

The Debate Over Sirius' Attempt to Directly License Music - SoundExchange Once Said A Marketplace Negotiation to Adjust for High Rates "Was to Be Expected"

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There have been many reports about the attempts by Sirius XM Radio to **license music directly from record labels, bypassing any royalty rates set by the Copyright Royalty Board**. Direct licensing would have Sirius pay the record labels or copyright holders for the rights to use music, avoiding any dealings with SoundExchange, which normally collects the royalties for the **public performance of sound recordings under the statutory license**. The most recent report about Sirius' efforts was in the *New York Times*, [here](#). Sirius, like webcasters, pays royalties set by the CRB (if they cannot be negotiated among the parties) that cover the public performance of all legally released sound recordings. While webcasters currently have royalties that are in place through 2015, the royalties for Sirius end in 2012, and are being litigated now (see our story [here](#) on the last royalties set by the CRB for Sirius). To avoid the uncertainty of litigation, with which webcasters are very familiar, Sirius has been attempting to license music directly from the copyright holders. This is not a new story - **Rhapsody** reportedly tried the same thing earlier this year, and Clear Channel tried to get royalty waivers from independent artists several years ago in exchange for more exposure for their music (see our stories, [here](#) and [here](#)). Each time a music service suggests that it might want to license music directly to try to recognize some savings over the rates established through CRB litigation, the music community objects - see, for instance, the statements of unions AFTRA and AFM [here](#), that of SoundExchange [here](#), and that of A2IM (the association of independent record labels), [here](#). But what is really wrong with the efforts of services to negotiate lower royalties? If you believe the testimony of **SoundExchange's own witness in the Copyright Royalty Board proceedings** - nothing at all. In fact it is to be expected.

In the CRB proceeding that was held in 2005-2006 (and from which, most of the settlements arose that now govern the royalties for sound recordings played by Internet radio stations), SoundExchange relied on a number of witnesses, including one expert, Michael Pelcovits, an economist whose model was the principal testimony relied on by the CRB in establishing the rates they determined to be reasonable. In his written testimony, Mr. Pelcovits stated as follows:

...a rate that is set too low may have serious economic dangers. By setting a rate too low, inefficient entry may be encouraged, and inefficient levels of production will be encouraged, which can hinder the development of an efficient market. It is also worth noting that setting the statutory rate too high will not necessarily be harmful to the market. ***If the price is too high, parties can (and are almost certain to) negotiate agreements for rates lower than the statutory standard. Thus, a rate that is set too high is likely to "self-adjust" because of the sellers' natural incentive to meet the market.***

(Emphasis added). The statutory rate referred to in this quote is the rate that is set by the CRB. What this quote says is that, if that rate is set too high, then parties will naturally negotiate after-the-fact to try to find what the real market rate should be, and that such negotiations should be expected - not feared as many

seem to be claiming as these attempts to cut deals come to light. In other words, the music community seemed to favor (and expect) such negotiations, before they were against them in their statements today.

In fact, it is quite clear that the negotiation of lower rates has already happened. In the many settlements that came about after the CRB decision on Internet radio rates was released after the 2006 proceeding, while the parties were fighting appeals and pursuing Congressional redress, rates lower than those that were set by the CRB were negotiated by many parties, including the Pureplay webcasters (on which Pandora relies), small webcasters, noncommercial webcasters, and even broadcasters (see our [summary of the rates under all these deals, here](#)). All of these settlements were deals that were negotiated, as Dr. Pelcovits put it, "to self-adjust....to meet the market." Clearly, the CRB rates are not sacred. So what is the difference between these deals done pursuant to the **Webcaster Settlement Acts**, and the deals that have been tried now and have been condemned by so many in the music community?

One possible difference is the loss of control. The settlement deals that were done under the Webcaster Settlement Acts all provided SoundExchange with the opportunity to decide which deals were **precedential in future CRB proceedings**, and which could be excluded from future rate-setting cases. So, as we've written before ([here](#) and [here](#)), the deals that set relatively low rates, like those with the Pureplay Webcasters and the small webcasters, were deemed non-precedential, while those deals with higher rates, like the agreement with the Broadcasters, were considered precedential - and in fact contributed to the [CRB decision in 2010 setting the rates for 2011-2015](#) for those webcasters not covered by one of the WSA settlements. Deals that are marketplace deals would not be afforded the non-precedential status afforded the WSA deals absent some new act of Congress.

In establishing the statutory royalty, Congress envisioned that the CRB would base its decision on the rates set by the marketplace for similar rights. In previous cases, because there were no freely negotiated marketplace rates (except for those recently done under the WSA and deemed "precedential"), the Copyright Royalty Judges had to rely on economic analysis of royalty schemes for other types of service and to come up with proper "adjustment factors" so as to determine the hypothetical rate that would be negotiated had these parties been negotiating rates for noninteractive webcasting. Obviously, this is an inexact science, and has led to some results that many have argued are too high (though, as the SoundExchange press release indicates, some in the music community believe that the rates are too low). Having freely negotiated rates may well provide some "real" basis for determining what a **willing buyer and willing seller** really would pay for music in a real marketplace. But we will see if any such rates can in fact be negotiated by Sirius or any of the other parties that have attempted such negotiations.

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