

ORIGINAL

Before the
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Washington, D.C.

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OCT 17 2001

GENERAL COUNSEL
OF COPYRIGHT

In the Matter of)

)
Determination of Statutory License Terms)
And Rates for Certain Digital Subscription)
Transmissions of Sound Recordings)
_____)

Docket No. 96-5
CARP-DSTRA

**Notice of Intent to Participate and
Objections of the American Federation of Musicians
and the American Federation of Television and
Radio Artists to Certain Proposed Terms
Contained in the RIAA Petition to Establish
Rates and Terms Governing the RIAA Collective
and to Suspend CARP Proceedings**

The American Federation of Musicians of the United States and
Canada ("AFM") is an international labor organization representing
110,000 professional musicians in the United States and Canada. AFM
members include featured artists and nonfeatured musicians who
perform on sound recordings made in the United States and Canada.
The American Federation of Television and Radio Artists ("AFTRA") is a
national labor organization representing 80,000 performers and
newspersons, including approximately 11,000 featured and nonfeatured
vocalists who perform on sound recordings made in the United States.
AFTRA members include featured artists and nonfeatured vocalists who
perform on sound recordings made in the United States.

In 1995, Congress passed the Digital Performance Right in Sound Recordings Act ("DPRA"). The DPRA gave copyright owners an exclusive right to perform publicly sound recordings by means of a digital audio transmission, but limited that right in several important respects, including the creation of a compulsory license for certain non-interactive digital audio services. Pursuant to the DPRA, the Librarian of Congress initiated these proceedings in 1995 to establish the rates and terms for the compulsory license applicable to pre-existing non-interactive subscription services. The Recording Industry Association of America ("RIAA") participated in those proceedings on behalf of sound recording copyright owners. The three pre-existing subscription services to whom the rates and terms would apply also participated.

On May 8, 1998, the Librarian issued a final rule and order setting the rates and terms applicable to the three pre-existing subscription services. 63 Fed. Reg. 25,394. All four parties to the proceeding, as well as the CARP, the Register and the Librarian agreed that the designation of a single entity to collect and distribute the compulsory royalty fees would create an efficient administrative mechanism. 63 Fed. Reg. at 25,412. The Librarian adopted a rule designating the RIAA as the single agent to receive royalty payments and statements of account. 37 C.F. R. § 260.3(e). The Librarian's final order made clear that the RIAA would fulfill this role by establishing a collective of record labels "which create more than 90 percent of all legitimate sound recordings sold in the

United States.” Upon the recommendation of the Register, the Librarian adopted several terms that had not been litigated before the CARP. The purpose of these new terms was to govern the operation of the RIAA collective. 63. Fed. Reg. at 25,413.

The RIAA appealed the conditions imposed on the RIAA collective. In Recording Industry Ass’n v. Librarian of Congress, 176 F.3d 528 (D.C. Cir. 1999), the court remanded for consideration of four of the terms imposed on the RIAA collective. Specifically, the Court remanded for further consideration of the terms imposed under 37 C.F.R. 260.2(d) (regarding the valuation the collective must give each performance), 260.3(d) (regarding the costs that the collective may deduct), 260.6(b) (regarding audits of the collective) and 260.7 (regarding the treatment of unknown copyright owners) on the grounds that the CARP had not considered these issues, leaving the record without any evidence upon which to establish such terms.

Pursuant to the remand, the Copyright Office issued a scheduling order directing the parties to file direct cases on the remanded issues. In response, the RIAA filed a petition with certain proposed amended terms. The RIAA asserted that it was neither necessary nor appropriate to convene a CARP on the terms governing the RIAA collective. The RIAA asserted, first, that fiduciary principles alone were sufficient to govern the operation of the collective. Even if that were not the case, however, the RIAA asserted that a CARP was not necessary because the three

subscription services did not oppose the RIAA's proposed amended terms. The RIAA Petition asks the Librarian to adopt those proposed terms pursuant to its authority under 37 C.F.R. § 251.63(b). The Copyright Office requested comment on the proposed terms in a Notice of Proposed Rulemaking issued on July 23, 2001 at 66 Fed. Reg. 38226.

