new formats. But every new technology is effectively a new configuration for which our whole catalog needs to be licensed separately all over again, by countless publishers, where any one of several co-owners of a song can frequently block its use. Faced with the need to clear large amounts of content, the mechanical licensing system defeats the will of consumers, record companies, music publishers and technology companies to get new offerings licensed.

Technology entrepreneurs are often shocked to learn that even though our sound recording rights are readily available, making our catalog available on their proposed service would require that either they or we undertake a massive effort to re-license all the relevant musical works on a work-by-work, copyright owner-by-copyright owner, and configuration-by-configuration basis. It should come as no sur-

prise that they are not interested in replicating our copyright licensing and royalty accounting departments and information systems. And their business plans contemplate negotiation with a few record companies, not thousands of publishers. They want us to provide one stop shopping. But for many offerings, as to most of our catalog, we simply cannot do that. The number of tracks that need to be re-licensed is so large—many times the number we clear for new releases in a year—and the average return from any individual track often so low, that the current system does not allow us to clear more than a small part of our catalog. As a result, too many of our potential business partners have thrown up their hands and abandoned their plans, and we have been far less successful than we would like in making our recordings available using new technologies. And songwriters and music publishers have suffered too, because they lose potential income from every song not being played as the result of the recording not being made available.

The Section 115 license is unique among all the Copyright Act's compulsory licenses in that it is not a blanket license. For example, an Internet webcaster can perform all commercial sound recordings by filing a single notice of intention and paying a single Section 114 royalty to the "designated agent." Likewise, cable systems can carry broadcast television programs by filing a single statement of account and paying a single royalty under Section 111. We need a similar system under Section 115.

You should be aware of other problems as well. The antiquated structure of Section 115 does not allow for the flexibility necessary to license emerging business models. The regulations implementing Section 115 historically have required a per-unit, cent-rate royalty payment. Such a per-unit payment often does not reflect the economic realities of a new technology. In addition, use of new technology has brought business arrangements much more complex than the sale of physical products. The traditional cent rate is inflexible and poorly suited to allowing both musical work and sound recording copyright owners to share fairly in diverse revenue streams. When a subscription service or distribution of locked content presents a different value proposition than the sale of traditional products, the mechanical royalty should reflect that. And if consumers are prepared to pay a premium price for a ringtone or DVD, or record companies are able to realize new revenue streams such as fees for loading locked content or sharing in ringback tone service revenues, it is appropriate that songwriters and publishers get their fair share.

In addition, in previous hearings, this subcommittee has heard about how uncertainty and disagreements concerning the application of Section 115 have paralyzed the licensing process. For example, we spent a year negotiating a structure for licensing of subscription services, and now over three years later we still have not agreed to royalty rates. We believe that ringtones are covered by the Section 115 license, but publishers have disagreed, insisting on privately negotiated licenses and rates. We think that distribution of a multi-format disc such as DualDisc should require payment of a single mechanical royalty per track, but because the disc is designed for playback on multiple devices, the same recording must be encoded several times in different formats. As a result, some publishers have asked for a multiple of the statutory royalty.

Because Section 115 is a relic of a different time, there are countless other questions. Must the royalty on locked content be paid when the content is unlocked or when the physical medium leaves the distributor's hands? Is a product sold from a kiosk a download or a physical product? If a consumer is allowed a second, convenience download so that they can enjoy the song on a second computer, all for the same price, wouldn't it be strange for us to pay double mechanical royalties, while if the consumer simply downloads once and makes their own copy, we do not? Why should the same business model and same consumer offering result in a different mechanical being due simply because a different technological solution is utilized?

Under the current structure, these are all important issues, some more controversial than others. Under a blanket license structure with a royalty more responsive to the marketplace, many of these issues might go away. However, for now, the uncertainty, and the resulting risk of legal liability, has severely limited our ability to clear tracks for use in new technologies and so retarded the growth of new consumer offerings.

CONCLUSION

Record companies succeed by bringing consumers music they love in formats they want. As the world's leading music company, nobody wants to enhance the availability of music through legitimate new product and service offerings more than Universal. However, I hope my remarks make clear that the widely diffuse and split

ownership of vast numbers of musical work copyrights makes individual negotiation of licenses for every new product or service offering an impossibility, and that a compulsory licensing system designed a century ago for piano rolls and wax cylinders, not ringtones and DualDiscs, is inadequate to remedy the situation. Accordingly, I look forward to working with this subcommittee, other record companies, as well as our colleagues in the music publishing and technology industries, to see if we can find common ground to reform Section 115 by introducing blanket licensing through a “designated agent” and greater royalty rate flexibility. Only by doing so can consumers have the benefit of new and exciting ways to access music and everyone in the music value chain benefit from new technologies.

I thank you for your time and would be happy to take your questions.

Mr. SMITH. Thank you, Mr. Kenswil.

Mr. POTTER. I might say, Mr. Potter, the last time you testified, I think you had just returned from your honeymoon; is that correct? So—

Mr. POTTER. Yes, sir, it is.

Mr. SMITH. You didn’t show any sense of distraction then. I’m sure your testimony will be good today, too, so please continue. [Laughter.]

**TESTIMONY OF JONATHAN POTTER, EXECUTIVE DIRECTOR,
DIGITAL MEDIA ASSOCIATION (DiMA)**

Mr. POTTER. I’m in trouble for a long time. Do I get an extra 2 minutes for that?

Thank you, Mr. Chairman, and Mr. Berman. Today, I’d like to use my time to offer a live action demonstration of a day in the life of an online music executive. XYZ Company is planning to launch an online music service. “Potter”, says my boss, “put together several options for our customers: preprogrammed radio, 100 channels to compete with local broadcasters and XM Radio; consumer-influenced radio: play artists and songs people like and then lots more, so they discover new music that that might enjoy and buy; on demand radio, the songs people want when they want, unlimited choice and music on demand, a new subscription service; subscription portable downloads also, like a movie rental service offering all you want, all the time, but don’t miss a payment, or your music will disappear; and of course, sell permanent downloads. Consumers understand those. Buy it today, and own it forever.”

“And Potter, get all the rights, pay all the royalties. Let’s not get sued, because that Copyright Act is harsh: strict liability, statutory damages of \$150,000 per copyright. No mistakes permitted.” So I go to work, mindful that the recorded music includes two copyrights I must license, in the sound recording and the composition and that both copyrights have sub-rights, for performances like radio and for distributions like CDs.

Licensing the preprogrammed radio is easy. One notice to SoundExchange, ASCAP, and BMI; I am fully licensed. I negotiate a royalty, I report the music we provide, and the creators get paid.

Consumer-influenced radio should be just as easy, and for publishing, it is. For sound recordings, well, that’s another story. The Copyright Register and the Congress say consumer preferences may influence programming, and it’s still permitted under the DMCA statutory license. SoundExchange has even licensed services that way, but record companies have sued Webcasters, and they say in court that consumer-influenced programming is not allowed by the DMCA. Why? Perhaps because they get to charge higher

royalties, and they don't have to share 50 percent with artists. My problem is that if I guess wrong about our service being eligible for the statutory license, I'm out of business or at least out of a job.

What's the solution? The interactive service definition in section 114 needs to be amended to ensure that consumer influence in programming is permitted, so long as generally applicable programming restrictions are not violated. That's a simple solution.

Now, back to licensing. On-demand radio is even harder. With no statutory recording license, I have to call the four major labels and hundreds of independents to negotiate sound recording licenses. Publishing should be easier. Back to ASCAP and BMI, because on-demand radio is just performing the music just like radio. But wait: someone asks me "have you gone to see Harry Fox? Have you gotten those mechanical reproduction rights for on-demand radio?" "Of course not," I say. Broadcasters pay performance royalties only, and the Copyright Register says that should be the same for online broadcasts or online radio. Did Congress really intend that broadcast and satellite radio pay performers once for performing music but that Internet radio pay twice?

