

United States House of Representatives
Subcommittee on Courts, the Internet and Intellectual Property
Committee on the Judiciary

Hearing on “Section 115 of the Copyright Act: In Need of Update?”

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TESTIMONY OF JONATHAN POTTER
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Mr. Chairman, Representative Berman, and Members of the Subcommittee:

Thank you for inviting me to testify today on behalf of the innovative, royalty-paying online music services offered by DiMA member companies, including by AOL, Apple, Microsoft, MusicMatch, Napster, RealNetworks, and Yahoo!. DiMA companies’ success is critical to America’s music industry, so I appreciate the opportunity to share the great strides that our companies have made toward building attractive royalty-paying online music services. More importantly, however, I will highlight how Section 115 of the Copyright Act – which should be a building block of online music services’ growth – instead remains the most significant roadblock impeding our industry’s progress, and how this Subcommittee might consider updating the law to benefit all the relevant constituencies – artists, publishers, recording companies, online services, and consumers.

DiMA members express their appreciation to Chairman Smith and Representative Berman for focusing the Subcommittee on curbing copyright piracy through a balanced approach that combines enforcement of the laws and public education. DiMA agrees with the Subcommittee that enforcement and education are critical foundations of any effort to deter piracy of copyrighted works. But, we believe firmly that piracy cannot be combated successfully unless consumers are offered a better choice – legal, royalty-paying services that include quality music, flexible usage rules, great personalization and first-class customer service, all for a fair price. By modernizing Section 115 of the Copyright Act and by clarifying how it applies to different types of digital music services, Congress can assist DiMA companies and the music industry compete against and curb piracy by ensuring the availability of the most comprehensive, most attractive royalty-paying offerings.

In recent years this Subcommittee has responded several times to promote the business and legal environment of legitimate online services. A statutory license was provided for webcasters in 1998, and the Small Webcasters Settlement Act was enacted in 2002. Both of these measures established a relatively stable legal environment for webcasting, and stimulated the creation of thousands of Internet radio stations. Most recently this Subcommittee moved CARP reform legislation through the House and DiMA hopes this legislation will soon become law.

In May 2001, three company CEOs, representing the online media and recording industries, testified before this Subcommittee that music publishing licenses were the single greatest impediment to launching great online music services. In December 2001 Register of Copyrights Marybeth Peters testified that music publisher representatives were taking advantage of legal uncertainties with respect to the application of §115 to new digital services and were aggressively demanding licenses for services already licensed by other collecting societies. Register Peters urged Congress to fix the problem by amending the law

In the same December 2001 hearing, Messrs. Ramos and Sherman also testified, but from a different songbook. They promoted a so-called “landmark” agreement between the recording and music publishing industries and The Harry Fox Agency, that they claimed would solve the problems identified in the May 2001 hearing and permit new subscription services to launch, gain publishing licenses easily and on a nondiscriminatory basis, and curb piracy.

As the Subcommittee is aware, there has been recent good news in the online music industry. Every month tens of millions of Americans visit AOL Music, the iTunes Music Store, Rhapsody and the RealNetworks Music Store, Napster, MusicMatch, Yahoo Music and MSN Music. These services stream more than 500 million songs and videos every month, sell more than two million downloads each week.

But again we are before this Subcommittee discussing how the outdated Section 115 of the Copyright Act continues to retard the success of online services. Although the online music situation has improved, it is not good enough – for songwriters, music services, record companies or, we hope, for Congress. What is holding back online music services today is the same impediment of three years ago: the inability of legal music services to easily obtain and pay for clear, certain, risk-free music publishing licenses, notwithstanding nearly 100 years of federal policy which favors clarity, simplicity, and straightforward licensing.

Congress established the Section 115 compulsory “mechanical” reproduction license in 1909 to facilitate the licensing of musical works for piano rolls. Congress’s goal at that time, and during the 100 years since, has been to promote the development of new music markets by making copyrighted compositions widely available, while also ensuring that copyright owners are aware of uses of their work and that royalties are paid.

