

**David J. Del Beccaro's Responses to Senator Grassley's Written Questions
for Judiciary Committee Hearing, Protecting and Promoting Music
Creation for the 21st Century**

1. You've raised concerns about the administrative assessment to be paid by digital music providers to fund the mechanical licensing collective under the Music Modernization Act (MMA), but does Music Choice use the section 115 license for digital phonorecord deliveries? If you are planning to enter that market in the future, wouldn't it be easier for you to do so under the MMA's blanket licensing scheme rather than the current song-by-song regime?

Response:

Music Choice does not currently use the mechanical license because it does not yet provide an on-demand audio service. The company is, however, actively considering expanding into that market. Music Choice certainly agrees that Section 115 must be converted into a blanket license in order to work properly for the licensing of music streaming services, but the shifting of all the administrative costs of the license onto the licensees is unprecedented in the history of the market for collective licenses and will prevent market entry to the benefit of the large, entrenched market leaders represented by DiMA.

- The current song-by-song structure was designed for piano rolls, record albums, and downloads, where it is relatively easy for a record company to clear one to twelve tracks of their own choosing on a song-by-song basis. But streaming companies license millions of tracks from the record companies who created them and the record companies refuse to extend the mechanical licenses they have already obtained to cover the licensed streams, and also refuse to provide the relevant music publishing data for the tracks they created. This leaves streaming services in an impossible position, where they cannot identify all of the relevant music publishers.
- The result is that the streaming services still accrue and set aside the money for those license payments, but the unidentified publishers don't get paid until they are identified. This doesn't benefit anyone, least of all the music publishers. So fixing this problem by converting the mechanical license into a

blanket license, similar to the sound recording performance and ephemeral licenses in Section 112 and 114 provides a needed benefit to streaming services, music publishers, and songwriters alike.

- Music Choice has raised concerns, not about the blanket license structure in the MMA, but regarding fee-shifting provision for the licensing collective. This provision, whereby the streaming services, including those who do not even use the statutory license, pay all of the administrative and other costs of the licensing collective, is unprecedented and anti-competitive. There are many examples of collective, blanket licensing in the music ecosystem, both statutory and contractual. Not a single one of these licensing arrangements has ever shifted the administrative costs onto the licensees as an additional fee, over and above the royalty fee.
- Administrative costs are overhead costs of the copyright owners, and always come out of the royalty stream after the license fees are paid. Those overhead costs are naturally baked into a royalty rate (as are all parties' overhead costs) in a functioning market. The MMA's cost-shifting provision therefore ensures that licensees must pay inherently above-market rates because the Judges are prohibited from considering the administrative fee (always the burden of the copyright owner in true market transactions) when setting the royalty rates.
- Additionally, shifting the costs of the collective, which is managed entirely by music publishers and songwriters, onto licensees removes all free market incentives for the collective to run efficiently. This, in turn, will cause the administrative fee to explode and far exceed the administrative cost levels we have typically seen with collectives like ASCAP, BMI, and SoundExchange. These additional and uncontrolled costs will make it difficult for smaller or newer companies like Music Choice to enter the on-demand streaming market. This only benefits the entrenched market participants, the very large tech companies who negotiated this legislation through their trade association, DiMA.
- Those DiMA members apparently were willing to take on these costs, not only to make it impossible for new market entrants to challenge them, but also as part of a series of trade-offs for significant benefits they get from other parts of the MMA, most notably hundreds of millions of dollars of protection

from potential litigation damages and other costs stemming from past conduct under the broken mechanical license system. Neither Music Choice nor any other future market entrant would receive any benefit from those limitations, making the legislative trade-off even more anti-competitive.

- There is no reason why the Section 115 license could not be fixed by conversion to a blanket license, to the benefit of both licensees and copyright owners, without adding this unprecedented fee-shifting provision. The model for such a license is in Sections 112 and 114, and has been functioning well for over twenty years.

2. Does having a different rate standard for Music Choice reduce your competition in the marketplace? Why should you have a different rate standard than your competitors, now or in the future?

Response:

- As a preliminary matter, Music Choice has competition in the marketplace, including competition for consumer listening in the home. All of the market research that has been done by Music Choice and terrestrial radio indicates that Music Choice's most significant competitor for listeners by far is terrestrial radio. Radio pays no royalties at all to the record companies and will continue to get that special treatment under the MMA. We therefore pay substantially more in royalties than our single greatest competitor, and nothing in the MMA will change that.
- To the extent Congress were to ever actually subject all music users to one uniform standard (including radio), it has always been Music Choice's position that the Section 801(b) standard should be used for all statutory licenses. Section 801(b) provides a fair, balanced, and superior rate-making standard, while the so-called "willing buyer / willing seller" standard has been a complete failure.
- The Section 801(b) standard has worked effectively for over 40 years and does not inherently favor licensees or copyright owners. This standard allows the Judges to consider a broad range of evidence to set reasonable rates for each

market segment to enable both a fair return to the copyright owner and fair income for the licensee.