Bottom line, to avoid lawsuits, I pay the Fox Agency double dip royalties on top of ASCAP and BMI royalties. What's the solution for Congress? Clarify that there is no licensable reproduction in online radio of any kind and that server copies get the same 112 exemption as exists for broadcasters. Online radio and broadcast radio should be treated alike.

Now, licensing subscription downloads, that's even harder, because Fox licenses on a song-by-song basis, and they won't even tell what songs they offer. I request a million songs, and they match only half. How can I compete with Grokster if I can't put another half million songs on my service? The solution, of course, is the blanket license that everybody is discussing. But then, I still have a problem: I offer a percentage of revenue royalty, because that is what works with monthly subscription fees. They don't want that. They want 8.5 cents per reproduction. That just doesn't work in today's business.

Then, Fox says to me they'll license subscription downloads only if I also pay them for nonexistent mechanical rights and on-demand radio. Is that a tying arrangement? Oh, and there's more: my service is offering time-limited downloads. It's a download; it's not a performance. But ASCAP and BMI want public performance royalties as well. Sounds like another double dip. I'm just trying to pay the publishers, but I only want to pay them once.

Licensing paid downloads, now, that should be easy. I'll get my Fox Agency mechanicals, and just like CDs, I'll pay one royalty per song. But now, Fox says they want more royalties, because we are permitting consumers to make several personal use copies for their iPod and their home stereo. But CDs pay only one royalty. They permit unlimited personal copies. How can this be? Multiple royalties at 8.5 cents each? I'll go broke with downloads priced at 99 cents and record labels taking the first 65 cents of that.

And guess who's back on the paid downloads? ASCAP and BMI. They want performance royalties for downloads. This is a real mess. Congress needs to amend sections 114 and 115 of the Copyright Act to clarify and simplify the process of obtaining statutory

licenses for legitimate royalty-paying online services. License processes that work for piano rolls, vinyl records and CDs don't for digital services; in fact, they obstruct progress. DiMA companies pay royalties today to publishers, producers, creators and performers, but we will gain more consumers, and we will pay more royalties if we can offer compelling services that compete effectively against piracy.

Thank you.

[The prepared statement of Mr. Potter follows:]

PREPARED STATEMENT OF JONATHAN POTTER

Mr. Chairman, Representative Berman, and Members of the Subcommittee:

Thank you for inviting me to testify today on behalf of the Digital Media Association and the online music industry regarding certain amendments to the Copyright Act that will trigger extraordinary growth in legitimate royalty-paying online music and a concomitant reduction in piracy. By clarifying and simplifying the compulsory composition mechanical license and the statutory sound recording performance license, Congress will provide business and legal certainty to legitimate online music innovators and eliminate multi-million dollar infringement risks that never were intended to affect law-abiding royalty-paying enterprises. By doing so, Congress immediately will promote the development and growth of DiMA companies' online music services as well as royalty payments to creators.

In significant part DiMA seeks four amendments:

- 1) Replace today's dysfunctional Section 115 compulsory composition mechanical license with a simple, transparent, comprehensive statutory blanket license that can be triggered on one notice, as described among the alternatives suggested to this Subcommittee in March 2004 by Register of Copyrights Marybeth Peters.
- 2) Clarify the scope of music publishers' licensable rights with respect to "ephemeral" and incidental reproductions of compositions that are associated with royalty-generating streamed performances, so as to finally end the infamous royalty "double-dipping" problem.
- 3) End years of confusion and litigation by clarifying the "interactive service" definition in Section 114, with regard to sound recording performance rights, to ensure that Internet radio programming based on user preferences falls squarely within the statutory license so long as the generally applicable programming restrictions for the statutory license are not violated and so long as users are not permitted to control how much a particular artist is heard or when a particular song might be played.
- 4) Equalize sound recording performance royalty standards so that all radio competitors—broadcast, cable, satellite and Internet—pay the same royalty to artists and recording companies.

Online music services offered by AOL, MSN, Napster, RealNetworks, Yahoo and other DiMA members compete every day against free music available on black market networks. DiMA companies are up to the task, but to successfully compete against free black markets, a music service must have a comprehensive catalog and be user-friendly, feature-rich and fairly priced. DiMA's proposed amendments will accomplish these goals, and in doing so will promote certainty, reduce litigation and risk, ensure royalty payments, and help legal online music services defeat piracy.

In March and July 2004, DiMA testified before this Subcommittee about the Section 115 and 114 licenses for compositions and sound recordings, respectively, which are historical business-model-specific anachronisms needing amendment by this Congress in order to achieve the laudatory goals for which they were intended. The Copyright Office also testified about these provisions, and provided a clear overview of several of their statutory shortcomings in the digital environment. Today's testimony will focus on the practical business implications of these outdated laws, and specifically on how legal online services' development (and our effort to wean consumers from pirate networks) is significantly hampered by the liability and business risks associated with these licenses.

I. SECTION 115 OF THE COPYRIGHT ACT IS AN ENORMOUS ROADBLOCK TO ONLINE MUSIC SERVICES' SUCCESS AND OUR ABILITY TO DEFEAT PIRACY IN THE MARKETPLACE.

Recently, senior executives of three online music services—RealNetworks, Napster and Sony Connect—were asked to identify the biggest obstacle to turning today's moderate success into more robust growth. They did not give the obvious answer—piracy. Instead, these executives identified difficulties associated with music publishing rights as their single biggest business problem. Not their biggest legal problem—their biggest business problem.

Perhaps this is not surprising. As you heard from DiMA, the RIAA, and the Register of Copyrights in March 2004, the Section 115 compulsory mechanical license for musical compositions is broken in significant ways—primarily because it was developed for business models and technologies of the past and is too rigid to accommodate the business models and technologies of today and of the future. As a result, this Congressionally-created license that was intended to simplify and promote the sale and distribution of royalty-bearing music is failing in the digital world.

The victims of Section 115's failure are those who invest in the music industry ecosystem—creators who are losing royalties, record stores that are unable to offer comprehensive in-store CD burning services, and online music companies that are not growing as fast as we should be. The beneficiaries are those who ignore royalties and licenses and creators—the black market networks that profit from unauthorized distribution of free music.

DiMA members' business goal is simple—to build innovative, fairly priced royalty-paying services that offer consumers every song that is also available on black market networks. The goal of the Section 115 compulsory license has always been to help companies like ours by making available the mechanical reproduction rights to every composition ever previously distributed.

But as the Subcommittee heard in March 2004, the 115 license is not up to its Congressionally-assigned task. Its scope is unclear, it is administratively dysfunctional, and the private market does not offer an alternative. Even in the year since the Subcommittee's last hearing, and amidst Congressionally-monitored negotiations, The Harry Fox Agency has remained unable to issue licenses for more than 50 percent of the compositions that DiMA companies seek to offer on our new subscription services. So instead our companies continue navigating the music publishing thicket, confronting obstacles that reduce the quality of our royalty-paying services while hoping eventually Congress will recognize the reality—that under current law it is essentially impossible to license a comprehensive music catalog for a modern music service.

Let's be crystal clear today:

- Aided by statutory uncertainty, music publishers continue to assert the existence of double-dip mechanical rights in streamed performances that the Register of Copyrights has repeatedly said do not exist.
- The Harry Fox Agency, the music publishers' in-house collective licensing agent, is absolutely unable to license mechanical reproduction rights in a fashion that works for comprehensive digital services.
 - Unlike many other countries' mechanical licensing organizations, HFA does not represent all publishers, and even those it represents can opt-out of any license that HFA agrees to.
 - HFA's multi-million dollar processing system and its 130-person staff are unable or unwilling to tell us even what songs HFA does or does not have authority to license, so that we can seek licenses and pay royalties elsewhere when appropriate.
- Third, there is disagreement even among music publishers regarding the scope of rights needed by online services, including whether the compulsory 115 license provides all rights needed by subscription download services that Napster, RealNetworks and other DiMA companies offer or will soon offer.
- And fourth, if the 115 license does provide the rights necessary to offer subscription and purchase download services, the licensing process is so expensive and inefficient that even the Copyright Office has asked Congress to authorize its repair.