Fast-forward almost 100 years and the underlying goals and principles remain the same. Royalty-paying online services are precisely the type of new music market that Congress intends to promote; and the Section 115 compulsory mechanical license could and should be playing an important role in building online music services with broad catalogs and the ability to compete with online black markets. Unfortunately, Section 115 is not very useful to online services, because (i) the licensing process is unworkable for digital music services; and (ii) its ambiguous scope causes uncertainty, risk, and excessive double-dip royalty payments.

The §115 licensing process is dysfunctional because:

- (a) it imposes outdated paper-based and traditional mailing requirements that hinder prospective licensees' ability to efficiently identify copyright owners, license their works and pay them royalties. While these systems may have been acceptable for licensing a few works at a time for compact discs, they cannot support the launch of a new online music service with a catalog of hundreds of thousands of songs;
- (b) its licensing and pricing standards were designed for simple physical, manufactured products, and simply are not feasible in the world of digital distribution;
- (c) its requirements are scrupulously precise and its penalties for noncompliance are harsh. Failure to comply strictly with these cumbersome requirements not only subjects a service to infringement liability, it also disqualifies a service from obtaining a compulsory license to that work forever. And do not underestimate the chill in the online music industry created by the Copyright Act's combination of a strict liability standard with extraordinarily high statutory penalties. Though intended to protect copyright owners and to be used against pirates, this combination of strict liability, high monetary penalties and a detailed, outdated statute is promoting fear and paralysis rather than innovation and new markets.

There are several disagreements about the scope of §115's application to legal, royalty-paying digital music services:

- (a) there is disagreement about whether on-demand Internet radio services which merely perform music require mechanical reproduction licenses, though they do not permit users to make or possess any reproduction; DiMA and the Register of Copyrights believe that on-demand performances may justify a higher performance royalty than pre-programmed radio services (and ASCAP and BMI charge almost a 50 percent surcharge for on-demand performances), but that the server-based and incidental reproductions associated with performance services are either royalty-free fair use or should be exempted from royalties under the ephemeral recording exemption that is provided to terrestrial broadcasters in §112 of the Copyright Act;
- (b) there is disagreement about whether the §115 license extends to subscription services, which charge consumers monthly in contrast to download services that charge per song purchased;
- (c) there is disagreement about whether the §115 license extends to all reproductions that are necessarily made to support distribution of a song, e.g., by a download store, or whether incidental network and transient reproductions or server copies require an additional license and payment.

Though the law and its impacts are complex, the overall result of the shortcomings of §115 are quite simple. This compulsory, guaranteed-to-be-available publishing license that Congress intended to be a meaningful alternative to direct licenses with 10,000

publishers and thereby promote new music markets and generate royalties to songwriters, is instead so administratively burdensome and of such uncertain scope that it is no alternative at all, and is undermining rather than promoting innovation and new royalty-paying markets.

To compete most effectively against online black markets DiMA companies' music selection must be comprehensive – we need all the music that a compulsory licenses promises. To achieve stability and promote innovation, we need clarity with respect to whether and how §115 applies to online music business models of today and in the future.

Several times the compulsory mechanical license has been updated to account for changing technologies and business models, but the evidence that it needs additional revision is overwhelming and conclusive. DiMA urges the Subcommittee to update this law for the next generation new market – innovative online services that with your support can be commercially successful and the best weapon against piracy.

I. What are the problems with the Section 115 compulsory mechanical license?

A. The license clearance process is so cumbersome as to be dysfunctional

The most apparent deficiencies of the mechanical compulsory license are its administrative requirements, which are obligated by the statute and Copyright Office regulations.

§115(b)(1) requires users of compulsory mechanical licenses to “serve notice of intention [to use the compulsory license] *on* the copyright owner” prior to a musical work’s use (emphasis added). Regulations require copyright owners to receive actual advance notice of the intended use of a work by certified or registered mail. However,

- Finding copyright owners can be almost impossible. Only about 20 percent of musical works are registered in the Copyright Office; many are not registered until several months after publication; and registrations are rarely updated when ownership rights are transferred.
- For pre-1978 works, copyright owner information is available only on card files that must be searched manually in the Copyright Office on a song-by song basis.
- If a copyright owner is identified, the licensee must notify the owner using a 2-page form for each individual composition, and send the form and then monthly statements of use and royalty checks by certified or registered mail.
- If the copyright owner cannot be located users must file a similar 2-page form in the Copyright Office, and pay a \$12 administrative fee per composition. This fee is prohibitively expensive considering that typically 25% of copyright owners cannot be located, meaning a comprehensive online service might have to pay the fee (and fill out the form) hundreds of thousands of times.