The AFM and AFTRA object to two of the terms proposed by the RIAA. Those terms, and the unions' objections, are explained in detail in Part II below.

Before turning to the unions' specific objections, we set forth in Part I the reasons why the law permits the unions to commence participation in this proceeding at this stage, and why the unions have a significant interest in the terms to which we object.

**I. Why the Law Permits AFM and AFTRA
to Commence Participation at this Stage and the Interests of the
AFM and AFTRA in the Proceeding**

The Notice of Proposed Rulemaking requires any party who wishes to object to the proposed terms to "state why it believes the law permits a new party to commence participation at this stage" (p. 38228). AFTRA and the AFM believe that the law that allows for their participation is stated succinctly in the Copyright Office Notice's quote from Senate Report No. 104-128: "If an agreement as to rates and terms is reached and there is no controversy as to these matters . . . the Librarian of Congress should notify the public of the proposed agreement in a Notice-and-Comment proceeding and, *if no opposing comment is received from a*

party with a substantial interest and an intent to participate in an arbitration proceeding, the Librarian of Congress should adopt the rates embodied in the agreement . . .” (emphasis added). That is the standard established by Congress that provides the legal basis for AFTRA and the AFM’s participation.

As demonstrated in this memorandum, AFTRA and the AFM have a significant and substantial interest in the proposed terms governing the distribution of royalties. Those terms will significantly affect the distribution to artists of their 50% share of the royalties paid by the subscription services. AFTRA and the AFM represent those artists – both the featured artists who are entitled to 45% of the royalties and the nonfeatured vocalists and musicians who are entitled to 5% of those royalties. Moreover, the unions are responsible for the appointment of the independent administrator that will make the nonfeatured distribution.

Neither the parties to the initial CARP Proceeding, nor the CARP Panel itself, raised or considered the terms for distribution that are at issue here. For example, the Librarian’s final rule and order, 63 F.R. 25394, 25413, states that “neither the parties nor the panel gave any consideration to the manner in which the collecting entity would deduct from payments to copyright owners its cost of administering the funds it receives and disburses.” Indeed, it is clear from the Librarian’s final rule and order, the decision of the D.C. Circuit Court of Appeals remanding

for consideration of these terms, and the RIAA's Petition that no party proposed or anticipated the development of terms to govern the operation of a "collective" or common agent designated to collect and distribute all of the compulsory royalty fees – precisely the terms that became the subject of the remand. Thus, even if the unions had participated in the proceeding from the outset, a new CARP convened pursuant to the remand still represents the unions' first opportunity to comment on these terms.¹

As a result of the remand, the RIAA has proposed terms to govern the operation of the collective empowered to collect license fees on behalf of all entitled parties. These terms will significantly affect performers. AFTRA and the AFM strongly oppose two of the proposed terms and are willing to participate in a CARP proceeding convened to take evidence on them. If AFTRA and AFM are not allowed to oppose these terms, the Library of Congress will be in the position of simply "rubber-stamping" an agreement between the RIAA and three subscription services – services that have no interest or concern in the method of distribution of royalty payments. That cannot be what the U.S. Court of Appeals for the

¹ In any event, to penalize organizations for failing to become parties at the initial stages of a CARP would likely result in parties involving themselves in a CARP in order to "reserve" their rights should rules, which no one contemplated, be proposed for the first time, such as here, after a CARP proceeding, after a Determination by the Librarian of Congress, and after an appeal to and decision by the U.S. Court of Appeals. AFTRA and the AFM have amply shown why the law permits them to commence participation at this stage. Failure to allow participation would result in the Librarian of Congress knowingly ratifying the proposals of the RIAA, while the arguments of those parties with substantial interests are ignored. That cannot be the record that the U.S. Court of Appeals sought in its remand.

District of Columbia intended when it remanded the Librarian's determination. It would be ironic if the three services, which, as stated earlier, have no interest in the distribution of royalties, could set terms that significantly affect the substantial interests of performers while the performers' objections are not considered. This would be the result should the Copyright Office not consider the unions' objections.