The practical impact of this statutory and market failure is, for our industry, staggering:

- First, legal online music services have substantially less music than black market networks.

- Second, the balkanized licensing system creates inconsistencies among companies' own offerings that promote confusion and consumer disappointment. The most frequent complaints from university students and others who try legal download and subscription services relate directly to music publishing problems:
 - “Why can I hear a song on your radio service but I can't purchase it?”
 - “Why can I purchase this song for 99 cents but I can't enjoy it as part of the portable subscription service that I am paying for?”
 - “Why are five songs from a CD available for purchase or the subscription service, but five other songs from the same CD are not available?”
 - “Why are these songs not available on your service at the same time I can buy them on a CD?”
- Third, online music services are forced to operate with extraordinary legal and financial risk—a risk that is recognized by investors and analysts. The ambiguity regarding whether an online radio performance implicates a licensable reproduction right is not a law school exam question. Coupled with the Copyright Act's strict liability and statutory damages of up to \$150,000 per work, a service of any size—particularly if its offering is innovative—is inviting trouble unless it agrees to publishers' demands for double-dip royalties. Some companies have chosen instead simply to stop innovating.
- And finally, from an operations standpoint, music publishing uncertainty imposes staff requirements, legal fees, insurance and administrative costs. DiMA companies spend millions of dollars annually just administering music publishing rights, beyond payment of the royalties themselves. This absorbs funds that our companies instead should use to develop and market innovative products and services, which will in turn grow our services, help defeat piracy and generate more royalties.

Simple Solutions are Available that Would Benefit Creators and Online Services. DiMA supports replacing today's dysfunctional compulsory composition mechanical license with a simple, transparent, comprehensive statutory blanket license that can be triggered on one notice, as described among the alternatives suggested to this Subcommittee last year by Register of Copyrights Marybeth Peters. DiMA companies are prepared to account for and report distribution of sound recordings and their embedded compositions directly to an agent designated by the songwriters and publishers, and to pay royalties directly to the agent who would in turn remit payments to publishers and songwriters. DiMA is prepared to negotiate fair royalties for songwriters and music publishers on an industry-wide basis, and to arbitrate a royalty rate if one cannot be agreed upon—just as today's 115 license requires.

This solution is not new; it would merely require adoption of the model used in the Section 114 statutory license that relates to sound recording performance rights. Services operating under the Section 114 license send one notice and secure a license to effectively the whole universe of sound recordings and then pay royalties to a designated agent. Music publishers, of course, are familiar with blanket licenses, and in the past few months, particularly with new leadership in place, the NMPA has expressed renewed interest in developing win-win solutions that can simplify all our lives by reducing risk and increasing our businesses and publishers' royalties. As concerns composition performance rights, ASCAP and BMI for several decades have provided comprehensive blanket-license solutions to songwriters, music publishers and licensees. While we continue to have differences with the performing rights organizations over whether performance licenses are required for certain business models, we agree that the blanket license works well for clearing large volumes of rights and royalties.

A transparent blanket-license solution would also benefit songwriters and publishers. Even assuming agreement about when a license is necessary, DiMA companies face unpleasant choices when HFA cannot make licenses available, and songwriters and publishers suffer also. Either we offer to consumers far fewer songs than they want and we lose consumers to pirate services, or we have to incur legal risks that Congress never intended and which would not arise if Section 115 could flexibly adapt to new business models. Whichever a service chooses, if HFA's licensing system cannot match license requests, royalties that are deserved are not getting to songwriters and publishers. Under a blanket license system, all songwriters and publishers get paid.

And as for the double-dip royalty issue, the Register of Copyrights has made several suggestions regarding solutions over the past four years, and virtually every one would be acceptable to DiMA companies. A simple clarification of the scope of

publishers' licensable rights with respect to "ephemeral" and incidental reproductions of compositions would solve these problems.

II. CLARIFY AND SIMPLIFY INTERNET RADIO LAWS TO PROMOTE SERVICE GROWTH AND INCREASE ROYALTIES TO RECORD COMPANIES AND ARTISTS.

1. *"Interactive Service" Confusion Inhibits Innovation and Stunts Growth of Services and Royalties.*

As the Subcommittee is aware, whether an Internet radio service is "consumer-influenced" and qualifies for the Section 114 statutory performance license, or is "interactive" and does not qualify, has been the subject of two lawsuits and a Copyright Office proceeding. Nevertheless, five years into this dispute and after millions of dollars wasted on legal fees, the recording and online music industries are no closer to having transparent rules that promote compliance rather than uncertainty. And unfortunately, just as music publishers have exploited uncertainty regarding reproduction rights issues to litigate into a better business position than Congress intended, so has the recording industry relied on legal uncertainty and litigation to inhibit Internet radio innovation and seek inflated royalties.

The "interactivity" dispute creates a very straightforward problem. Internet radio pays millions of dollars in royalties every year to artists and the recording industry. Broadcast radio—even digital broadcast radio—pays zero. If Internet radio is saddled by rules forcing our programming to be like broadcast radio, or forcing company-by-company negotiations regarding royalties that our broadcast competitors are not even required to pay at all, then how are we to compete, succeed, and generate even more royalties for sound recording companies and artists?

The problem is fairly simple: In the 1995 Digital Performance Right in Sound Recordings Act and its 1998 amendments, Congress sought to promote Internet radio as a competitive consumer-friendly medium that benefits the recording industry by generating royalties and promoting sales of sound recordings. The 1995 Act limited the benefits of the statutory license by imposing programming restrictions on the radio services (e.g., limiting how many times a single artist can be played in a 3-hour period) and disqualifying "interactive" programming that essentially provided on-demand or near-on-demand service. There was no uncertainty nor any litigation regarding this standard.

The 1998 amendments modified the definition of "interactive" service, changing it from a fairly straightforward and objective test to one requiring a complex subjective analysis. Typically American law is comfortable with "reasonableness" standards and balancing tests, but in the copyright environment where there is strict liability with high statutory damages, uncertainty can chill innovation and destroy the entrepreneurial spirit.

Moreover, where an online music service provides on-demand streaming and digital download or subscription offerings alongside statutory radio offerings, the direct licenses necessary for the on-demand services provide the labels with significant leverage through which to enforce their view of the scope of the statutory license.

The Register of Copyrights and the RIAA (in public filings and its licensing practices) have agreed that services can benefit from the statutory license even if they permit consumers to express preferences as to genre, artists and specific songs. But the recording industry's litigation position has been markedly different, going so far in one instance as to assert that webcasts are not permitted to allow any level of individual consumer influence over a program to qualify for the compulsory license.

To compete against broadcast radio—which pays no royalties—and cable and satellite radio—which do pay, but pay less than Internet radio, Internet radio must be able to create innovative consumer-influenced offerings using the power of our technology. Instead of holding back the royalty-paying medium, we urge the recording industry and Members of Congress that believe sound recording companies should be paid, to consider unshackling Internet radio's programming restrictions and promoting the medium that pays.

And let's not forget the artists. The statutory license requires that 50% of royalties paid by statutory license Internet radio services be paid directly to recording artists. The recording companies' efforts to restrict the scope of the statutory license by defining all innovative services as "interactive" directly decreases the amount of royalties paid to artists by Internet radio services.

Once again, in furtherance of fully-licensed litigation-free royalty-paying online music, DiMA urges the Subcommittee to amend the "interactive service" definition to ensure that programming based on user preferences falls squarely within the statutory license, so long as the generally applicable programming restrictions for the statutory license are not violated and so long as users are not permitted to control how much a particular artist is heard, or when a particular song might be

played. DiMA companies want to focus our energy on developing exciting royalty-paying products and services that combat piracy, rather than on lawyers and litigation.