The process of identifying and providing notice to a copyright owner, or determining that notice is not possible because there is no registration data or the data is incorrect, might take several weeks per copyright. This is not helpful when a service is competing against online black markets that have no licensing costs, no marketing costs, no content acquisition costs, and have made the song available while the royalty-paying service is still filling out forms and sending registered mail.

At minimum, even merely as a matter of government oversight, modernization and customer service, there is no escaping that this licensing process does not work. And if the compulsory mechanical license is to continue to exist, we urge the Subcommittee to at least ensure that it is administrable, efficient, and employs modern technology.

B. The scope of 115 does not comport with the necessary manufacturing practices of the digital download business or the physical recording business.

The antiquated Section 115 undermines online services because it requires that royalties be paid for every reproduction that is “made and distributed.” This was reasonable for 90+ years when most observers believed that each reproduction or phonorecord – a piano role or a vinyl record or compact disc – was intended for distribution and, thus, deserved a royalty. For online services, however, not every fixation or reproduction is intended for distribution, because many reproductions necessarily occur in the electronic process of delivering a download.

Read literally, §115 might mean that reproductions that are not distributed, but which are necessary to the manufacturing or distribution process (e.g., server copies, archive copies and network and cache copies and buffer copies), are not eligible to be licensed pursuant to §115. And if that is the case then digital download stores and subscription services may be risking crushing infringement lawsuits, because these technologically necessary copies are not currently being licensed separately with each of more than 10,000 music publishers.

This is also an issue for the traditional recording industry, whose compact disc manufacturing process requires production of a so-called “glass master” that the factory uses to stamp each blank CD into a phonorecord. Does the §115 license, by implication and based on historical practice, cover this reproduction though it clearly is not intended for distribution?

The risk is even greater for online services than it is for physical CD manufacturers. Product manufacturers might have a waiver and estoppel defense based on decades of not being sued with respect to the glass master, but online services, whether independent or owned by traditional record companies, have no such defense available. The infamous MP3.com and Farmclub lawsuits brought by music publishers against online music services that had not secured reproduction rights licenses for their server copies, are evidence of the enormous swords that the current Copyright Act has handed to publishers to shut down new services that have not complied with the publishers’ views about what licenses are required for server copies.

Congress could not possibly have intended that a compulsory license must be accompanied by a direct license for the very same work with respect to the very same activity; otherwise the compulsory license would have no value at all. This, however, is the absurd result if the §115 license does not cover all necessary reproductions made in the process of manufacturing the reproductions that are intended for distribution.

C. It is Unclear Whether or How §115 Applies to Subscription Services and their Specific Offerings.

Today – more than two years after they were the subject of the “landmark” HFA-RIAA agreement that was to have solved associated publishing disputes – the activities at the heart of today’s online music subscription services remain burdened by controversy and disagreement about what rights they implicate and what licenses are necessary.

Generally these services (which may be of particular interest to the Subcommittee because they are at the heart of the new legal university-based services) incorporate two separate products – limited downloads and on-demand streams (or on-demand radio).

With respect to on-demand streaming services, music publishers claim a mechanical right is implicated by the server copies and other reproductions of the composition which are merely intended to facilitate the licensed performance (which generates performance royalties, e.g., to ASCAP, BMI or SESAC). In this instance the publishers’ mechanical right claims are not associated with distribution of a song, but rather because they claim that on-demand streams substitute for distributions that would have generated mechanical royalties. This analysis absurdly would obligate on-demand streaming services to pay two royalties to the same publishers for a single activity, although the performance rights organizations are already receiving a 50% surcharge for on-demand performance royalties as compared to pre-programmed Internet radio. Nevertheless, the double-dip royalty has been agreed to by the recording industry in the RIAA-HFA agreement. Fortunately the Copyright Office has maintained a principled position in this dispute, and in 2001 recommended that Congress clarify that performance royalties pay completely for on-demand performances, and that mechanical royalties should not be obligated by Internet radio performances, including by on-demand performances.