III. Objections to the Proposed Rules

The AFM and AFTRA object to two of the terms that are proposed by the RIAA and consented to by the subscription services. We discuss each of those terms and our objections, in turn. Before turning to that discussion, we note that in November 1998, the RIAA formed SoundExchange² to serve as a common agent to collect and distribute royalties from the preexisting subscription service compulsory royalties, as well as for the webcaster compulsory royalties which are the subject of the current ratesetting proceeding in Docket No. 2000-9 CARP DTRA 1 & 2. Thus, as a practical matter, we are discussing the terms that will apply to SoundExchange.

A. The Method of Distribution to Artists: 37 C.F.R. § 260.3(c)

In the final rule and order issued on May 8, 1998, the Librarian of Congress promulgated the following rule, codified at 37 C.F.R. § 260.3(c), regarding the method of distribution of royalties to artists:

² AFTRA and the AFM both sit on the Board of SoundExchange to protect artists' rights and to ensure that artists receive their royalties. However, on many important issues, including approval of expenses, artists' representatives on the Board have no vote.

The agent designated to receive the royalty payments and the statements of account shall have the responsibility of making further distribution of these fees to those parties entitled to receive such payment according to the provisions set forth at 17 U.S.C. 114(g).

The “parties entitled to receive such payment according to the provisions set forth at 17 U.S.C. § 114(g)” include featured artists (pursuant to §114(g)(2)(C)), nonfeatured musicians (pursuant to § 114(g)(2)(A)), and nonfeatured vocalists (pursuant to § 114(g)(2)(B)). Thus, the term as promulgated by the Librarian imposes responsibility on SoundExchange to distribute royalty fees to the artists and artist representatives named in §114(g)(2) as well as to copyright owners. This is consistent with the Librarian’s view that SoundExchange (or any common agent) has a “fiduciary responsibility of making an equitable distribution *among those entitled to receive a portion of the funds.*” 63 Fed. Reg. at 25413 (emphasis added).

The RIAA’s Petition seeks to alter 37 C.F.R. § 260.3(c) to require SoundExchange to distribute only to copyright owners and not to artists. The proposed amended term states:

The collective designated to receive the royalty payments and the statements of account shall have the responsibility of making further distribution of these payments to copyright owners of the exclusive right under 17 U.S.C. 106(6) whose sound recordings were performed by the services making the payments. Such copyright owners shall allocate their receipts according to the provisions set forth at 17 U.S.C. 114(g)(2).

The unions have three distinct objections to this proposed amended term.

1. The Amendment is Improper Because this Term Was Not Remanded.

First, the proposed amendment is improper because 37 C.F.R. § 260.3(c) was not a subject of the remand by the D.C. Circuit Court of Appeals in Recording Industry Ass'n v. Librarian of Congress. The Librarian's May 8, 1998 final rule and order does not indicate that 37 C.F.R. § 260.3(c), as promulgated, was objected to by the RIAA or any of the three subscription services. Unlike the other four terms discussed in the RIAA's Petition, the D.C. Circuit did *not* find that 37 C.F.R. § 260.3(c) was improperly imposed or that it was unsupported by evidence. Thus, there is no procedural basis at this time to amend it.

2. The Amendment Will Significantly Harm Nonfeatured Artists.

Second, the proposed amendment will significantly harm nonfeatured musicians and nonfeatured vocalists, who, together, are entitled to 5% of the receipts from the subscription services' compulsory royalty.³ These nonfeatured artist shares are to be deposited in escrow accounts and distributed to nonfeatured artists by an independent administrator jointly appointed by the unions and the copyright owners.

³ Under §114(g)(2)(A), nonfeatured musicians are entitled to 2 ½% of receipts from the compulsory license, which are to be deposited in an escrow account managed by an independent administrator jointly appointed by copyright owners and the AFM, and then distributed to nonfeatured musicians. Similarly, under §114(g)(2)(B), nonfeatured vocalists also are entitled to 2 ½% of receipts, which are to be deposited in an escrow account managed by an independent administrator jointly appointed by copyright owners and AFTRA, and then distributed to nonfeatured vocalists.