2. *All Radio Services, or At Least all Digital Radio Services, Should Pay the Same Royalties and Play by the Same Rules.*

i. Sound Recording Performance Royalty Should be Equalized.

Today DiMA renews our request that the Subcommittee equalize the sound recording royalties paid by radio services. Setting aside the legalese and the history of how we got to today's disparity, let's focus today on fairness—to competing services, to artists and to recording companies.

All competitors deserve a level playing field, particularly when an obligation is structured by government. As technologies are developed and new competitive services develop, government should not favor or disfavor any single service or technology absent compelling circumstances, which are not apparent in the radio programming market. The Subcommittee is familiar with cable and satellite television programming royalties and the basis for equity in that marketplace. The same holds true in radio—broadcast, cable, satellite and Internet radio.

As a starting point DiMA acknowledges the frustration that Mr. Berman and others have long expressed regarding the U.S. broadcast industry's exemption from sound recording performance royalties. But let's not get bogged down on that issue, as significant as it clearly is. Instead, the Subcommittee should address forthrightly the anticompetitive impact when Internet radio pays artists and recording companies nearly 11 percent of revenue, and our cable and satellite radio competitors pay less than 8 percent of revenue. As DiMA pointed out in the July 2004 hearing, one cable music service has launched a broadband radio service, yet apparently has found a royalty loophole because it is using a transmission technology that is not Internet protocol. This sort of gamesmanship cannot be what Congress intended, but Congress can put an end to them by setting technology-neutral royalty standards.

Putting aside which of the many possible standards should prevail—and whether the right choice already exists in current law or whether a new standard should be developed—basic fairness requires that competitors pay the same royalties to the same providers of the same content. Similarly, artists and recording companies deserve a fair value placed on their creative works which is impossible in a world of multiple royalty standards, and fairness to consumers obligates a level playing field so that competition is robust and the most innovative and efficient radio service wins, rather than the service that is most favored by Congress.

ii. The Inequity is Multiplied by the "Aberrant" Ephemeral Sound Recording Reproduction Royalty.

As the Copyright Office noted in a 2001 Report to Congress, there is an imbalance in the legal and financial treatment of so-called ephemeral copies of compositions in the broadcast radio context, and similar copies of sound recordings utilized by Internet radio.

Since 1976 broadcast radio has enjoyed a statutory exemption to make reproductions of compositions so long as the reproduction remains within the radio station's possession and is used solely to facilitate licensed performances of the same music. Internet radio services also require ephemeral recordings to enable their webcasts, but while broadcast radio typically requires a single ephemeral copy webcasters require several copies to accommodate competing consumer technologies (e.g., RealNetworks or Windows Media) and services (e.g., dial-up or broadband Internet access). Each of a webcaster's ephemeral recordings functions precisely like the copy exempted for radio broadcasts, but Internet radio is saddled with having to license these copies, rather than having an exemption. In the first Internet radio CARP, the recording industry was awarded nearly a 9 percent bonus on top of the performance royalty for the making of these ephemeral copies.

In its Section 104 Report to Congress, the Copyright Office said that the compulsory license for sound recording ephemerals, found in Section 112(e) of the Copyright Act, "can best be viewed as an aberration" and that there is not "any justification for imposition of a royalty obligation under a statutory license to make copies that . . . are made solely to enable another use that is permitted under a separate compulsory license." *Section 104 Report, p. 144, fn. 434.* The Copyright Office urged repeal of this compulsory license; DiMA asks the Subcommittee to act on this request.

iii. Competitors Should Not Have Different Programming and Functionality Rules Based Only On Their Different Technologies.

As the Subcommittee may recall, the Section 114 sound recording performance right includes several rules that apply to Internet radio but not our competitors. Since technology has evolved and our competitors have become available over the Internet or other flexible digital formats, it seems reasonable to amend the sound recording performance complement rules that needlessly differ among competitive technologies and services. One example is the prohibition against engineering Internet radio programming to facilitate recording, which is not similarly applied to cable and satellite radio. The result is that XM Radio markets a marvelous MyFi device that records up to five hours of programming for consumers' portable enjoyment, but Internet radio companies cannot offer a similar product.

Additionally, programming restrictions that were put in place to reduce the substitutional impact of Internet radio should be relaxed, as digital broadcasters whose programming is available over the Internet present the same piracy risk to recording companies yet they do not have anti-recording obligations, are not saddled with programming restrictions, and of course they do not pay sound recording royalties.

Years before the introduction of subscription download services DiMA brought to the attention of the Congress and the Copyright Office the limitations on innovation and the legal uncertainty associated with Section 115 of the Copyright Act. More recently, we have highlighted the limitations on innovation, and the anticompetitive impacts, of Section 114. In both instances the statutory weaknesses are results of the provisions' exacting requirements and their construction in support of only the business models that existed or were anticipated at the time of enactment.

Today, the Copyright Office, the recording industry and even the music publishers finally recognize the validity of many of our concerns. We hope the Subcommittee agrees, and we hope you will expeditiously enact amendments to Section 115 and 114 to promote legal, flexible, innovative royalty paying digital music solutions. Don't do it for online services' benefit; do it for the creators who will benefit from the growth of legal services and the associated reduction in piracy.

Thank you for the opportunity to testify today.

Mr. SMITH. Thank you, Mr. Potter.

Let me acknowledge the presence of the gentleman from South Carolina and the gentleman from Utah. I appreciate their attendance.

It seems to me that there is general agreement on the need to reform section 115, and Mr. Newton, let me address my first question to you. What I'd like to do is ask some specifics. And as we reform section 115, Mr. Newton, if we were to move toward a system similar to the SoundExchange business model, is that something that you would support?

Mr. NEWTON. I appreciate you asking me that. This all gets so complicated that I don't feel comfortable answering for our organization, and I would—

Mr. SMITH. Fair enough. Is there anybody else who would want to answer that question? Mr. Kenswil, you mentioned a number of business models, nothing in particular. How does that strike you?

Mr. KENSWIL. Well, SoundExchange is set up as a performance royalty organization. Mechanicals are a bit different, but the general idea of a place to notify that you are using material and to send your payments so that these companies don't have to worry about 10,000 different royalty statements going out we think is a very good idea.

Mr. SMITH. Right; a good improvement.

Let me ask all the witnesses today, going to the subject of royalty rates, and again, this is asking you maybe to be more precise than you want to be. Would you favor generally flat rate or a percentage royalty rate? Mr. Newton, do you have a preference there or not?

Mr. NEWTON. You know, the technology that exists to move around music from the owners to the consumer is so amazing these days that to me, the technology should be to account for it. And it is my understanding that some places, they are already doing it. So whether it is a percentage

or—

Mr. SMITH. Flat.

Mr. NEWTON.—or a flat rate, but even if it is a flat rate, it should float along with inflation, because the Constitution says that they want to promote the progress, so I think we really have been going backwards since 1909 as our percentage as what that statutory rate.

Mr. SMITH. And you made the point in your testimony that it has not kept up with inflation.

Mr. NEWTON. No, it hasn't.

Mr. SMITH. And I agree.

Mr. Israelite.

Mr. ISRAELITE. I think in the pure mechanical downloading field, which is the most analogous to the sale of music, the publishers and songwriters would probably prefer to keep penny rate, although they'd like to see it adjusted upwards. But in the brand new world that we call subscription services, the publishers are very open to new models and, in fact, have proposed considering percentage models, as long as there would be some type of base-ment that would make sure that you didn't get in a situation where we're already being squeezed but earning less under a new system.

Mr. SMITH. Right; Mr. Kenswil?

Mr. KENSWIL. Well I think we have to be careful every time we draw a line between different types of services getting a different type of rate, so if you had a penny rate on one and a percentage rate on another, that just means drawing that line becomes more difficult. I think a percentage rate solves many, many, many of the problems that we're facing, whether it be the fact that songwriters get less as a percentage of high priced items and more of a percentage of low-priced items under the flat rate; that makes no sense at all.