Another issue concerns whether limited downloads (which are generally locked on a consumer’s PC hard drive and are usable only for a period covered by a subscription fee) are licenseable under §115(g)(4), which applies to phonorecords made for the purpose of distribution by “rental, lease or lending.” The Harry Fox-RIAA agreement explicitly covers subscription services under §115, but DiMA companies report to me that some publishers have disagreed with that view. If Congress wishes for innovative distribution services to flourish, including those that are explicitly and effectively substituting for online black markets, then clarification would be helpful.

Questions have been raised as the applicability of §115(g)(4) to subscription services generally, perhaps because the subscription payment is not tied to a specific work that is

being licensed. Here again we urge the Subcommittee to clarify the law based on simple goals that have withstood the test of time – promoting new markets and assuring payment of royalties. By focusing on these goals DiMA believes these scope issues will be resolved favorably, both for innovative royalty-paying services and the creators whose works are winning consumer loyalty.

D. Requiring royalties to be calculated on a penny-rate and per-work basis is overly restrictive in a dynamic market when consumer offerings and prices are changing dramatically to meet demand

In the 1976 Act §115(c)(2) required licensees to pay royalties of 2¾ cents for each work embodied in a phonorecord, and authorized future rate adjustments to be negotiated or determined by arbitration. In the almost 30 years since the rate has always been set at a fixed penny-rate for each work embodied in a phonorecord. Today's rate is 8.5 cents per work; in 2006 the rate will increase to 9.1 cents per work. This fixed-rate per-work royalty rate calculation creates several problems in today's music dynamic music industry.

The most significant problem is that the rate structure cannot adapt to products and services that are changing in response to consumer demand and in an effort to inhibit piracy. Calculating royalties on a per-work or per-reproduction basis was reasonable during the several decades when albums and CDs included a fixed number of reproductions of songs. Today, however, copy-protected and copy-limited CDs and downloads are being offered, but they often include or permit several reproductions of the work. For example:

- A dual-session CD includes two versions of every song, each version in a different format. This ensures consumer flexibility, e.g., the ability to play the CD in a traditional CD player and a computer, but it also limits consumers' ability to use the PC to copy the songs or to convert them into unprotected formats.

Consumers perceive a copy-protected dual-session CD as a single product that plays in the same devices as a traditional CD, or perhaps as a product with less value than the traditional unprotected CD that also played in multiple devices but permitted unlimited copying. Publishers, however, opportunistically view the dual-session CD as being two reproductions and, thus, obligating two royalties. Should, however, this CD generate double- or triple-royalties to publishers because in an effort to stem piracy the CD has two or three copy-protected reproductions of works rather than a single unprotected reproduction? Recently the Harry Fox Agency issued its formal opinion that multiple-session CDs require multiple royalties.

- Similarly, an online service could test-market downloads that limit consumers to making three copies on CD or portable devices, but publishers have suggested that this would require four royalties – one for the original download and three more for the authorized consumer reproductions. One major recording company

has actually prohibited online services from limiting how many copies of downloaded songs can be made, or sought an indemnification from the online service, for fear that this anti-piracy limitation would trigger double, triple, and quadruple mechanical royalties, or more.

In addition to the royalty issues associated with innovative products and services, today's sound recording prices are also innovative – they have dropped dramatically in response to consumer demand, and in an effort to retain market share in the competition against piracy. Three years ago CDs with about twelve songs were priced at \$11 wholesale and \$16 retail, and mechanical royalties were less than 10% of the wholesale price. Today downloads are priced at about 70 cents wholesale and as low as 79 cents retail, and publishers are receiving 12 percent of the wholesale price and often 10 percent or more of the retail price. In 2006 downloads may be priced at \$1.19, but DiMA companies expect they are just as likely to be priced at 69 cents; only time will tell. Whatever happens to prices, the publishers proportional share of revenue should not dramatically increase or decrease, but rather should adjust along with industry economics.

