

INTERNET RADIO **THE BASICS OF YOUR MUSIC ROYALTY OBLIGATIONS**

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I. Introduction

As over-the-air broadcasters and Internet-only companies make more and more use of music on the Internet, they need to be aware of their liabilities for music royalties. There are many dangerous myths currently circulating that could very well get a company streaming music on the Internet into trouble. For instance, many broadcasters believe that their ASCAP and BMI royalties cover them for all on-line music use. This is not true. ASCAP and BMI cover the broadcaster only for the public performance rights to the underlying music *composition* – the song itself – when an ASCAP or BMI song is played over-the-air and simultaneously streamed on the Internet. As set out below, for digital transmissions – like the Internet – there is an additional royalty, payable to a company called SoundExchange. This additional royalty compensates the *performers* of music. This royalty must be paid in addition to the fees paid to ASCAP, BMI, and SESAC.

Another myth is that no royalty is due because the Sound Exchange royalties expired at the end of 2005. While the negotiated royalties that are set out below did technically expire at the end of the last year, by law, Internet radio services must continue to pay at the old rate until new rates are established. Any payments made are subject to retroactive adjustment when the new rates are established.

Yet, even with these royalty obligations, the use of music on-line continues to expand. Increasingly, consumers are looking to the Internet for the kinds of entertainment that was once provided exclusively by over-the-air broadcasters. Music, and now video, is available on a myriad of websites, and the availability of these services on the Internet only seems to be growing. The future promises even more availability of this kind of content, as wireless access to the Internet becomes more common. Soon, the digital consumer will be connected to the Internet anywhere, anytime. Thus, the advantage of the traditional broadcaster – that its signal is ubiquitous – will be matched by their Internet brethren.

In today's world, the broadcaster wants to go where its audience is, and that will include the Internet. The over-the-air broadcaster can widen its reach, both

geographically, and into places where its current signal does not reach. Those steel buildings that block the signal of broadcast stations need no longer be an obstacle to the listener who can tune into their favorite station by going to their computer. In recent months, more and more broadcasters seem to be putting their signals onto the Internet to be competitive to the programming that is already there.

But, in making the decision to become an Internet broadcaster, there are many legal issues that need to be understood. This memorandum describes the issues relating to music royalties. Any Internet radio operator needs to be aware of the rules of the road, and this memo provides a basic overview of those rules. This memo is not meant to provide a full guide to all the legal issues that may arise in operating an Internet radio station, and it cannot even provide a full picture of all the legal issues involved with the music royalty obligations of such an operation. Any business decision should be made only after assessing the particular business plan that you may have in mind with someone well versed in the details of the royalty obligations. This memo should be looked at as a starting point for assessing the liabilities that you may face in any Internet radio venture.

As is clear by the conditions set forth below, this memorandum addresses the music royalty issues only as it affects Internet radio services. There are other statutory licenses for satellite radio, digital cable radio, and digital business services. These royalties are not addressed by this memorandum. For on-demand services, including downloads and podcasts, there is no fixed music royalty. Instead, permission must be obtained directly from the copyright holders in any performance before it can be used by such services. The royalties set out below do not apply. Individual negotiations with copyright holders are required to use music in connection with these on-demand services.

As noted above and as described in the last section of this memo, the current music royalties for Internet radio are in a state of flux. At the time that this memo was written, a proceeding was underway before the Copyright Royalty Board to determine the music royalties for the use of sound recordings on Internet radio stations for the period of 2006 through 2010. As these royalties have not been established, those currently streaming are doing so at the risk of having royalties established that would create unanticipated, retroactive royalties for all streaming done after December 31, 2005. So, all Internet radio broadcasters should proceed with caution.

II. Music Royalties

A. The Traditional Performing Rights Organizations

Traditional broadcasters are accustomed to paying royalties for the use of music to ASCAP, BMI, and SESAC. These royalties compensate the composers of music that is broadcast by traditional radio stations. In the Internet radio world, ASCAP, BMI, and SESAC are still paid for the use of their music. For an Internet-only station, each of these organizations has its own license for Internet music use, and each works in a

slightly different manner. All involve a minimum fee. In addition to the minimum fee, there are royalties based either on revenues or website usage. Information regarding the specific fees that are due to each service can be found on each of these companies' websites.