- Section 801(b) does not result in discounts, subsidies or below-market rates. In fact, it enables massive rate increases when warranted, as evidenced by Sirius XM's recent 40% rate increase and the streaming services recent 44% mechanical rate increase both under Section 801(b). The record companies have supported and benefited from Section 801(b) for years when setting their mechanical license rates paid to publishers for CDs/downloads. It is only now, when they no longer need this license (given the industry shift to on-demand streaming), that they want to take it away from everyone else.
- In 1998, when Congress created a new "willing buyer willing seller" standard" for webcasters and other future market entrants, it grandfathered the few, pioneering digital music services already operating under the more flexible Section 801(b) standard, in recognition of those services' legitimate business expectations and their role in creating the very first market for digital music.
- Subsequently, the "willing buyer / willing seller" standard has proven to be a failure as implemented by the Copyright Royalty Board. That standard is based on the false premise that the music licensing market is a functioning, competitive free market where negotiated rates reflect true "market rates." This is not the case.
- Under "willing buyer / willing seller," the Judges have felt obligated to use negotiated rates from on-demand streaming, the only unregulated market in the digital music world, as benchmarks. Indeed, When Mitch Glazier of the RIAA was asked at the hearing how one could possibly determine what a "market" rate would be in a regulated music market, the only example he gave was on-demand streaming service royalty rates. However, given streaming services must have songs from all major record labels where no catalog substitutes for another, the labels, operating as a complimentary oligopoly, are able to extract unreasonably high, "take it or leave it" royalty rates not reflective of a competitive free market.
- As evidence of willing buyer/willing seller's failure, in the 20 years since its enactment there has not been a single streaming service that has ever had a single profitable year from its streaming operations (including name brands

like Pandora and Spotify) and most webcasters have either exited the market or transitioned to on-demand streaming/direct licensing and are no longer subject to the willing buyer/willing seller standard (see sampling of such services below). There is no “willing buyer” in a market where no buyer has ever made any profit.

- Sampling of the Willing Buyer / Willing Seller Graveyard
 - AOL Radio (formerly Spinner; exited webcasting market later merged into Slacker)
 - Beats Music and iTunes Radio (transitioned to direct licensing as part of Apple Music)
 - CyberRadio 2000 (exited webcasting market)
 - Groove Music (Microsoft streaming service formerly known as Xbox Music and Zune Music; exited webcasting market)
 - Last.fm (formerly CBS Radio; exited webcasting market)
 - Live365 (exited webcasting market; re-entered in late 2017 under new ownership and with a new business model)
 - Milk Music (Samsung’s webcasting service; exited webcasting market)
 - Music Unlimited (former Sony webcasting service integrated into Spotify and transitioned to direct licensing)
 - NetRadio (exited webcasting market)
 - New Normal Music (exited webcasting market)
 - Pandora (transitioned to on-demand and direct licensing)
 - Radioio (exited webcasting market)
 - Rara (exited webcasting market)
 - Rdio.com (exited webcasting market; assets acquired by Pandora now under direct licensing)
 - Songza (exited webcasting market and transitioned to direct licensing after merger with Google Play Music)
 - Yahoo! Music (formerly LAUNCH cast; exited webcasting market)
- The result is that the only companies that have stayed in the streaming market are (i) large technology companies willing to lose money on music in order to obtain some perceived benefit in their primary business lines, or (ii) startups with management focused on making money for the founders and early investors in the IPO market, who don’t care whether the company can be viable after they cash out. But no significant streaming service still in the market actually uses the statutory license

- Further, Congress twice, in 2002 and 2009, has had to step in and undo the unreasonably high rates set using this standard. This has never been necessary with rates set under Section 801(b).
- As noted above, Music Choice’s position has always been that the more flexible Section 801(b) standard should be used for all statutory licenses. But if Congress will not end the failed experiment of “willing buyer / willing seller” entirely (especially now that there are no webcasters of any consequence actually using it), it at least should not sweep the few remaining, marginally profitable companies onto that unsustainable standard and put them out of business, too.

3. Your concern seems to be focused on the burden of the assessment on smaller digital music providers, but the Music Modernization Act states that the assessment is to be based on usage and reasonably calculated to equitably allocate the mechanical licensing collective’s (MLC) costs across services. Don’t these provisions help mitigate your concern and ensure that the assessment is applied in a fair and equitable manner based on the extent to which a digital music provider is obtaining the benefits of the MLC’s services?

Response:

No, those provisions do not mitigate Music Choice’s concerns at all.

- First, these provisions do nothing to solve the problem of incentivizing inefficiency created by shifting the overhead costs of the collective onto the licensees.
- Second, even if the resulting massive fee were apportioned to licensees based on usage, those fees would still be prohibitive to smaller and newer market entrants. The apportionment of fees is done by the Copyright Royalty Judges in a formal proceeding. Music Choice has participated in several proceedings before the Copyright Royalty Board, and knows that the legal fees associated with those proceedings run in the millions of dollars. That burden, alone, would prevent most small companies from entering the market.

- Moreover, the statutory language providing for equitable allocation is vague and open to many interpretations by the Judges.
- Finally, a service entering the market with low usage may pay a smaller percentage of the massive overall administrative fee than one of the large, entrenched DiMA members, but that service will also have a much lower revenue base from which to pay the fee. On a percentage of revenue basis, there is no reason to believe that such smaller services like Music Choice would pay less than the massive entrenched services. But we do not have the luxury of treating music as a loss-leader to support unrelated and highly profitable business lines like Apple, Google, or Amazon, and have no ability to cash out in an IPO while losing money like Pandora and Spotify.