Regardless of whether the publishers' interpretation of current law is correct, the issue for this Subcommittee is whether the law should be amended so as to not even permit the publishers' argument that it (a) requires only fixed-price royalties when all other prices are changing dramatically; and (b) imposes multiple royalties solely because the publishers works are being protected against unauthorized copying; and (c) creates risk rather than certainty whenever a new technology or business model (e.g., limited downloads and on-demand streams) is developed. And more generally, is §115 designed to promote new legal markets by simplifying the payments of royalties, or to promote piracy by requiring multiple royalties, fixed price royalties and increasing risk?

II. **The Harry Fox Agency does not offer a service that adequately substitutes for a well-crafted administrable §115 license.**

Some may claim that the §115 license is outdated and irrelevant, and that the Harry Fox Agency licenses the same mechanical right more efficiently. The facts prove otherwise.

First, Fox licenses only between 60 and 65 percent of available compositions, compared to the §115 license which covers 100 percent. If royalty-paying online music services are to compete with royalty-free online black markets, we need the ability and right to license 100 percent of the music that is supposed to be available under a §115 compulsory license.

Second, a compulsory license is available as a matter of right to all prospective licensees. By contrast, the Harry Fox Agency – unlike ASCAP, BMI or SoundExchange – is not required to and does not have the rights to license to all. When a prospective licensee seeks licenses for a new business model or technology, even if seeking only to bulk license the rights otherwise available through the §115 process and willing to pay full statutory royalties, HFA often refuses to license, or its member publishers do not permit it to license, or licensing is endlessly delayed. I have personally been told by a senior HFA

executive that if an innovative business developer wants a license, she must be prepared to demonstrate the strength of the idea, the financial strength of the company, and to negotiate a royalty rate. This does not sound like ASCAP, BMI or SoundExchange, who post their license forms on public websites in an effort to attract licensees with a simple and nondiscriminatory process.

Third, HFA is capable of providing a license that has rights equivalent to §115 rights, but it also can and does offer more rights or less rights when it suits its own institutional interests or those of its member publishers.

- In a widely-reported litigation between music publishers and the Universal Music Group concerning UMG's Farmclub online music service, billions of dollars in statutory damages were implicated when the court found that UMG's licenses from HFA did not include all rights that were otherwise available under §115, but rather included fewer rights. If the largest recording company in the world and all of its sophisticated lawyers were confused by HFA and §115, and as a result inadvertently infringed copyrights in approximately 25,000 songs, the existing §115 is obviously flawed for the online music industry and HFA is obviously not the solution.
- The reverse occurred several months later, when the recording industry sought to avoid future infringement suits and Farmclub-like litigations by signing an agreement with HFA that would provide the rights that otherwise would be provided under §115. In this instance HFA refused to provide a license for only the rights available under §115, and instead required the recording industry to also license and pay for non-existent mechanical rights associated with on-demand streaming – license terms that the recording industry did not want and that the Register of Copyrights has said are not necessary.

Fourth, even when HFA cooperates in licensing online services, and commits to expedite license clearances and provide legal certainty, it fails to provide the quality of service that business requires, and that Congress should expect, from a compulsory licensor. Consider the following:

- HFA refuses to disclose to licensees which publishers it represents except on a song-by-song basis in response to a formal license request. This secretiveness is contrary to common business practice, when a seller or licensor eagerly discloses what is available so as to attract purchasers or licensees.
- Moreover, every publisher retains the right to withdraw works from any HFA license. This creates significant hardship among licensees who rely on HFA, only to later have works withdrawn from their available catalog.
- When a service submits a license request and a list of compositions to HFA the response often takes 1-2 weeks, or longer. The response typically has three categories – songs that are licensed, songs that are not in the HFA catalog, and “we don't know.”
- In the two and a half years that record companies and online services have been operating pursuant to the RIAA-HFA agreement, the experience of our members and other licensees has been that 40 – 60 percent of the millions of licenses

requested have been denied, either because the songs are not in HFA's repertoire or, more frequently, because HFA cannot determine whether they are or not in the HFA repertoire. According to HFA's own responses to the prospective licensees, the largest majority of license denials are because the HFA database – even after almost \$20 million in recent investment – has not been able to match the composition data submitted with the license request – title, composer, album, UPC code, etc – to a particular song. Some might suggest that online services are submitting faulty data to HFA, but our members report that the data they submit to HFA is precisely the data provided to the online service by the record company.