The up side of increasing penny rates is fine during an era when sales rates are increasing, but we made a price cut last year of over 20 percent of our wholesale price, yet our cost for mechanical royalties went up. And I would say if you look at what the percentage of two cents was to the price of a wax cylinder in 1909, I think you may find that the percentage, the 8.5 cents out of a dollar now being received on downloads may well be higher.

Mr. SMITH. Thank you, Mr. Kenswil.

Mr. Potter.

Mr. POTTER. I think we support percentage of revenue pricing across the board. We are in a time of very dynamic pricing. Mr. Kenswil mentioned the price is going down in the sound recording industry. I will tell you that our goal is to wean consumers off pirate services, and if we have to charge them 39 cents or 59 cents or 79 cents, it is better than them taking the music for free.

I would agree with Mr. Israelite that there probably should be a floor. If we are giving music away for free, they should not get nothing; if we are giving music away as a loss leader, they

shouldn't get nothing, but in a time of pricing dynamics and in times of trying to attract consumers away from free, we've got to figure out what the right price point is.

Mr. SMITH. Both Mr. Berman and I have a special interest in interoperability. Mr. Potter, you are the one here today who is probably less likely to think that there is a problem with the lack of digital interoperability. And I do anticipate having a hearing on the general subject of interoperability; however, I do want to take advantage of the opportunity today to ask you what you think about it, and if we have time, I will ask the other panelists to respond as well.

Why should we not be concerned about that?

Mr. POTTER. I think we should be concerned about interoperability, but I think if we look at people who can now send a WordPerfect document to someone who uses a Microsoft computer, Microsoft decided it was worthwhile to interoperate with Corel software, or whoever owns WordPerfect today, and they decided to do it in the marketplace, and it worked.

You know, the hue and cry of consumers is what our companies listen to every single day. I happen to believe that when people can move their music to all their devices seamlessly, they will buy more music; they will buy more devices, and it will be better for everybody.

Mr. SMITH. Okay; thank you, Mr. Potter.

Mr. Berman is recognized for his questions.

Mr. BERMAN. That is funny, because in a way, your answer to the question on interoperability, I could hear the music publishers give that as an answer to questions on reforming the 115 license, but that does not mean it should not be reformed.

But I am—in your statement, Mr. Potter, you say the Harry Fox Agency, the music publishers' in-house collective licensing agent, is absolutely unable to license mechanical reproduction rights in a fashion that works for comprehensive digital services. Mr. Israelite, you say as of today, NMPA's members and Harry Fox Agency's affiliates have issued over 2.85 million licenses to 215 different licensees for digital delivery of musical works. These licenses represent the vast majority of musical works for which there is any meaningful level of consumer demand.

These sound like different versions of reality. Could each of you respond to the other one's comments and kind of develop this for us a little more?

Mr. ISRAELITE. I'd be happy to start. I have a great deal of respect for Mr. Potter, but I think that his testimony was probably more relevant last year. Since the hearing last year, the National Music Publishers and the Harry Fox Agency have come forward with a completely new openness to considering new types of models for subscription services, and so, in the letter that was submitted to you, Mr. Chairman, that's been shared, we are open to the idea of bulk licensing. We are open to the idea of a designated agent. We are open to the idea of a blanket license. We're open to the idea of a percentage of royalties for these subscription services.

So I think there has been quite a bit of movement by my organization in that regard. With regard to the pure downloading, I think that's working pretty well, and I think the success of the iTunes

model shows that for pure downloading, that's a system that can work pretty well under the current system.

Mr. POTTER. Let me start by thanking Mr. Israelite for confirming the statement in my testimony that they're willing to look forward and fix the system by creating a blanket license and agreeing to a blanket license. We agree that a blanket license is necessary, so I don't think we need to focus our time on the flaws in the existing system.

Mr. BERMAN. It sounds like we have a deal. [Laughter.]

There are many bizarre aspects to this situation in a world where performances versus distributions and transmissions have different statutory mechanisms for compensation and issues of ephemeral copies and whether something is a performance or a distribution. These are sort of metaphysical questions that—I mean, it sounds like the issue a lot is about how are the creators in this new world going to get compensated?

I don't believe the songwriters or the music publishers have a fundamental interest in metaphysical questions about how many different reproductions are made in some kind of digital online service. They're worried about getting shafted in this particular world. And I guess percentage of revenues is fine. I mean what happens in a situation where you allow 30 days free? Is it percentage of revenues to that specific recording? Is it the revenues of the entire company then divided up by some monitoring agency like ASCAP and BMI do in that world? And how are we supposed to figure out what the just rate of return is in this particular situation?

Eight cents sounds pretty small. For some reason, it's a maximum, because apparently, the record labels have some ability through a device known as controlled compositions to pay less than that if they can, I guess, leverage that kind of an agreement with a songwriter, a music publisher, and I'm just wondering if this—the notion that how we are going to come to terms with this if you folks can't sort of negotiate, all of you taking some risks in negotiating a feasible sense of compensation for this new world that we all seem to agree is absolutely critical to providing an alternative to the piracy that's going on now, I mean, somewhere, everybody has to get off sort of fixed positions and figure out, sort through this in a way that lets you bring on new services; lets you folks facilitate these sound recordings coming to people in the ways they want to hear; and allows the creators to get adequate compensation and be incentivized to continue to produce new music.

I will yield back.

Mr. SMITH. Thank you, Mr. Berman.

The gentleman from Utah, Mr. Cannon, is recognized for questions.

Mr. CANNON. Thank you, Mr. Chairman. I didn't realize we'd been abandoned, I was so engaged in Mr. Berman's questioning. I appreciate the time.

Mr. Potter, in your testimony, you urged that we clarify the definition of interactive service to ensure that programming based on user preferences falls squarely within the statutory license. For example, consumers should be able to rate an album, the artist or the

song according to the customer's preferences without the service being rendered interactive. Is that right?

Mr. POTTER. Yes, sir.

Mr. CANNON. And then, the idea is to enable the Internet radio to create innovative technological services in order to be able to compete with broadcast radio as well as cable and satellite, which either pay no royalties or pay less than Internet radio; is that right?

Mr. POTTER. Yes, sir.

Mr. CANNON. And, Mr. Potter, section 115 was developed for business models and technologies of the past. It is not able to adapt to current technologies or future technologies. Can one safely assume that inaction by Congress in this area would hamper technology and innovative growth?

Mr. POTTER. Undoubtedly. I think Mr. Kenswil's industry and my industry have had our fights over the years about how to license in ways that promote innovation, and frankly, our companies are working much more closely together on new services and new opportunities and new licensing schemes. I think the publishers and the songwriters have had a slower awakening, and I think that Mr. Israelite is right that in the last several weeks since his arrival, and frankly, even in the last several months immediately before his arrival, we have had much healthier discussions, and I think there has been a much greater recognition that we are all on the same side.

We need laws, as Chairman Smith said back in last March's hearing a year ago, that set general guidelines, and the laws need to set general guidelines on what the rules are so that the technologies and the business people and the product developers and the consumers can drive toward the future in legal ways that spin out a lot of royalties to creators.

Mr. CANNON. And when you say a lot of royalties to creators, you mean you want them to make more money in this process.

Mr. POTTER. I would love to see them make more money in this process, because if they make more money, I think our companies will, also.

Mr. CANNON. As you know, I love music, and I like the idea of having a more and more robust market. We have come a long way in the last 8 years or so; really wonderful things are happening, and your industry has a lot to do with that. But in a letter to Chairman Smith, the National Music Publishers Association suggested that online services' combined royalties to record companies and music publishers should not exceed 50 percent of revenue. Mr. Potter, would your members support that?

Mr. POTTER. I think they would, sir. We are happy to agree with Mr. Israelite and his organization on that one.

