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That CARP Is No Keeper: Copyright Arbitration Royalty Panels - Change Is Needed, Here Is Why, and How

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THAT CARP IS NO KEEPER: COPYRIGHT ARBITRATION ROYALTY PANELS—CHANGE IS NEEDED, HERE IS WHY, AND HOW

I. INTRODUCTION

In June of 2002, the United States House of Representatives Subcommittee on Courts, the Internet, and Intellectual Property held an oversight hearing on the Copyright Arbitration Royalty Panel (CARP) structure and process. The CARP process has been under review for several years, and has come under heavy criticism lately. Much of the recent criticism has focused on the Webcasting decision of June 2002. This public criticism and congressional prodding has prompted the United States Copyright Office to consider changes to the CARP structure and process.¹

This Note will explore the history of the current CARP, beginning with an overview of the Copyright Royalty Tribunal, the predecessor to the current CARP. This will be followed by an overview of the current CARP structure and an overview of a typical CARP proceeding. The Note will then explore the Webcasting decision and the criticisms centered on this decision. The Note will also look at the general criticisms of the current CARP process and structure, including, but not limited to, the escalating costs of CARP proceedings, the instability and inconsistency of CARP decisions, and the inefficiency with which small claims are handled in the current system. The Note will then discuss possible solutions and proposals offered by industry participants, regulators, and legislators. Lastly, the Note will conclude with an overview of the current stage of reform within the Copyright Office (i.e., what structure and process changes the legislature and the Copyright Office have considered and enacted to date, and have what the author predicts the legislature and the Copyright Office will do in the near term).

¹ See, e.g., Andrew Caffrey, Copyright Office Rethinking Royalties, WALL ST. J., Sept. 16, 2002, at R13 (discussing a possible structure change to CARP by the Copyright Office).
II. BACKGROUND

A. COPYRIGHT LAW ORIGINS AND BASICS

"The Congress shall have power to ... Promote the Progress of Science and useful Arts, by secaring for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."2

This Constitutional grant of power to Congress led to the enactment of the first copyright statute in this country, the Copyright Statute of 1790.3 Since that original enactment, Congress has made significant changes to the copyright law four times.4

Copyright gives the owner of "original works of authorship" protection under the laws of the United States.5 The works afforded this protection include literary, dramatic, musical, artistic, and certain other intellectual works (both published and unpublished).6 The 1976 Copyright Act7 generally allows the owner of a copyright the exclusive right to do, and to authorize others to do, the following:

(1) to reproduce the work in copies or phonorecords;
(2) to prepare derivative works based upon the copyrighted work;
(3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
(4) to perform the work publicly, in the case of literary, musical, dramatic, and choreographed works, pantomimes and motion pictures and other audiovisual works;

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2 U.S. CONST. art. I, § 8, cl. 8.
3 Act of May 31, 1790, ch. 15, § 1, 1 Stat. 124 (repealed 1831).
6 Id.
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(5) to display the copyrighted work publicly; and
(6) in the case of sound recordings, to perform the work publicly by means of a digital audio transmission. 8

These rights are not unlimited in scope, however. For example, a major limitation is the doctrine of "fair use." 9 Another limitation of copyright protection is compulsory licensing, under which limited uses of copyrighted works are permitted upon payment of royalties and compliance with statutory conditions. 10

Copyright protection is not a difficult thing to achieve. 11 To qualify, a work, including a song, 12 "must embody some minimal degree of originality that can be traced to the efforts of the author." 13 Next, the work must be "fixed" in a sufficiently permanent environment. 14 Therefore, once a song has been created that is somewhat original, and is reduced to some permanent form, it is protected under copyright law. There is no publication or registration requirement for songs, although there are certain advantages to registration. 15

B. STATUTORY LICENSES

A statutory license is a license provided by the law (as opposed to one voluntarily provided by the individual copyright owner). 16 In the 1909 Copyright