- Even HFA's confident "yes" responses have included errors, and it is the online services that bear the very high legal risk which results. On hundreds of occasions, HFA responses to license requests have included false positives – approvals for compositions that actually are not in HFA's repertoire. Why is this a problem? Because a service that relies on HFA's approval will immediately make that song available for distribution, and be liable for infringement under the strict liability standards of the Copyright Act. There is no safe harbor for well-intended licensees, and HFA's contract with licensees does not indemnify licensees, even in the limited situation of false positives. Moreover, once a service has made available on its website an HFA "false positive," current section 115 permanently disqualifies that service from ever utilizing the §115 compulsory license with regard to that composition.

So unless HFA can license with absolute confidence and legal certainty 100% of available compositions, and can approve and process licenses expeditiously, without regard to new technologies or business models and without coercively imposing unwanted license terms or denying license terms that are desired, HFA can never be an adequate substitute for an efficient and comprehensive §115 compulsory license.

III. The Unworkable and Ineffective §115 Licensing Process Leaves Licensees No Choice Except To License Through HFA, and to Yield to Aggressive HFA Practices.

In October 2001, following the stinging infringement verdict against Universal Music Group in the Farmclub lawsuit, the recording industry signed a license with the National Music Publishers Association and HFA to enable the launch of licensed online music services, in a manner that supposedly was free of legal risk. At the December 2001 hearing of this Subcommittee Messrs. Sherman and Ramos, who also join me before you today, congratulated their industries for their so-called "marketplace" agreement that reportedly resolved all the music publishing problems that theretofore had prevented licensed online music services from launching. However, as we have discussed above, the agreement solved very few of the fundamental publishing problems for online services.

This RIAA-HFA agreement is remarkable for several reasons. Most notably, as described by Mr. Ramos in that December 2001 hearing, the recording and publishing

industries agreed that the process of producing and delivering “on-demand streams” – which are, of course, performances – “entail[s] the making and distribution of copies of musical works and, accordingly, constitute digital phonorecord deliveries (or “DPDs”) within the meaning of Section 115 of the Copyright Act.” In other words, the recording industry agreed that a transitory performance constitutes a “distribution” of a phonorecord, which heretofore had only been associated with physical manifestations such as piano rolls, vinyl records, cassettes and compact discs – and downloads which incorporate a possessory experience.

Hopefully the Subcommittee will agree with the Register of Copyrights, who opined in the August 2001 Section 104 Study and in the December 2001 hearing that reproductions made in the technical process of delivering a performance – even an on-demand performance – are royalty-free fair use (a defense, by the way, that Universal Music Group did not raise in the Farmclub lawsuit); indeed, Register Peters suggested that copyright law should be clarified to ensure that such reproductions are exempted from royalty obligations – just as terrestrial broadcasters’ ephemeral recordings are exempted by §112 of the Copyright Act.

But there is no principled legal basis to conclude – as the publishers and recording industry did in their agreement – that reproductions associated with the delivery of performances are “made and distributed” and therefore covered by §115 only if the performances are “on-demand” and not if the performances are part of a pre-determined program. However, no record label or online service that licenses music from HFA can complain about this unprincipled position, since the Agreement contains a specific silencer clause that prohibits signatories from disagreeing publicly -- including before this Subcommittee -- with HFA’s imposition of payment obligations for nonexistent rights.

What the recording industry wanted was to license to online services the right to offer consumers two new subscription offerings: on-demand streams and tethered downloads. Tethered downloads are downloads that cannot be removed from the subscriber’s hard drive. They cannot be copied to a blank CD or an MP3 player or uploaded to the Internet. The consumer experience is limited compared to a CD, but the entirety of the song is actually distributed to and then located on the consumer’s PC. There is no disagreement that tethered downloads are reproductions that are made and distributed, and therefore are covered by the §115 license. That is the license that the recording industry sought from the Harry Fox Agency. Yet, HFA refused to grant them that license, unless they also licensed on-demand streams.