Mr. CANNON. And the same letter to NMPA suggested that online services royalties should be divided two-thirds to recording companies and artists and one-third to music publishers and songwriters. Would your members agree with that formula?

Mr. POTTER. I think our members would stay far away from that agreement or disagreement. You know, our view is everybody needs to get their fair share from their creative inputs, but at the end of the day, I'm not going to tell Mr. Kenswil or Mr. Israelite or their

respective colleagues in their industry or members how they should divide the royalty pie. That is just none of my business.

Mr. CANNON. You just want it fixed or in a way that's clear so you guys can innovate and create and get it out better.

Mr. POTTER. The most important thing is the rights have to be fixed and clear. The rights have to be clear so that we can innovate without getting sued and without getting sued out of business by the statutory liability and strict liability statutory damages. The second thing is to have a clear path toward resolving the royalty disputes, and frankly, the simpler path, the fewer transaction costs, the fewer arbitrations and rate courts, the better, because we need to go innovate in products and services, and these guys need to go create new music.

Mr. CANNON. Thank you for saying that. That was very clear, very precise, elegant and right to the point, and I agree with that.

Mr. Israelite, at the March 2004 hearing that was just referred to, the NMPA representative who testified before the Subcommittee testified that section 115 mechanical compulsory license does not need to be updated and that the Harry Fox Agency offers a marketplace solution for the licensing needs of digital musical services. It sounds like you are more open to legislation that would convert the existing compulsory license into a blanket license; is that correct?

Mr. ISRAELITE. I think that the Publishers Association and their songwriter partners have come a long way since the hearing from last year. We've heard the Committee. We've listened to a lot of the industry, and one of the things that we are now open to is the idea of a blanket license. We think we should first try it in the space that is known as subscription services. So that is everything between pure downloading, which is most analogous to sale, and pure radio, and everything in between, which we call subscription services, which includes on demand; it includes limited downloads and things of this nature. We are very open to these new ideas, and in fact, in response to, I think, an appropriate comment from Mr. Berman, we've taken risks, and we have actually agreed to license without having any guaranteed rate in the future.

We don't know what the rate is. And for over 3 years, the songwriters and the individual publishers haven't been paid by those subscription services, because we agreed to go ahead and license now and wait until we work out a rate in the future. And that was something that I think our folks did in good faith to try to make a new technology work. And so, I think we are doing exactly what's appropriate in the marketplace, which is we are taking risks, and we are also open to new ideas, as we've been, as I suggested, since the last hearing by supporting the idea of a blanket license in the subscription world.

Mr. CANNON. Thank you.

I note, Mr. Chairman, that my time has expired, and I yield back.

Mr. SMITH. Thank you, Mr. Cannon.

The gentleman from Michigan, Mr. Conyers, is recognized for questions.

Mr. CONYERS. Thank you, Mr. Chairman.

Mr. Newton, I was really excited about your CD article I, section 8, because the only time I have referred to article I, section 8, was

to remind the Administration that only the Congress has the right to declare war. And so, I was very anxious to get this back to my equipment upstairs, but then, I realized that you were, in fact, referring to another part of article I, section 8. [Laughter.]

Mr. CONYERS. And I am still going to play it, but not with the anticipation that you are a political activist in disguise who has come to this hearing today. [Laughter.]

Nevertheless, I wanted to try to figure out a way that we can deal with the issue of the publishers and composers, and I just wanted to begin by asking Mr. Israelite that under a blanket license, why shouldn't service providers receive licenses from and report directly to a centrally-designated agent or individual copyright owner of a nondramatic musical composition?

Mr. ISRAELITE. Mr. Conyers, we are very open to that idea of direct reporting from the providers. We think that we should try it first in the subscription world, but that would be something we would be open to.

Mr. CONYERS. Well, you know, the royalties for the publishers go through RIAA first, which sometimes delays the receipt of the royalties by the publishers, and I think we have to try to figure a way how we deal with this so that these creators on the bottom, they are on the end of the food chain, and by the time they go through all of these hoops, there can be a very diminished reward for the ones that have created the music, and that compels me to approach what we do with 115 very carefully.

For example, if a blanket license and designated agent proposals are established, would anyone mind dealing directly with the publishers instead of going through the record labels? Is that beyond contemplation?

Mr. KENSWIL. Well, certainly, if I can respond, right now, there are many services that only want to deal with the record labels. We're told, for instance, by cellular companies that they will not carry our product on all the services they have unless we clear the publishing rights and pay the publishers. Much of that is because we have the infrastructure to do that, and they do not. If that infrastructure problem was resolved, we would absolutely have no problem with any service that chooses to go directly with the publishers to do so.

We really don't have any interest in spending all the overhead money we spend now in collecting the money and then paying it back out again.

Mr. CONYERS. Is it true that DiMA now pays royalties through RIAA and probably wouldn't mind going directly to publishers if all these other issues were resolved?

Mr. KENSWIL. That varies company by company, since it deals directly with the companies. I can only speak for Universal, and our subscription deals provide for the DiMA members to pay the publishers directly, as they now stand. Other companies may have different arrangements.

Mr. CONYERS. Mr. Potter, did you have a comment?

Mr. POTTER. I did, sir. I think on the—and Mr. Kenswil can probably confirm this as well—on the issue of paid downloads, similar to what we all know Apple is selling with the iTunes for 99-cent singles, those publishing rights are typically sublicensed by the

record companies. On the subscription services, which is the on demand radio or which is the tethered download or the rental system, the Napster to Go service, for example, those are typically direct from the Harry Fox Agency, and in all cases with performance royalties, we pay directly to ASCAP and BMI.

Our companies are entirely agnostic as to who we write the checks to and who we report to. We have the data to report to everybody, and we're prepared to give it to them directly and quickly as well as to give them their money directly and quickly.

Mr. CONYERS. I close on this observation if anyone wants to comment on it. Have the music publishers ever been challenged in court for asserting rights that they do not have? Because the Internet companies believe that the law doesn't permit publishers to get royalties for temporary copies, but and they say the law is unclear, but at the same time, I don't recall anyone trying to verify this analysis by filing a challenge with either the Copyright Office or in Federal court. Do you?

Mr. POTTER. I think that the Copyright Office, Mary Beth Peters, has actually made her position very clear on the issue of what we obviously articulate as the double dip royalties, and she said that our position is the correct one. She said it in her 104 report in August of 2001, and she said that several times before this Committee. She has said that this is the way the law is in some circumstances, and it should be in all circumstances.

Having said that, it's obviously up to the Congress to legislate, but the music industry has been a see no evil, hear no evil business for many, many decades. There's a lot of folks at this table and behind us in our industries who understand that there is a lot of gray areas in the law, and there's no reason to challenge it, because it can probably hurt you more than it helps you.

So, our plea is to you to clarify the law, to minimize the risk, to let us spend less money on lawyers and more money on marketers and innovators so we can sell more music and pay more royalties.

Mr. SMITH. Thank you, Mr. Conyers.

Mr. CONYERS. Thank you.

Mr. SMITH. The gentleman from Virginia, Mr. Goodlatte, is recognized for his questions.

Mr. GOODLATTE. Mr. Chairman, thank you for holding this very interesting hearing.

Mr. Potter, I would like to follow up; in fact, I would like to ask all of you on the conversation you had with Mr. Berman regarding the progress that you are making toward working out these issues in the private sector since last year's hearing. I think we are not quite to where Mr. Berman described it as having a deal, and I would like to hear you tell us what kind of progress you are making and whether you think the parties can come up with a final workable solution without intervention by the Congress.

Mr. POTTER. I think that we have to start from the premise that Congressional action is absolutely necessary. It may be a consensus presentation by the industries and a request, a joint request to legislate, but the law that exists today, both in 115 and 114, is remarkably micromanaging, and it is built, constructed specifically for industries as they existed at the time of enactment or as some who are in the room thought the industries might develop.