<http://www.ascap.com/weblicense/>

<http://www.bmi.com/licensing/webcaster/>

<http://www.sesac.com/licensing/internetLicensing.asp>

For Internet radio stations that simulcast the signal of an over-the-air broadcast station on a nonsubscription basis, fees for Internet usage of the music licensed by ASCAP and BMI are covered by the current broadcast licenses. However, the broadcast licenses cover only the over-the-air programming which is simultaneously streamed on the Internet. If a broadcaster is operating a "side channel" not being broadcast over-the-air and that channel features music, a separate Internet-only license must be obtained.

B. The Performance Right in Sound Recordings

In the digital world, the royalties paid to composers of music through ASCAP, BMI, and SESAC are joined by a new royalty due to SoundExchange. Unlike the traditional broadcast music royalties that pay the *composers* of music, the SoundExchange fee goes to the *performers* who are featured on a recording of a piece of music. The Digital Millennium Copyright Act ("DMCA") required that royalties be paid to the performers for all digital uses of music except those in an over-the-air digital transmission by a broadcast station, e.g. through the Ibiquity digital radio system or as part of a Digital Television stream. The royalty to SoundExchange is paid both to the owners of the copyright in the performance of a piece of recorded music and to the performers of that music. Half of the fees collected go to the performers, and half to the copyright owner in the performance (usually the record company). This royalty comes about as the result of a "compulsory license" which allows Internet broadcasters to use music without the explicit permission of the artists and copyright holder, provided that the broadcaster pays this royalty fee and complies with certain usage restrictions that are described below. The royalty rate is set by a government agency called the Copyright Royalty Board.

The rates charged to a webcaster under the compulsory license are discussed in later in this memo. In order to qualify for the compulsory license, an Internet radio station must meet a number of requirements. If these requirements are not met, and the webcaster does not, through some private negotiation with the copyright holder, directly obtain permission to use the music in its transmission, then the webcaster has violated the law and is subject to damages and penalties for copyright infringement. Thus, to get the benefit of this statutory license, the Internet radio operator should carefully observe all of the requirements set out below.

Step One – Registration with the Copyright Office

To qualify to use the compulsory license, a webcaster must register with the Copyright Office, filing a Notice of Use of Sound Recordings Under Statutory License. That form is to be filed before the commencement of service, and must be submitted with a filing fee, currently \$20. A single filing can be used to register multiple streams available on the same website.

The required form can be found on the Copyright Office's website:
<http://www.copyright.gov/forms/form112-114nou.pdf>

The form appears somewhat confusing, as it asks if you are registering for a Section 114 license and/or a Section 112 license. In fact, webcasters need both, as Section 114 deals with the right to perform a musical work, while Section 112 gives a webcaster the right to make "ephemeral copies" of the work. An ephemeral copy is the transient copy of the recording that is made in any digital transmission process, as data is transmitted from server to server and, theoretically, copies reside on the memory of a computer for at least some period of time, no matter how short that time may be. While some have argued that the ephemeral copy has no independent value, technically, there is still a portion of the royalty paid to cover the making of that copy.

You are also required to indicate whether you will be a subscription or nonsubscription service. There is a box for "Pre-existing subscription services." These were the few digital subscription services that existed in 1998, who are subject to a different royalty than services which have come into existence since then. Other than the handful of Preexisting Services, everyone else would be a "New Subscription Service" or a "New Nonsubscription Service," depending on whether a fee is charged to the consumer for the use of the service.

Step Two – Comply with the Performance Restrictions

Under the provisions of the DMCA, a service must meet a number of restrictions on the way in which the sound recordings are used. Adopted principally as a means to make it difficult for listeners to capture a digital copy of a sound recording played on a digital service, these rules adopt restrictions which may make some familiar broadcast practices difficult to replicate on the Internet, and may cause some broadcast stations to forfeit their rights to the compulsory license if they do not modify their practices. These rules include the following:

A. *No Interactive Service.*

A webcaster cannot provide an "interactive service." An interactive service is one which allows a listener to receive a specially created stream where the listener can dictate the songs

being played. In other words, a broadcast-type transmission in which the broadcaster makes the musical selections, is permitted. However, allowing a consumer to determine the songs played on an Internet stream by picking from a menu of songs would take the website out from under the compulsory license. Playing call-in requests is not prohibited, as long as the Internet station selects which requests to play, and when they will be played. Services providing a limited degree of interactivity, allowing a listener to select or deselect particular artists that will be included in a stream, or to skip a limited number of songs, but which do not guarantee that any particular song or artist will be played at any particular time, are in a gray area where hard and fast lines have yet to be drawn delineating what is permissible under the statutory license and what is not.