9 17 U.S.C. § 107 (2000). Fair use exceptions are essentially a defense to a charge of copyright infringement. The Fair Use exception is most commonly raised in educational activities, literary and social criticism, parody, and First Amendment activities such as news reporting. ARTHUR MILLER, INTELLECTUAL PROPERTY: PATENTS, TRADEMARKS, AND COPYRIGHT, IN A NUTSHELL 354 (3d ed. 2000). The Copyright Act explicitly identifies four interests which should be weighed in a balancing process to determine whether a fair use exception is appropriate: (1) the purpose and character of the use, including its commercial nature; (2) the nature of the copyrighted work; (3) the proportion that was used; and (4) the economic impact of the use. 17 U.S.C. § 107 (2000).
12 The author has used the example of a copyright for a song due to the importance of musical copyrights in the context of Webcasting. See infra Section II.E.
13 Rose, supra note 11, at 320. See also 17 U.S.C. § 102(a) (2000).
14 Rose, supra note 11.
15 U.S. Copyright Office, supra note 10 (noting some of the major advantages of copyright registration: establishing a public record of the copyright claim; registration is necessary before an infringement suit may be filed in court; registration may provide evidence of the validity of the copyright).
16 Susan Chertkof Munsat, Statutory Licensing for Webcasters: Everything You Wanted to Know But
Act, there was only one “compulsory license,” that which allowed a person to make a sound recording of a song that had been previously recorded and to distribute copies of that recording to the public. Under the license provided by the 1909 Act, the statutory royalty rate was $.02 per copy. This rate was set by statute, was not subject to change, and lasted from 1909 to 1978. Since the rate ($.02) was set by statute, and since the user paid the copyright owner directly, there was no need for any governmental intervention into this process (i.e. there was no need for an agency to set a rate, or to collect and distribute royalties).

During the drafting of the 1976 Copyright Act, Congress realized that statutorily set rates (i.e. $.02 for sound recordings) were too inflexible and did not provide fair compensation to the copyright owner. Congress was also planning to add several other statutory licenses at this time. Congress saw that there would be a need for an administrative body to periodically adjust the rates of the royalties associated with these new statutory licenses. Also, Congress saw the need for a body to distribute the royalties collected from users. Under the system envisioned by Congress, royalties would be deposited with the Copyright Office and distributed according to decisions made by this new administrative body.

While the Senate and the House both agreed on the need for this new administrative body, they were unsure of the most appropriate structure. The Senate proposal called for a tribunal composed of a three-member panel that would reside within the Copyright Office. The members of this panel would be

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Were Afraid to Ask, in PLI’s MUSIC ON THE INTERNET UNDERSTANDING THE NEW RIGHTS & SOLVING NEW PROBLEMS at 141, 149 (PLI Patents, Copyrights, Trademarks, and Literary Property Handbook Series No. 640, March 2001) (“It [statutory licensing] is an efficient way to license because it permits a webcaster [user] to perform all of the sound recordings it wishes to perform without obtaining separate licenses from each copyright owner.”).


18 Id. at 32.

19 Id.

20 Id.

21 Id.; see generally 17 U.S.C. §§ 116-9 (2000) (adding new statutory licenses in the areas of cable retransmissions of over-the-air broadcast signals, jukebox performances of music, and the use of published musical works and published pictorial, graphic and sculptural works by noncommercial educational broadcasters).

22 CARP Hearings, supra note 17, at 32.

23 Id. (especially important in instances “where there were many copyright owner claimants to the same funds and there were controversies as to how much each claimant was entitled to receive”).