That is a very hard way to legislate, because as soon as the industry veers off into a new direction that's unexpected, and that could be any industry. It's sort of like if you literally by statute said gas stations must be full service, and then, somebody said, well, why can't we be self service? We want to have you pump your own gas. But they had to go back to Congress. That's the level of detail that 115 includes and in some respects 114. So I think regardless of what negotiations transpire and results transpire, we do have to come back to legislation.

Mr. GOODLATTE. Mr. Israelite, do you want to comment on that?

Mr. ISRAELITE. Thank you. It is difficult for me to evaluate this, being so new on the job, but what I can tell you is in just the few weeks that I've been on the job, we've had very productive initial discussions with the digital folks and with the recording industry and with the songwriting groups, and so, I'm encouraged, and I'm optimistic.

The music business is one where there are historical conflicts, and one of the things that I think can help us is that we are all very united in the fight against piracy, and I think that a lot of our efforts in that regard can help us to learn to work better together, and so, I'm optimistic about that, but I do think that we ought to give negotiations a chance to work, and I think if you look at the progress from just last March to where we are today, you see some significant movement. And so, I'm optimistic that we can continue that.

Mr. GOODLATTE. Mr. Kenswil or Mr. Newton, do you have any comments on that?

Mr. NEWTON. I did want to comment, and this goes back to your question, Mr. Conyers, about how shocked you were that I used article I, section 8 in dealing with these issues, and we understand that it was James Madison who wrote the very powerful and concise words that deal with these copyright issues. I was shocked when I saw that it was on the same page as the war powers and the Post Office and building roads, but to me, it also shows how important he thought it was to give it incentive.

And the only profession mentioned in that article I, section 8 is authors. The inventors are not involved in this discussion we are having today. It mentions inventors, but we are talking about authors. We sign away some of those exclusive rights to our publishers. Sometimes, our publishers are our own selves; that's in my case, some cases. So it is very clear, very ungray, the exclusive rights, and that's the point of my song, and I hope we get a chance to get to that. The exclusive rights are given only to the authors.

Mr. GOODLATTE. Mr. Newton, you are on my nickel, and I need to get—

Mr. NEWTON. Okay; sorry.

Mr. GOODLATTE.—a couple of other questions in.

Mr. Kenswil, did you want to respond?

Mr. KENSWIL. Obviously, the marketplace is usually the best place to decide these things. I agree that we probably need to come back to you. Hopefully, we will get to an agreement. If everybody agrees to work day and night for several weeks, I'm sure we could get there. It's a matter of the desire, and then, hopefully, we can

come back to you with an agreement that could be codified, which will probably be necessary.

Mr. GOODLATTE. Mr. Potter, in Mr. Israelite's written testimony, he states that the National Music Publishers Association members and the Harry Fox Agency affiliates have issued over 2.85 million licenses to 215 different licensees for digital delivery of musical works. Have online music services been able to satisfy consumer demand for specific types of content, or are there still types of music for which there is significant consumer demand that are unavailable to online music service companies, and can a consumer obtain these types of music legitimately online?

Mr. POTTER. Your question goes to types of music, and that's a tough one to answer. Let me provide a couple of ideas. One is that any single song, if the consumer wants it at that moment, and it's not on our service, it's available on Grokster and Kazaa. It's a really simple proposition for the consumer. If I can't get it legally, I know I can get it illegally.

Mr. GOODLATTE. I understand that. Can they get it legally?

Mr. POTTER. Can they get it legally? There are still several bands, frankly, that have not authorized their songs; several people on the master recording issues, and that's an issue that—

Mr. GOODLATTE. But there's no genre or type of music that isn't being licensed.

Mr. POTTER. I don't know that there is a genre or type of music that is not being licensed, but there are several holes in the catalogue for several online services.

Mr. KENSWIL. I can identify one just off the top of my head, and that's international music. There are many, many millions of songs that have never been available in this country, and there is a marketplace for them. The reason for that is in the past, it has not been economic to release them. Online makes it economic to release them. But we go back, we have a large Indian repertoire, a large Mandarin repertoire of music, Cantonese repertoire at Universal. It's very hard to do that, because not only can't we find the publishing companies to license; we probably, in many cases, there isn't one, because those rights have never even been assigned in this country.

Mr. POTTER. That might get to the orphan copyright study that I know the Copyright Office is doing.

Mr. GOODLATTE. I think Mr. Israelite wanted to comment, if that's all right.

Mr. ISRAELITE. I'll just mention that at least in the subscription world, we've agreed to license everything, and we've agreed to do that without even knowing what our compensation will be in the future, and again, we're also open to a blanket license that would license everything in that space. And so, you know, one of the things that's important to remember is that as quickly as these services want to offer music, ultimately, the money has to find the right people who need to get paid. And so, part of the equation is being able to provide the proper information, make the request in the proper way, and so, we've been working through those issues, but it's something we're committed to doing.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Goodlatte.

We will be continue the discussion, as I mentioned. We will be identifying some issues we would like for you all to comment on.

Mr. Newton, we promised you time to sing the song, and you had mentioned, and I think others had mentioned as well, the article I, section 8. There aren't very many Subcommittees in Congress, maybe fewer than six, who can point to the Constitution as a basis for their jurisdiction, and the Intellectual Property Subcommittee is one of those, and that is what, I think, makes it a little bit distinctive. Now, as you proceed to sing that song, are you going to sit right there, or do we need to——

Mr. NEWTON. No, I think I would like to stand.

Mr. SMITH. That would be great.

Mr. NEWTON. I find that it is much easier to remember the lyrics to songs than it is to memorize a speech, and in preparation for coming up here a few years ago, it just occurred to me that these words were so precise that they would make a good song, so this takes about 2 minutes.

[Mr. Newton performs song.]

[Applause.]

Mr. SMITH. Thank you, Mr. Newton. I don't know about the U.S., but that will be number one on our chart in any case. [Laughter.]

Thank you very, very much.

I think we need to conclude. I appreciate everybody's interest. We stand adjourned. Thanks.

[Whereupon, at 5:54 p.m., the Subcommittee adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE HOWARD L. BERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND RANKING MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Mr. Chairman, thank you for scheduling a hearing on Section 115. It has been a year since the last hearing on this issue and I think it is important to assess developments that have occurred in the digital music arena and what strides the parties have made to address the concerns expressed last year.

A primary concern for all those making and distributing music is the threat of piracy. Piracy threatens to harm an industry that is responsible for providing many jobs in my district and the country, from the recording artists to the back-up singers, sound engineers, musicians and the businesses that supports these talents.

There are things we can do to restrict piracy: technology can provide digital rights management technologies, we can strengthen civil and criminal copyright laws, we can address the peer to peer networks, incentivize prosecution of egregious offenders, include more efficient provisions in trade laws and I can go on. All of these mechanisms are important aspects in battling piracy.

The issue of piracy comes to the forefront when facilitating the distribution of music—digital and on-line, in any format, to any place someone wants. I've come to the conclusion that aspects of the Section 115 license hinder the development of new services. This in turn makes theft of music more attractive and then denies all segments of the music industry and those facilitating legitimate services their rightful compensation.

Last year, NMPA described this issue as the “flavor of the month.” It is more likely the flavor of the next decade. Recently, *The Washington Post* reported that within the next decade the CD likely would be surpassed as a format of choice. Replacing it would be *not* a new physical format, but a data file. The success of Apple iTunes and the launch of the Napster subscription service may not speak to the death of the physical format, but definitely speaks to its decline. In helping to facilitate movement from the use of CDs to the digital age, we need to ask how the Section 115 license would best be reformed.

The last time we addressed this issue, we were at least united on a core principle—the prevention of piracy. Each party here has had a vested interest in preventing the theft of intellectual property that continues to this day. Each party also has an interest in being able to deliver as much music as possible to maximize revenues or royalties. However, other than piracy and the need to provide access to music, the parties have presented divergent views about change to Section 115. Furthermore, subsequent digital music licensing hearings on the application of the Section 114 license elicited many differing opinions as well.