Unfortunately, during the time period relevant to this proceeding, the total nonfeatured artist share of the royalties collected by SoundExchange will be quite small. Even assuming that SoundExchange distributes the nonfeatured artist shares directly to the independent administrator jointly appointed by the AFM, AFTRA and the copyright owners – that is, that SoundExchange acts consistently with 37 C.F.R. §260.3(c) as promulgated by the Librarian – the independent administrator will face significant challenges in making the distribution, and will only be able to distribute very small sums to individual nonfeatured artists.⁴

If, however, RIAA's proposed amended term is adopted, and SoundExchange distributes the nonfeatured musicians' and vocalists' shares to each individual copyright owner, the independent administrator will be forced to spend nonfeatured artist royalties to administer a process to collect the nonfeatured artist share from hundreds of companies. These costs will reduce the amount of royalties

⁴ To illustrate, the AFM and AFTRA understand that SoundExchange's first distribution, covering the period from 1996 through the first quarter of 2000, will be based on the performance of approximately 500,000 identifiable songs, whose copyrights are owned by hundreds of different companies, and which probably embody the recorded performances of thousands of nonfeatured musicians and vocalists. Unfortunately, that first SoundExchange distribution will only total approximately \$5,000,000, so that the approximate total of the nonfeatured artist share will be a mere \$250,000. Obviously, in these circumstances not every nonfeatured artist who performed on a sound recording transmitted by the subscription services will be able to receive a royalty, and, no matter what distribution formula is devised, individual payments will be small. Payments to artists will further be reduced by the necessity to expend nonfeatured royalty money in order to research the identity and addresses of session musicians and background vocalists on the relevant sound recordings. At this time neither the digital services nor the copyright owners are providing any such data with respect to any of the 500,000 songs for which the services have paid royalties.

actually paid to artists. Moreover, a large number of companies only receive very small payments, and while these royalties aggregate to a substantial amount, it would not be cost effective to track down the unions' 5% of the money from each company. The independent administrator's efforts are unlikely to be 100% successful, which will further reduce the royalties available for distribution to nonfeatured artists.

Congress intended that nonfeatured musicians and vocalists would benefit from the proceeds of the compulsory license in the DPRA. This intent will not be fulfilled unless the terms set by the Librarian provide for the most efficient possible means of paying the nonfeatured artist shares to the independent administrator.

The unions and the copyright owners jointly have appointed the AFM and AFTRA Intellectual Property Rights Distribution Fund to act as the independent administrator for both the nonfeatured vocalists' royalties and the nonfeatured musicians' royalties. This Fund has an excellent track record of making efficient and appropriate distributions to nonfeatured musicians and vocalists in circumstances that are similar in nature (if not in sheer magnitude) to the situation presented here. However, the practical reality is that unless SoundExchange pays nonfeatured vocalist and musician shares directly to the independent administrator, the costs of administering the collection of the

nonfeatured share together with the other necessary costs would leave little for actual distribution.

The AFM and AFTRA understand that SoundExchange member companies are required to agree to direct payment of the nonfeatured artist share to the independent administrator as a condition of their membership in SoundExchange. However, the RIAA's proposed amendment to §260.3(c) would require SoundExchange to pay the nonfeatured artist share that is attributable to nonmember record companies to those record companies rather than to the independent administrator. And, it would allow SoundExchange to amend its internal operating rules to allow the same to happen with regard to member companies. Either of these eventualities would severely undermine if not destroy the ability of the independent administrator to pay royalties to nonfeatured vocalists and musicians.

3. The Amendment Also Is Harmful to Featured Artists.

The RIAA's proposed amendment is also harmful to featured artists, who are entitled to 45% of the compulsory license fees collected from the subscription services pursuant to § 114(g)(2)(C). Artist groups, manager groups and even (at various points) some digital broadcasters have publicly called for direct payment of featured artist royalties to artists rather than to the record company copyright owners. Among other reasons for artists' concern, many featured artists have expressed the fear that if SoundExchange pays their 45% share of the royalties to the

copyright owner record companies in the first instance, those companies will have the opportunity to recoup advances from these royalties.