24 Id.

25 Id.

26 Id.
appointed by the Register of the Copyrights from the membership of the American Arbitration Association, or a similar organization. The Register would convene the panel in the event of a controversy over royalty rates or royalty distributions.\textsuperscript{27}

During the time the legislature was deciding the structure of this new administrative body, the U.S. Supreme Court handed down an important decision regarding the appointment of persons carrying out executive branch functions.\textsuperscript{28} The Supreme Court ruled that certain functions of appointed officials were executive in nature, and should be appointed by the president.\textsuperscript{29} To avoid the constitutional uncertainty that may have arisen if the Register of Copyrights (a member of the legislative branch) appointed members to this new administrative body, Congress decided to create an independent regulatory agency.\textsuperscript{30} This agency was known as the Copyright Royalty Tribunal ("CRT"). The CRT became an independent agency in the Legislative Branch that received support from the Library of Congress and had its decisions reviewed directly by the Federal Court of Appeals.\textsuperscript{31}

The Copyright Royalty Tribunal ("CRT") existed in one form or another from 1977 to 1993.\textsuperscript{32} During this period Congress created new statutory licenses and eliminated one of the existing licenses.\textsuperscript{33} In 1982, the CRT came under intense fire from the Cable Industry.\textsuperscript{34} The CRT decided to set the royalty rate that cable systems must pay when they retransmit certain copyrighted programming.\textsuperscript{35} Ted Turner, of Turner Broadcasting, called for the abolition of CRT and testified before Congress,\textsuperscript{36} "[t]his CRT decision puts us out of business."\textsuperscript{37}

\textsuperscript{27} Id.
\textsuperscript{28} Buckley v. Valeo, 424 U.S. 1, 143-4 (1976) (holding appointments of legislative officials by someone other than the President unconstitutional); see generally U.S. CONST. art. II, § 2, cl. 2.
\textsuperscript{29} Id.
\textsuperscript{30} CARP Hearings, supra note 17, at 33.
\textsuperscript{31} See id. at 15-22 (statement of Robert A. Garrett, attorney-at-law).
\textsuperscript{32} Id. at 33.
\textsuperscript{33} Congress created a new statutory license in 1998 to govern retransmission of over-the-air television signals to home satellite dish owners. See 17 U.S.C. § 119 (2000). Congress also eliminated the jukebox compulsory license due to the fact that there were sufficient private license agreements by this time. In 1992, Congress also created a statutory license the manufacture and for importation of digital audio recording technology ("DART"). See 17 U.S.C. § 1003 (2000).
\textsuperscript{34} CARP Hearings, supra note 17, at 16.
\textsuperscript{35} Id.
\textsuperscript{36} At this time, Ted Turner was President of Turner Broadcasting and was testifying in his capacity as a representative of the cable broadcasting industry. See generally About TBS, Inc.: Corporate History, available at http://www.turner.com/about/history.html (discussing the company and Turner's role then).
During the remainder of the 1980s and the early 1990s, several proposals were considered by Congress concerning the structure of royalty rate-setting and distribution. These included basically everything from eliminating compulsory licenses altogether and allowing market negotiations, to privatizing the system, to a host of other ideas. 38

In 1993, Congress concluded that a full time agency was not justified and thus enacted the Copyright Royalty Tribunal Reform Act of 1993. 39 This legislation abolished the CRT and replaced it with the ad hoc CARP system now in place.

C. CURRENT CARP STRUCTURE AND PROCESS

Under the current CARP system, ad hoc arbitration panels are administered by the Librarian of Congress and the Copyright Office. 40 The CARPs adjust royalty rates and distribute royalties collected under the various compulsory licenses and statutory obligations of the Copyright Act. 41 These compulsory or statutory licensing provisions compel copyright owners to license certain uses of their works to different parties who then pay the prescribed royalty.

Whenever there is a controversy on the distribution of compulsory copyright royalties or the adjustment of copyright royalty rates, the Librarian of Congress is authorized to convene a three-person CARP. 42 Administrative responsibilities prior to the declaration of a controversy are assigned to the Copyright Office.

