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May 14, 2018

The Honorable Chuck Grassley
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

The Honorable Dianne Feinstein
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Re: Music Modernization Act (S. 2823)

Dear Chairman Grassley and Ranking Member Feinstein:

Since 2003, SoundExchange has administered the statutory license for the use of sound recordings on digital radio set forth in Sections 112(e) and 114 of the Copyright Act. We have also represented the interests of the entire U.S. recorded music industry — artists and labels, from household names to aspiring new artists — before the Copyright Royalty Board (CRB) in every Section 112/114 rate-setting proceeding since that time. We have paid out more than $5 billion in royalties that we have collected from more than 3000 digital radio services.

SoundExchange fully supports the comprehensive Music Modernization Act, S.2823. The music industry has undergone a transformation in the 20 years since the statutory license for digital radio was created, and this bill is a necessary update towards a fair marketplace that creators deserve. If passed, it will immediately improve the lives of many in the industry, including the more than 150,000 artists and rights owners we represent. I'm writing today in connection with one particular, critical aspect of the bill: The MMA's common sense requirement that *all* digital radio services operate under the same set of rules.

Under current law, digital radio services fall into two categories: (1) three "grandfathered" services whose rates are set under the below-market policy-based rate-setting standard set forth in 17 U.S.C. § 801(b); and (2) *more than three thousand* other digital radio services (including those that must compete against the grandfathered services) whose rates are set under the willing buyer-willing seller (i.e. fair market) standard set forth in 17 U.S.C. § 114(f).

The historical reason for these two different standards is clear. When Congress created the digital performance right in 1995, it simply adopted the Section 801(b) standard that applied to the statutory license for musical works (the Section 115 license that is also addressed in the MMA). Then, in 1998, when Congress expanded the statutory license to clarify that it covered free internet radio as part of the Digital Millennium Copyright Act (DMCA), Congress also began the transition to achieve a fair market rate in the statutory license. Specifically, under the compromise reached at the time, certain pre-1995 digital radio services would continue to enjoy the Section 801(b) rate standard, based on the theory of "business reliance" (i.e., that they had made prior investments based on that standard). But Congress's intent was clear: by creating this new standard for the huge majority of statutory licensees, the DMCA *"was designed to move the industry to market rates*." *SoundExchange, Inc. v. Muzak LLC, [854 F.3d 713, 719 (D.C. Cir. 2017)]*.

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Letter from Michael Huppe to The Honorable Chuck Grassley and The Honorable Dianne Feinstein

Twenty years have passed, and it's time to complete the transition. The Music Modernization Act reflects that final step. (Importantly, the MMA would *also* transition the Section 115 rates to the willing buyer-willing seller standard.)

As noted above, the special below-market rate standard in 17 U.S.C. § 801(b) is available only to *three* companies: Sirius XM (but only for its consumer satellite radio service); Muzak (but only for its DishCD service); and Music Choice (but only for its residential music service). These three companies were "grandfathered" into the 801(b) rate standard in 1998, solely because they happened to be in existence at the time. And today even *these* three companies offer certain services that are paying at the willing buyer-willing seller standard, like thousands of other services.

In our opinion, these companies *never* should have been grandfathered in the first place. When compulsory licensing forces creators to surrender their intellectual property for the benefit of these companies, at a minimum the law should compensate the creators with a fair market rate – regardless of the timing. But whatever the reasoning behind this twenty-year-old rationale, the justification for giving these companies preferential treatment has long since evaporated.

When it comes to satellite radio, the landscape has changed radically. In 1998, Sirius and XM were separate companies deep in debt, and had not actually launched their services yet; today, Sirius XM is a merged company that generates more than $5 billion a year in revenue.

Music Choice dominates the marketplace for residential music services offered over cable and satellite television services, but that's due almost entirely to Section 801(b). Music Choice has competitors who cannot use the 801(b) rates, and can therefore be undercut. Indeed, commercial interests no-less-significant than MTV have tried to operate competing services under the willing buyer-willing-seller standard, but MTV's "Urge" network was unable to compete with Music Choice which was paying roughly *half the cost* for the music.

Mood Media also gets the benefit of 801(b) rates for its DishCD service solely because it acquired Muzak. Indeed, Mood thought it could sneak the rest of its residential music service business into the grandfathered rates by buying Muzak. After doing so, Mood purported to shift its newer, "willing buyer-willing seller" residential music service to Muzak, in a transparent effort to allow these new services to take advantage of the lower rate. Fortunately, the D.C. Circuit saw this cynical ploy for what it was, and ruled against Mood for this game-playing.

<u>Importantly, each of these companies has competitors that pay at market rates</u>.

Not surprisingly, the three beneficiaries of the below-market rate standard are urging Congress to preserve their unfair advantage. There's no sound policy reason that Congress should give these three companies a perpetual advantage in the marketplace, simply because they happened to be in existence in 1998.

In their April 20th letter to you, they argued that the below-market rate standard provided in Section 801(b) "works to the benefit of both licensees and content owners." That's preposterous. The CRB has often used the Section 801(b) rate standard to set statutory rates that are expressly less than a marketplace rate. In the first satellite radio proceeding, the CRB set the rate at 6%, rising to

8% over the term, even though it concluded that the market rate was *in the neighborhood of 13%.* In the second satellite radio proceeding, the rates drifted to 11% over the term – *still below the market rate* that the CRB had previously identified. These two decisions together likely cost creators more than $1 billion. Likewise, even as the marketplace has changed and the services matured, the CRB has consistently been unmoved by marketplace evidence, and elected instead to continue the statutory rate for Music Choice and Muzak at approximately the same historic low levels, which is significantly less than the rates paid by their direct competitors. Experience has shown that the absolute best an artist or content owner can hope for under the 801(b) standard is that the CRB will set a marketplace rate — i.e., a willing-buyer-willing-seller rate. More often than not, though, creators are forced to accept less than a market rate for their work.

These three companies also argue that the standard results in "reasonable rates that promote competitive marketplaces." That assertion defies economic common sense. How can it promote competition to guarantee three companies a competitive advantage over other services? Sirius XM makes billions of dollars a year off music, and there's no good reason to force artists to subsidize its business. Similarly, the § 801(b) standard has enshrined Music Choice's dominance of the market for music services over residential cable systems. Music Choice can easily undercut any competitors on price, simply because it has been around for a while.

Finally, the three grandfathered services claim in their April 20th letter that their perspective "was excluded from any discussion regarding this change . . ." That's simply not the case. There have been numerous hearings touching on this issue in the last decade. In fact, as long ago as June 25, 2014, these services were engaged in debating this very point. That's when David Frear (Sr. Exec. Vice President and CFO of Sirius XM) testified before the House Judiciary Committee on these issues as part of a Music Licensing hearing. I know – because I was sitting next to him. So the 801(b) issue has been in play for several years, and certainly should come as no surprise to anybody in the industry.

In short, the 801(b) standard helps three companies at everyone else's expense. That's it. There's no policy rationale justifying preservation of the standard beyond a desire to pad their bottom lines, at the expense of their competitors as well as the creators on whose music their business depends. We urge Congress to remedy this historical anomaly so that these three companies can no longer operate in the marketplace with their "thumb on the scale" when paying for the music.

Thank you for considering these facts as the Music Modernization Act is considered by your Committee.

Sincerely,

Michael J. Huppe
President & CEO