If there had been in place a workable § 115 compulsory license, the recording industry would have been able to license every composition desired for the tethered download subscription services, and never would have signed a mechanical license for on-demand streams that they did not need or want, never paid the Harry Fox Agency a \$2,000,000 advance that was never recouped, and would not still be paying \$83,000/month to extend that unwanted and unnecessary license.

But the reality is that §115 is antiquated, inefficient, and perhaps legally insufficient, which left the recording industry no choice but to accept rights they did not need as the price for the rights they wanted.

As discussed in other parts of this testimony, the results of the HFA license have been disastrous. Licensees get no advance notice as to what publishers or compositions HFA does or does not represent. More than 50% of license requests have not been granted. Licensees have paid millions of dollars in advances to HFA, but still do not know what royalty rate will be charged them. And, there have been no reports that any of the millions of dollars paid by recording companies and online services to HFA have been paid to songwriters or publishers.

Of course Messrs. Sherman and Ramos's rosy predictions of December 2001 have not come to pass, which is why we are here today. But regardless of the administrative hurdles that continue unabated, it is essential that the Committee now implement the Register's recommendation – that transitory performances of sound recordings or compositions should not trigger a mechanical license or a reproduction right or royalty of any kind.

IV. Solutions are Available that will Ensure Full Compensation to Rightsholders, Reduce Services' Legal Risk and Promote Innovative Comprehensive Offerings that Can Effectively Compete Against Piracy.

DiMA appreciates that today's oversight hearing does not require endorsement of a single solution, and so I will take this opportunity to suggest several alternatives that we believe merit this Committee's consideration. Given the need for online services to expand to meet consumer demand and to help fight online piracy, we urge the Subcommittee to rapidly consider the available alternatives and to move quickly toward a legislative proposal that will make the Section 115 license effective and efficient. The end result of any of our suggested alternatives would serve to promote Congress's historical goals with respect to the §115 mechanical compulsory license -- simple and straightforward availability of compositions, and assurance of royalties to songwriters and publishers.

1. Modernize Administration of §115 License. If the Committee chooses to simply improve the efficiency of the existing §115 license, several steps are necessary and appropriate:
 - a. Congress should direct the Copyright Office (or a contractor) to create an electronically searchable database of all known registered copyrighted works. DiMA and our companies want to pay creators all the royalties that are due, but copyright owners that cannot be found cannot be paid.
 - b. End the requirement of separate notices for each song licensed, of paper-based forms, and of notice and payment by registered or certified mail. Instead Congress should authorize batch electronic filing of reports that compositions will be used or have been used, have notices transmitted electronically to registered copyright owners or maintained in the

Copyright Office if works are not registered. Of course, Congress should also authorize timely and transparent electronic payments of royalties.

- c. Today the Copyright Office does not accept payments on behalf of songwriters and publishers, and if a work is not registered or the registration not up-to-date, the licensee can use the work royalty-free. Instead, to ensure that creators are paid by licensees, Congress could direct the Copyright Office (or an agent) to accept royalties on behalf of Copyright owners whose works are licensed, with payment to be made when the copyright owner registers the work or updates registration information.
 - d. Perhaps most importantly, licensees that have attempted in good faith to utilize the compulsory mechanical license should not be penalized for the inadequacies of the Copyright Office process or the Harry Fox database. Rather, any legislation should provide good faith licensees with “safe harbor” protection against penalties or infringement liability, so that section 115 becomes a tool for mutual benefit, not a trap for the unwary.
2. Modernize the Scope of the §115 License to Cover “All Necessary” Reproductions or Phonorecords. As discussed earlier, some have argued a literal interpretation of Section §115 that covers only phonorecords that actually have been “made and distributed,” but excludes the physical means used to produce them. This interpretation, if accepted by a court, would expose to infringement liability the glass master and stamper copies that are inherently necessary for the production of record albums and CDs, as well as the many copies of a work that necessarily are made as part of the technological underpinnings of a digital download service. This would undermine 95 years of Congressional intent to promote the production and distribution of sound recordings that generate royalties for songwriters and publishers. Clarifying this ambiguity would not be complicated, and would meaningfully reduce the legal uncertainty associated with digital distribution.
 3. Clarify that §115 Does Not Apply to Performance Services, and That it Does Apply to Limited Download Subscription Services. As discussed earlier, the Harry Fox Agency has aggressively exploited the ambiguities of § 115 to demand licenses for on-demand performances, notwithstanding the Register of Copyrights’ conclusion that no such license is required, and that royalties associated with such performances should be performance royalties rather than mechanical royalties. We urge the Committee to act on this recommendation. Additionally, clarity regarding the application of §115 to subscription services generally would be helpful, to confirm the general belief that limited download subscription services are covered by the §115 license.
 4. Clarify Legal Authority to Set Percentage-of-Revenue Royalties. As discussed earlier, the availability of a percentage-of-revenue alternative for calculating mechanical license royalties would provide helpful rate flexibility at a time of