Congress believed that placing the panel under the supervision of the Register of Copyrights and the Librarian of Congress made good sense due to the fact that both of these offices were already significantly involved in the process. 43

38 CARP Hearings, supra note 17, at 19.
42 17 U.S.C. § 802(a) (2000) (the Librarian of Congress selects two arbitrators from lists provided by professional arbitration associations). 17 U.S.C. § 802(b) (2000) (qualifications of these arbitrators include experience in conducting arbitration proceedings and any qualifications which the Librarian of Congress shall adopt. The two arbitrators selected by the Librarian will, within ten days of their selection, choose a third person from the same lists, and this third person will serve as the chairperson of the arbitrators. If the two initial arbitrators cannot agree on the third person, the Librarian selects the third arbitrator).
43 H.R. REP. NO. 103-286, at 11 (1993) (the Copyright Office was already involved through their licensing division, which received royalty payments; the Register's Office was involved through the Register and the General Counsel, who promulgate regulations related to the statutory licenses. These offices continue to be significantly involved in CARP proceedings.). 17 U.S.C. § 801(d) (2000) ("The Librarian of Congress, upon the recommendation of the Register of Copyrights, shall provide
Additionally, Congress believed that ad hoc arbitration panels would be more efficient than full time commissioners.\(^4^4\)

These ad hoc arbitration panels recommend the royalty rate and distribution of royalty fees collected under the statutory licenses. In addition, they set the terms and conditions of certain statutory licenses. Each three person CARP is selected for a particular proceeding and has 180 days to deliver a recommendation to the Librarian of Congress.\(^4^5\)

A typical CARP proceeding evolves as follows: initially, once a dispute or controversy arises, the Copyright Office designates a voluntary negotiation period among the parties to negotiate their dispute.\(^4^6\) If an agreement is not met in negotiation, the parties proceed to a CARP. Each participant in the proceeding must then submit a written direct case. This sets forth the party’s reasons as to what the party believes the rates or distribution should be. Next, the Copyright Office conducts a limited discovery period.\(^4^7\) Once discovery is concluded, the Librarian selects two arbitrators from a list of designated arbitrators.\(^4^8\) These two arbitrators then select a third arbitrator from this list to serve as their chairperson.\(^4^9\)

The arbitrators then consider the written testimony submitted by the parties.\(^5^0\) They may conduct oral hearings, and parties often present rebuttal testimony.\(^5^1\) After considering the evidence and testimony presented (within the 180-day time limit) the panel delivers a written recommendation of what the royalty rate or distribution should be to the Librarian of Congress.\(^5^2\)

Once the Librarian receives the CARP report, he has ninety days to either accept the report, or reject it.\(^5^3\) The Register of Copyrights is also required to advise the Librarian on his decision.\(^5^4\) If the CARP report is rejected, the
The Librarian of Congress and the Register of Copyrights may deduct from royalty fees collected or deposited reasonable costs incurred in these proceedings. \(56\) Any party wishing to appeal the decision may do so by appeal to the United States Court of Appeals for the District of Columbia Circuit. \(57\)

D. THE WEBCASTING DECISION

Since its creation in 1993, the Copyright Arbitration Royalty Panel system has conducted nine full proceedings. \(58\) The most recent and arguably the most controversial CARP decision dealt with the royalty rate that webcasters must pay when they transmit sound recordings over the Internet. \(59\)

In order to webcast music, an operator must obtain two licenses. The first is the license for the underlying musical composition (the written notes and lyrics). This is often referred to as a “musical work.” \(60\) The second license the user must obtain is the license to the actual recording itself (the “sound recording”). \(61\) Generally, the license to perform or reproduce a musical composition can be

U.S.C. § 802(h)(1) (2000). Note, however, that 'reasonable' is not statutorily defined and these costs can become quite large. See infra Section III.