Moreover, artists' payments will be delayed, and costly and burdensome audits will be required to ascertain whether artists have received their full compulsory royalty shares. The result would be that many, if not most artists, would not receive the royalty checks they should.

Since the early 1990s, the AFM and AFTRA have fought for the twin principles that artists (including featured artists) should share in any new income streams from the digital performance right, and that those shares should be nonrecoupable.⁵ The AFM and AFTRA negotiated over that very issue with the RIAA and the major record companies in 1994, in connection with their joint efforts to obtain enactment of the DPRA. The result of those 1994 negotiations was a written agreement between the AFM, AFTRA, RIAA and the major record companies stating, among other things, that the compulsory license royalties created by the DPRA would be "inalienable." This contractual agreement prohibits the record companies from recouping the compulsory license royalties.⁶

⁵ The structure of the DPRA strongly suggests that Congress agreed that the artists' shares of the compulsory royalties should be nonrecoupable. In Section 114(g)(1), Congress specifically stated that featured artists would share in the proceeds of exclusive rights licenses "in accordance with the terms of the artist's contract." Congress did not refer to featured artists' contracts – which is where any recoupment right arises – in Section 114(g)(2)(C). Rather, in that section Congress simply required that featured artists be allocated 45% of the receipts from compulsory licenses.

⁶ Although the RIAA has not yet conceded that the record companies' contract with the AFM and AFTRA forbids the recoupment of compulsory royalties, they have not produced any evidence that the word "inalienable" in that agreement means something else. The unions' contemporary negotiation notes plainly indicate that recoupment was included in the word "inalienable." The RIAA is now trying to make an end run around the unions' contracts and claims by bringing this issue before the Copyright Office – with respect to a term that was not subject to the remand, and in a proceeding in which the unions were not

In response to these various pressures, the RIAA and SoundExchange publicly have agreed that for the time being, and with regard to SoundExchange and RIAA member companies, SoundExchange will distribute featured artist royalties directly to the artists. Discussions of this issue will continue as all of the interested parties seek a satisfactory solution. Given this context, the RIAA's proposed amendment to § 260.3(c) is harmful to featured artists because it is, in effect, an end run around the record companies' present obligation and commitment to pay featured artists royalties to the record company copyright owners in the first instance.

B. Deduction of Costs by SoundExchange: 37 C.F.R. § 260.3(d)

The Librarian promulgated 37 C.F.R. § 260.3(d), which stated:

The designated agent may deduct reasonable costs incurred in the administration of the distribution of the royalties, so long as the reasonable costs do not exceed the actual costs incurred by the collecting entity.

This was one of the terms remanded by the D.C. Circuit Court of Appeals, on the grounds that the CARP had received no evidence on the question of the deduction of costs by the collective.

Now the RIAA seeks to amend this term to read as follows:

Before making the distributions specified in paragraph (c) of this section, the designated collective may deduct reasonable costs incurred in the administration of the

original parties. In any event, as described in the text, the RIAA has agreed at least in the immediate future to treat the artists' shares of compulsory royalties as non-recoupable.

collection and distribution of the royalty payments, so long as the reasonable costs do not exceed the actual costs incurred by the collective.

On its face, it is not clear what the amended term means, or how, precisely, it changes the rule as promulgated by the Librarian. The RIAA notes that the subscription services have agreed to the amendment. However, the subscription services have no interest in what costs SoundExchange may or may not deduct prior to paying royalties, so that their agreement does nothing to elucidate the meaning of the term.

The amended term adds the word “the administration of the collection ... of the royalty payments” to the description of costs that may be deducted. If that means only that SoundExchange may deduct from distributions the administrative costs – such as staff and computer expenses – that it incurs in seeking and receiving royalty payments, then the change is not controversial, and, indeed, is probably unnecessary.