product and service innovation and price fluctuation. Some have expressed concern that publishers' revenue would be disproportionately reduced in comparison to sound recording revenue or consumer electronics revenue. They worry, for example, that companies might give music away for free in order to sell associated goods and services, so the revenue bases for calculating publishing royalties would be substantially reduced. Such a concern is at best hypothetical. This has never been a problem for European publishers, who for several decades have calculated mechanical royalties on a percentage-of-revenue basis. Additionally, for several decades here in the United States – during economic booms and busts when broadcast revenue goes up and goes down – publishers have collected billions of dollars in performance royalties based on percentage of revenue calculations.

5. Convert the §115 license into a blanket license, and conform it structurally with all modern compulsory and statutory licenses. The mechanical compulsory license is provided only on a per work basis because in 1909 when the license was developed, and in 1976 when it was modified, licensees typically licensed only a handful of compositions at one time in order to produce a piano roll or composition book or a record album.

Today, however, online services require hundreds of thousands or even a million licenses simultaneously, as they compete – against each other and against online black markets – to offer consumers the most comprehensive music selection possible. Only with a blanket license can services be confident of non-infringing access to all available music for purposes of lawful commercial distribution, which is precisely Congress's goal during the past 100 years. Only through a blanket license can services launch free of legal risk, which would free tremendous resources for marketing, customer service, and improving systems to deliver royalties electronically.

I am not suggesting that the Congress consider granting online music services an all-you-can-eat-for-one-low-price license, nor am I suggesting that services would avoid providing detailed reports of use to ensure that royalties are paid accurately to deserving songwriters. Rather I am suggesting that just like ASCAP, BMI, SoundExchange, and license administration collectives in Europe, the Copyright Office or its designee simply could grant licenses on a non-discriminatory basis for the use of all copyrighted compositions for all necessary associated reproductions, contingent upon the regular filing of detailed reports of how compositions are used and which compositions are used. This would not transfer the burden of royalty accounting to songwriters, and would not eliminate the technological problems facing the Copyright Office and HFA today. But it would enable services to create robust offerings without legal risk, and to pay more money to songwriters and less to lawyers – and that is a win-win for America.

Three years ago Mr. Ramos promised this Subcommittee that the Harry Fox Agency would bulk license, electronically, on a non-discriminatory basis, and enable online

music services to launch without legal distress if they work with HFA. Instead HFA licenses only whom they please and when they please, rejects more than 50% of license requests submitted by licensees, hides their database from licensees that pay millions of dollars to use the repertoire and pay the songwriters that HFA represents, and causes more risk than it mitigates by aggressively seeking to license rights that do not exist and by providing false positives when licenses are approved.

It is time for Congress to provide for today's online music environment the same rights it provided in 1909, 1976, and what this industry needs – a compulsory mechanical license that relieves legal risk to well-intended royalty-paying services, that promotes new markets for music, and assures royalty payments to songwriters. A simple, updated, functional risk-free non-discriminatory §115 license would be a win-win for creators, distributors and consumers.

Thank you.