17 U.S.C. § 802(g) (2000) (any decision of the Librarian with respect to a determination of an arbitration panel may be appealed by any aggrieved party who would be bound by the determination. This appeal is to the United States Court of Appeals for the District of Columbia Circuit and must be brought within thirty days after the publication of the Librarian's decision in the Federal Register. The court may only modify or vacate a decision of the Librarian if it finds that the Librarian acted in an arbitrary manner. The court may either remand the case to the Librarian or enter its own determination with respect to the amount or distribution of royalty fees and costs. If no appeal is brought within thirty days, the decision is final.). See also CARP Hearings, supra note 17, at 34 (six decisions of the Librarian have been appealed to the United States Court of Appeals for the District of Columbia, and in each instance, the Librarian's decision was upheld).

58 CARP Hearings, supra note 17, at 34.

59 See U.S. Copyright Office, Rates and Terms for . . . Webcasting, at http://www.copyright.gov/carp/webcasting_rates.html (last modified Feb. 24, 2003) (providing for a timeline and overview of this decision). Digital audio transmission known as webcasting is covered by statutory license. See 17 U.S.C. § 114 (2000) (describing the scope of exclusive rights in sound recordings), § 112 (enumerating the limitations on exclusive rights in the case of ephemeral recordings); see also Munsat, supra note 16, at 147 ("Webcasting generally refers to the streaming of audio on the Internet. It is sometimes called 'Internet radio.' Webcasters often transmit several different channels of uninterrupted music divided into highly themed genres [e.g., classical, alternative rock, etc.]. Other webcasters retransmit the signals of over-the-air radio programming.").

60 Munsat, supra note 16, at 147.

61 Id.
obtained from one of the three major songwriter and publisher groups. The sound recording rights are usually owned by the record company that recorded and distributed the material. However, in some instances, the webcaster may be able to obtain a statutory license to perform sound recordings on the Internet. In order to qualify for a statutory license, the webcaster must meet certain conditions.

These statutory licenses are a result of the Digital Performance Right in Sound Recordings Act of 1995 (DPRA). The DPRA established a sound-recording performance right for digital transmissions. The Digital Millennium Copyright Act (DMCA), signed by President Clinton in 1998, further amended the Copyright Act. The DMCA was a piece of legislation that addressed many issues related to technology and the Internet, and it provided for, inter alia, a statutory license for webcasters that do not provide on-demand services. Webcasters who meet the statutory license requirements discussed previously must first notify sound recording copyright owners by filing an "Initial Notice" with the Copyright Office. The statutory license did not provide for a royalty rate so webcasters were forced to negotiate with copyright owners. Many of these negotiations were unsuccessful, and therefore, the Librarian of Congress had to

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63 Munsat, supra note 16, at 148.

64 See 17 U.S.C. § 114(d)(2) (2000) (detailing the conditions that must be met for a webcaster to qualify for a statutory license).


67 17 U.S.C. 114(d)(2) (2000) (granting copyright holders the exclusive right to authorize on-demand webcasts (on-demand refers to the ability of a listener to be able to request a particular song at a particular time)). See also Rose, supra note 11, at 331 (noting that other key provisions of the DMCA include: "(1) mak[ing] it a crime to circumvent "built-in" anti-copying measures to prevent copyright infringement of the software; (2) outlaw[ing] the manufacture, sale, or distribution of devices that can crack software protection codes; (3) limit[ing] liability of [ISPs] and [OSPs] from copyright infringement when acting solely as a conduit for transmitting information; [and] (4) creat[ing] a new license for sound recordings that are digitally transmitted").

68 The Copyright Office has forms available for this purpose. See U.S. Copyright Office, Forms, at http://www.copyright.gov/forms (last modified Mar. 25, 2003) (providing downloadable forms and information on how to request forms by mail).

69 See Steve Gordon, Examining Arguments in Controversy Over Webcasting Royalty Rates, 18 No. 6 ENT. L. & FIN. 1 (2002) (noting that initial negotiations were unsuccessful because the record companies were asking for more than many webcasters were willing to pay).
convene a CARP to determine the rate. These rates are supposed to represent the rates that "would have been negotiated in the marketplace between a willing buyer and a willing seller." On February 20, 2002, the CARP delivered its report recommending the rates and terms for webcasting to the Librarian of Congress. On May 21, 2002, the Librarian of Congress issued an order rejecting the CARP's recommendation on webcasting rates and terms. The Librarian issued his final determination on June 20, 2002.