B. *Transmission of Copyright Information.*

An Internet radio service must identify in text on its site during (but not before) the time that any song is being played, the (i) title of the sound recording (i.e. the song title), (ii) the album or CD from which the song came, and (iii) the featured artist. And, if technically feasible, the sound recording must be accompanied by information that is encoded by the copyright owner that identifies the sound recording title, the featured artist and related information concerning the underlying musical composition.

C. *Sound Recording Performance Complement.*

The Internet radio service is also subject to a number of restrictions on how often songs by the same artist or from the same album can be played. These restrictions are referred to as the “sound recording performance complement.” These restrictions have two components:

1. *One Album or CD Restriction.* On a particular channel, within any three hour period, the programming can contain no more than three selections from any one album or CD, and no more than two such selections can be played consecutively; and
2. *Featured Artist Restriction.* On a particular channel, within any three hour period, the programming can contain no more than four different selections by the same featured artist or from any set or compilation, and no more than three such selections can be played consecutively.

D. *Advance Program Schedules.*

With a very limited exception for noncommercial classical music broadcast stations that had published program guides prior to 1998, the webcaster cannot publish an advance program schedule which identifies when a specific recording, album or CD or featured artist will be played on its stream. This does not prohibit a DJ from announcing that a particular song is coming up, though the exact time cannot be given.

Additional restrictions prohibit the use of music in association with visual images of a product in such a way so as to imply an association between the music and the product. Music must also be used on a site that is principally related to music, not to the sale of a particular product.

The compulsory copyright only applies to legal recordings – so do not use bootlegs. Webcasters are also required to cooperate in various anti-piracy efforts, to make it more difficult to record songs off of the music stream that is provided.

Step Three – Calculate and Pay the Royalties

The royalties that SoundExchange collects from the webcaster are set on an industry wide basis. The royalties were originally to be revised every two years, through an arbitration proceeding. However, the first arbitration proceeding was quite long and expensive, and it produced a result about which no party was happy, so Congress changed the rules last year. Now, the royalties will be adjusted once every five years. A new government board, the Copyright Royalty Board has been created. The Board has three permanent Judges who will hear cases having to do with various compulsory licenses.

The initial royalty rates were established in 2002, and modified by various settlement agreements between the recording industry and different webcasting factions. All of the current royalty rates for webcasting technically expired at the end of 2005. There is currently a proceeding underway before the Copyright Royalty Board to determine the rates for 2006 through 2010. As you might expect, SoundExchange is suggesting that the rates be raised, while the various webcasting groups are asking that the rates be reduced. Unless there is a settlement, a decision as to the royalties may not come out until early 2007. However, the rates that are established will be retroactive to the beginning of 2006.

Under the law, Internet radio companies must continue to pay royalties at the old rate until the Copyright Royalty Board sets the new rates. ***Thus, Internet radio services should keep paying at the rates in effect through 2005, knowing that the services may be either entitled to a rebate, or they may have to pay more, depending on the outcome of the current proceeding.***

A summary of the rates that were in effect in 2005, which Internet radio webcasters should still be paying until the new rates are established, are set out below. Forms for submitting royalty payments to SoundExchange can be found on the SoundExchange website: http://www.soundexchange.com/licensee_home.html. SoundExchange does not send a bill to webcasters. Instead, each webcaster is responsible for determining the amount of its own royalties and submitting those royalties when due, with required reports computing the applicable fee. For the most part, fees and reports are to be filed on a monthly basis. SoundExchange also has the right to audit Internet services. Early this year, it announced that it had exercised that right with response to several Internet radio services, though the results of those audits have not been made public.

Different types of services pay at different rates. The rates at which services should currently be paying are as follows:

Nonprofit Associations, Educational Institutions and Government Agencies

Nonprofit webcasters pay a specially negotiated rate. Nonprofit music stations pay \$500 yearly, which entitles them to stream to an average of 200 simultaneous listeners (146,000 aggregate monthly tuning hours). If a service streams more than that amount, the nonprofit webcaster pays either on the basis of “performances” (one listener who listen to one song is one “performance,” two listeners listening to the same song would be two performances and so on) or on the basis of aggregate tuning hours (one listener who listens for one hour would be one “aggregate tuning hour,” two listeners who listen for half an hour each would be one tuning hour, as would 4 listeners who each listen for 15 minutes each). The nonprofit royalty for that listening above 146,000 aggregate tuning hours in a month, is .02176 cents (\$0.0002176) per performance or .251 cents (\$0.00251) per aggregate tuning hour. The webcaster makes an election as to whether to pay based on aggregate tuning hour or on a per performance basis.