However, with no record to elucidate the meaning of the proposed change, it is not clear that RIAA intends the amendment to be so limited. Moreover, the practical reality is that a dispute has arisen among the unions, the RIAA and SoundExchange with regard to the question whether SoundExchange may deduct, prior to distributing royalties, the copyright owners’ legal costs in connection with the Copyright Arbitration Royalty Panel that set the rates payable by the subscription services. The unions, the RIAA and SoundExchange are currently in discussions regarding this issue.

The unions do not believe that the amended term in fact properly may be read to allow the deduction of CARP legal expenses prior to the distribution of royalties. Nothing in the DPRA allows the deduction of 50% of the copyright owners' CARP litigation expenses from the artists' share of the compulsory royalty; indeed, Section 114(g) mandates that the artists receive 50% of the compulsory license receipts. Although the legislative history defines receipts to exclude *administrative fees* paid to the copyright owners' collective, we know of no support for the notion that administrative fees can include the substantial legal fees incurred *in litigating the compulsory license rate*.⁸

It is also worth noting that even the proposed amended term contemplates the deduction of expenses "incurred by the collective," i.e., SoundExchange. But, in this instance, SoundExchange did not incur the CARP litigation expenses. Those expenses were incurred by the RIAA, which controlled the CARP litigation.

The practical problem underlying this issue is obvious. CARP expenses could exceed \$1 million, and, while artists do derive some benefit from achieving a higher rather than a lower license rate in a CARP, the fact remains that artists had no control over the litigation choices made by the RIAA and should not shoulder 50% of the cost of

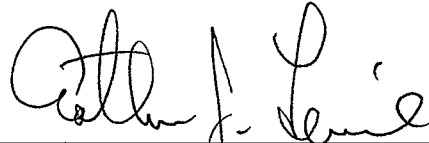
⁸ In addition, when attorneys' fees are to be considered as part of costs in the Copyright Law, they are specifically enumerated. See 17 U.S.C. Section 505 ("...the Court may also award a reasonable attorney's fees to the prevailing party as part of costs.").

those choices.⁹ The unions object to the amended term to the extent that it may suggest that such a deduction is allowable and to the extent, if any, that it allows the RIAA to make an end run around the dispute regarding SoundExchange's treatment of CARP legal expenses.

Conclusion

The AFM and AFTRA have stated important objections to two of the terms proposed by the RIAA and published in the Notice of Proposed Rulemaking. These proposed terms to which the AFM and AFTRA object will have an adverse affect on artists, and the unions are willing to participate in a CARP to develop evidence on these issues.

Date: October 12, 2001



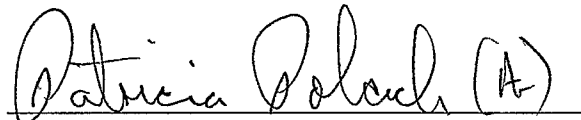
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⁹ Moreover, as noted above, the nonfeatured artist shares are already so small, and the administrative burdens in distributing their share are so extraordinary, that it is manifestly unfair for them to pay any share of the RIAA's CARP expenses.

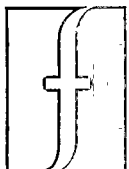


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October 17, 2001

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OCT 17 2001

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OF COPYRIGHT

In the Matter of Determination of Statutory License Terms And
Rates for Certain Digital Subscription Transmissions of Sound
Recordings
Docket No. 96-5 CARP-DSTRA

Dear Mr. Carson:

Enclosed are an original and five copies of **Notice of Intent to Participate and Objections of the American Federation of Musicians and the American Federation of Television and Radio Artists to Certain Proposed Terms Contained in the RIAA Petition to Establish Rates and Terms Governing the RIAA Collective and to Suspend CARP Proceedings**. This is in compliance with the Copyright Office Notice of Proposed Rulemaking published in the Federal Register Monday, July 23, 2001.

If you have any questions, please feel free to contact me.

Sincerely,

Arthur J. Levine

AJL/mrm
Enclosures