The Librarian ruled that a rate of $.07 was the appropriate rate for both Internet-only retransmissions and AM/FM radio broadcasts. The ruling was based largely on previous marketplace deals, of which there had only been one. The Librarian accepted the CARP's conclusion that the RIAA/Yahoo! Agreement (the only marketplace deal) represented the "best evidence of what rates would have been negotiated in the marketplace between a willing buyer and a willing seller."

This hearing was quite extensive and extremely controversial. There is little doubt that webcasters were displeased with the decision of the Librarian. Their primary complaint was, quite simply, that the rates set by the CARP, and adopted by the Librarian of Congress would put many webcasters out of business. The

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70 See Munsat, supra note 16, at 153.
71 Gordon, supra note 69.
74 Naraine, supra note 72.
75 The only marketplace deal that had taken place was between the Recording Industry Association of America (RIAA) and Yahoo!. This deal set the benchmark for Web radio royalty payments. Id.
76 Id. (quoting the Librarian of Congress).
77 The webcasting CARP consumed over forty days of evidentiary hearings and generated almost 15,000 pages of transcript. CARP Hearings, supra note 17, at 16.
79 Gordon, supra note 69. Indeed, more than 200 Internet-based stations shut down immediately following the rate decision. Id. "More than 30 percent of U.S. Internet radio stations have stopped broadcasting in the past year, and some webcasters are moving operations overseas to avoid paying a royalty that takes effect next month [October, 2002] for copyrighted music." William Glanz, U.S. Webcasters Hit Hard by Royalty Decision, WASH. TIMES, Sept. 21, 2002. But see, Michael Papish, College
Recording Industry Association of America ("RIAA")\(^80\) complains that the rates are too low. RIAA claims that Webcasting will have a negative effect on already faltering record sales.\(^81\) They claim that if the recording industry is going to survive, future income must be derived more from licensing than from sales of CDs.\(^82\) RIAA also states that the licensing royalties must be shared with artists, background musicians, and music unions.\(^83\)

As a result of the decision of the Librarian of Congress, both sides to this issue filed notices of appeal with the Federal Court of Appeals in Washington, D.C. Also, on July 26, 2002, a bill was introduced in the United States House of Representatives that would exempt some small webcasters from paying the full royalty [See Section V Recent Legislation, infra].\(^84\) Most importantly, however, the Webcasting decision brought to light many of the problems of the current royalty setting system (CARP).

III. PROBLEMS WITH THE EXISTING CARP STRUCTURE AND PROCESS

The problems with the existing structure can generally be lumped into one of three categories: 1) the costs of CARP proceedings; 2) the instability and inconsistency of CARP decisions; and 3) the inefficiency with which small claims are handled in the CARP system.

A. THE COSTS OF CARP PROCEEDINGS

The most serious flaw in the current CARP process is the expense of the proceeding.\(^85\) Participants in a CARP proceeding bear not only their own substantial legal fees, but also the cost of the CARP proceeding itself. This can include costs for things such as expert witness fees, consultant fees, arbitrator fees, Copyright Office costs, out-of-pocket expenses, and time lost from running businesses and producing copyrighted works.\(^86\) Howard L. Berman stated that:

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\(^80\) The Recording Industry Association of America is a trade group whose members produce and control ninety percent of all legitimate sound recordings in the world.

\(^81\) Gordon, supra note 69.

\(^82\) Id.

\(^83\) Id.

\(^84\) H.R. 5285 was introduced by Representatives Inslee, Nethercutt, and Boucher, and provided that Web based radio stations with less than $6 million in annual revenue would be exempt from paying the full royalty. See infra Section V.A.