Note that the Corporation for Public Broadcasting had negotiated a private deal with the recording industry that allows its member stations to stream music on their websites without paying these or other royalties. The terms of this deal are confidential. Broadcasters receiving CPB money should discuss the deal with the CPB to see if their streaming activities are covered. If they are, no additional, independent royalty payment would be due. Note, however, that the CPB deal has apparently expired, as NPR is one of the parties currently participating in the Copyright Royalty Board proceeding.

Small Commercial Webcasters

In late 2002, after a public outcry claiming that the royalties established by the initial royalty arbitration proceeding would put smaller commercial entities out of business, the recording industry reached an agreement to establish a special rate for “small commercial webcasters,” essentially those with less than \$1.2 million in revenue.

While the rates are high as compared with traditional ASCAP and BMI rates, they were the first industry-wide percentage of revenue rates agreed to by the recording industry.

These royalties require that a small commercial webcaster pay a royalty equal to 10% of its revenue on the first \$250,000 of its revenues, and 12% of all revenues thereafter, or 7% of its expenses, whichever is higher. A minimum fee of \$2,000 per year is established for those webcasters who make less than \$50,000 in revenue. For those who make more, the minimum fee is \$5,000.

The \$1.2 million eligibility figure looks at revenues of the webcaster and any company under common control which uses sound recordings as the basis of its income. Thus, a broadcaster which has revenues of greater than \$1.2 million is not eligible for the small webcaster deal, even if the webcasting is done through a separate company, if the broadcast and webcasting companies are under common control.

Commercial Webcasters (including broadcasters)

For all other nonsubscription webcasters who are eligible to pay royalties under the compulsory license, payment is based on listening. These webcasters have the option of either paying on a per performance basis (per song per listener) or based on aggregate tuning hours. The webcaster must track its listenership using either of the measurement standards set forth below. Most services opt for the Aggregate Tuning Hour payment, as there are few commercially available tools that track and report on listenership on a per song basis. The rates are as follows:

Per Performance: The rate is .0762 cents (\$0.000762) per song per listener, except that 4% of all performances can be excluded. The 4% exclusion is meant to take into account partial performances due to listeners tuning out, player malfunctions and similar factors – but does not include situations where the webcaster offers a “skip button” where a song can be skipped.

Per Aggregate Tuning Hour: The other option is to pay based on aggregate tuning hours. A pure webcaster would pay 1.17 cents (\$0.0117) per aggregate tuning hour. A broadcast simulcast (identical to the over the air broadcast but for the commercials, which can be changed) would be charged at the rate of .88 cents (\$0.0088). The lower rate offered broadcasters was premised on the assumption that, due to higher commercial loads, more informational programming, etc., broadcast simulcasts are likely to have fewer songs in a typical hour.

The minimum fee for such services is \$2,500 or \$500 per channel, whichever is less. There are lower rates for programming that is primarily “talk” in nature.

Subscription Services

In addition to the rates specified above, a webcaster offering a subscription service can pay either based on the per performance or aggregate tuning hour options listed above, or it may elect to pay based on a percentage of revenue. Under the current rules, this election is to be made when the webcaster begins its service, and cannot be changed. If the subscription webcaster decides not to pay on the basis of usage, it can elect to pay 10.9% of its subscription revenues to SoundExchange. The subscription revenues would include revenues received from subscription fees, advertising in the subscription streams, banner ads unique to the subscription page, and any sale or other use of information gathered about the subscribers. Those subscription webcasters electing the percentage of revenue model are required to pay a minimum fee of 27 cents per subscriber (including trial subscribers) per month, with a minimum annual fee of \$5,000.

III. Conclusion

This memo addresses only the basics of the webcasting royalties. Each of the royalty options addressed above have numerous filing requirements and paperwork reporting obligations that must be met, and all require the reporting of information to SoundExchange to demonstrate that the webcaster is properly computing its payments. And, as set forth above, these royalties, while they still must be paid, are subject to *retroactive adjustment* once the Copyright Royalty Board determines the rates for 2006-2010.

While complicated, the system can be learned and compliance has been achieved even by the smallest of companies. So, while the royalties present a new challenge to those companies interested in streaming their content on the internet, they should not present a bar. Companies are doing it today – and competition will only be more difficult as time passes.

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