There seems to be little progression in terms of agreement on how to address Section 115. The Copyright office found little consensus in the negotiations they observed last summer and DiMA's testimony still reflects concerns identical to those voiced in that hearing.

The issues to be resolved in Section 115 seem arcane and dull, but have enormous impact on the way music reaches its listener. The parties have raised a number of questions which need to be resolved to enable digital music distribution. For example, should we modernize the administrative requirements to obtain a Section 115 license? Currently these requirements are burdensome for users and don't seem to work with newer digital business models.

Furthermore, should we provide clarity to the scope of Section 115 by explaining what we intended to be encompassed within the meaning of the words “digital phonorecord delivery?” The definition we provided does not do much good if those who use it do not know what it means. Finally, there is the issue of valuation of the

work. On this point I digress for a moment to note that the static rate of 2 cents per copy for a musical composition which lasted for almost 70 years was reprehensible. We cannot, however, change the past. We must focus on the future and establish the most effective way to determine the actual value of a reproduction of a musical composition. The rate that has always been used is a per reproduction rate. This may have worked when the reproductions were piano rolls, but does it work in the digital world when there is no tangible item to hold onto?

Perhaps it would be best to let the market figure out a solution to the problem. We already have a good example of private parties resolving a way to deal with physical reproduction issues, and that example is the EMI Music Publishing and Sony BMG deal at the end of last year. In that vein, I would like to throw out the idea that all of the interested parties, including the Performance Rights Organizations come together and negotiate changes to Section 115 that would facilitate both the copyright owner's and consumer interests. If by a time certain the community has not been able to come to an agreement, then working closely with the Copyright Office we will in a bi-partisan way consider creating our own changes.

The focus needs to remain on providing rightful compensation to those who provide the music. Our efforts must continue to focus on preventing piracy and help facilitate legitimate digital online services. I look forward to hearing from the witnesses about how changes to Section 115 would help in achieving our goal.

I yield back the balance of my time.

LETTER FROM THE REGISTER OF COPYRIGHTS OF THE UNITED STATES OF AMERICA



The Register of Copyrights of the United States of America
 United States Copyright Office · 101 Independence Avenue SE · Washington, DC 20559-6000 · (202) 707-8350

September 17, 2004

Dear Representatives Sensenbrenner, Conyers, Smith and Berman:

As you requested in your letter dated July 7, 2004, the Copyright Office has hosted a series of discussions between the National Music Publishers' Association, Inc. ("NMPA") and its subsidiary The Harry Fox Agency, Inc. ("HFA"), the Digital Media Association ("DiMA") and the Recording Industry Association of America, Inc. ("RIAA") relating to possible legislative approaches to modernize section 115 of the Copyright Act. In accordance with your request, we met on several occasions with the interested parties jointly in addition to meeting individually with representatives of each of these groups to survey their concerns and identify areas of agreement. During this period, the groups also had discussions among themselves.

In general, we found the parties willing to explore legislation to establish a blanket licensing scheme in Section 115 to facilitate the licensing of copyrighted musical works, but there are significant differences among the parties regarding the appropriate scope of such a license and regarding operational and economic issues. At this point, there is not sufficient agreement to form a basis for us to draft any model legislative language. However, the parties have, at our request, jointly identified the key issues and summarized their current positions with respect to each of those issues:

- *Scope Issues.* From the narrowest to the broadest, the parties have discussed five alternatives for the scope of a Section 115 blanket license:
 - a. covering online subscription services offering "tethered" downloads and/or on-demand streams;
 - b. covering all online services, including those offering digital downloads for sale;
 - c. covering all online services and new physical formats, i.e., multi-session CDs and "locked content";
 - d. also covering traditional physical formats (CDs, etc.); and
 - e. also covering other uses of musical works in new product offerings;

Generally DiMA and RIAA favor a broader license. They believe that the licensing of musical works, especially for new media and new types of distribution, must be streamlined if these products and formats are to compete successfully against piracy. NMPA has favored a less expansive license, noting the extraordinary upheaval that even limited changes will cause publishers and their traditional business practices, and believing that the significant economic costs of creating and operating a blanket license authority could severely impact writer and publisher royalty income.

- *Streaming.* A subset of the scope issue is whether the Section 115 license (which historically has applied to distribution of musical works embodied in sound recordings) does or should extend to on-demand streaming. RIAA and NMPA have previously agreed that the process of on-demand streaming, viewed in its entirety, i.e., from the making of sever reproductions to the transmission and local storage of the stream, invokes rights subject to licensing under Section 115 and are prepared to affirm that agreement in this legislation. DiMA has not agreed with RIAA and NMPA's characterization of current law, nor is DiMA prepared to adopt the RIAA-NMPA agreement in new legislation.
- *Basis of Royalty Payments.* RIAA and DiMA favor explicit legislative approval of a percentage-of-revenue option for arbitrators (or Copyright Royalty Judges) who in the future set Section 115 royalties. NMPA believes that current law does not preclude an arbitrator from setting a percentage-of-revenue royalty but has not agreed that affirmative statutory language is appropriate.
- *License Terms.* The parties have discussed several issues with respect to the terms of a potential blanket license.
- *Controlled Composition Clauses.* NMPA favors requiring payment at the statutory royalty rate irrespective of "controlled composition clauses" in recording contracts, which reduce the royalty rate paid by record companies to songwriters and publishers, with respect to activities subject to a blanket license. RIAA opposes this change, which it contends would significantly diminish record companies' licensing flexibility and have significant economic impact.
- *Sublicensing.* Recording companies have been sublicensing the right to digital phonorecord deliveries to Internet services pursuant to amendments made to Section 115 in 1995. Under a blanket license, NMPA prefers for payment, reporting and auditing purposes that the proposed designated agent or music publishers deal directly with the services making covered deliveries. RIAA and DiMA would prefer to offer services and record companies the option of sublicensing if they so agree.
- *Cost/Funding Issues.*
 - a. NMPA is concerned about the start-up costs associated with creating a new database and royalty collective, which necessarily involves administering a payment and distribution system involving millions of musical works and tens of thousands of owners. NMPA is acutely aware of royalty distribution complications associated with the many musical works that have split ownership (i.e., rights divided among two or more songwriters and/or publishers).
 - b. NMPA is also concerned that the collective will suffer a free-rider problem, as the collective must be capable of managing all Section 115 rights, but many copyright owners and users may choose to license Section 115 rights directly and thereby

Hon. F. James Sensenbrenner, Jr., et al.

-3-

September 17, 2004

avoid sharing the costs of creating and administering the blanket license infrastructure.

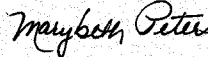
- *Miscellaneous.* The parties have also discussed the process of selecting a common agent, and ministerial (but important) issues of payment, auditing, and notice and recordkeeping.

Based on our discussions with the parties, we believe that this is a fair summary of the principal issues and the positions taken by the parties. It should be noted that in preparing this summary, the parties have expressed some reservations about staking out hard-and-fast positions in writing on all the key issues because many of the scope and associated issues are interrelated, and the positions of the parties with respect to each of the individual parts of any legislative proposal would depend necessarily on their evaluation of the proposal as a whole.

The parties are continuing their discussions on these issues in the hope that they might agree upon a legislative solution to the problems associated with modernizing Section 115. However, in light of the complex issues and the economic stakes involved in these discussions, there is little likelihood that the parties will reach sufficient agreement to create a consensus legislative proposal before the October recess.

The parties have expressed a willingness to continue discussions among themselves and with the Copyright Office with the goal of coming up with consensus legislation, and I would be pleased to play whatever role that you conclude would be useful in addressing the reform of section 115.

Sincerely,



Marybeth Peters
Register of Copyrights

The Honorable F. James Sensenbrenner, Jr.
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The Honorable Lamar Smith
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