\(^85\) CARP Hearings, supra note 17, at 3 (statement of Rep. Howard L. Berman).

\(^86\) Id. at 17 (prepared statement of Robert Alan Garrett, attorney-at-law). Mr. Garrett is a partner in the law firm of Arnold & Porter and represents, inter alia, the recording industry in proceedings.
"[t]his is often millions of dollars, sometimes much more expensive than the royalty claim that the CARP is addressing."\textsuperscript{87} The costs can be "astronomical."\textsuperscript{88} These tremendous costs are not consistent with the goal of compulsory licensing, i.e. the reduction of transaction costs.\textsuperscript{89} The process is beyond the ability of many interested parties to afford.\textsuperscript{90} Also, forcing private parties to pay the arbitrator's fees is "unjust to the financially less fortunate and to the nonprofit entities that have a very large interest in the proceedings of the CARP."\textsuperscript{91}

The cost of the current CARP process is a concern for all parties, "whether it is a copyright owner or a copyright user, a small party or a large party."\textsuperscript{92} The well-funded party ends up shouldering the burden for entire industries standing to benefit from the statutory licenses. On the other hand, small parties are disadvantaged financially as well. They must either, "rely upon the records developed by the participating parties [parties to the CARP proceeding] or resort to voluntary negotiations with the copyright owners on terms they may otherwise find objectionable."\textsuperscript{93} Thus, it is clear that the potentially "astronomical" costs of a CARP proceeding can impact both sides of the dispute. The costs are also significant to the CARP "institution."\textsuperscript{94} The Copyright Office and the Library of Congress personnel must conduct various phases of the proceedings.\textsuperscript{95}

B. THE INSTABILITY AND INCOSTISTENCY OF CARP DECISIONS

Stability and consistency in judicial decisions allows parties to litigation to adequately assess litigation risks and to adequately determine prospects for settlement. These qualities (stability and consistency) are needed in CARP

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\textsuperscript{87} \textit{Id.} at 3 (statement of Howard L. Berman).

\textsuperscript{88} \textit{Id.} at 26 (statement of Bruce Rich, attorney-at-law).

\textsuperscript{89} \textit{Id.} at 17 (statement of Robert Alan Garrett, attorney-at-law). The goal of compulsory licensing is the reduction in transaction costs between parties. The tremendous costs of these proceedings have the effect of "decreasing the compulsory licensing royalties that copyright owners receive and increasing the amounts that copyright users must pay for the compulsory license—a result that is inherently antithetical to a principal purpose of compulsory licensing . . . ." \textit{Id.}

\textsuperscript{90} \textit{CARP Hearings, supra} note 17, at 4 (statement of Rep. Rick Boucher).

\textsuperscript{91} \textit{Id.} See also \textit{supra} notes 40-57 and accompanying text.

\textsuperscript{92} \textit{CARP Hearings, supra} note 17, at 15 (statement of Robert Alan Garrett, attorney-at-law).

\textsuperscript{93} \textit{Id.} at 26.

\textsuperscript{94} \textit{Id.} at 35.

\textsuperscript{95} \textit{Id.} Examples of the duties that the Copyright Office and the Library of Congress must undertake include discovery relating to the written direct cases submitted by the parties, and review of the CARPs' decisions. \textit{Id.}
proceedings as well, but are largely lacking. The ad hoc nature of CARP arbitration panels makes consistency difficult, if not impossible to obtain. Because the panelists are selected for each hearing, it is often the case that they may never participate in another CARP proceeding. Thus, any expertise developed during the process (e.g., in rate-setting or subject matter) will not likely benefit future proceedings.

Also, rates made by these ad hoc panels are often too narrow to establish precedent. This results from the fact that the decision is often rendered on a basis that "focus[es] on reaching a bottom-line result in the given proceeding rather than on explicating a thorough and complete analysis of the relevant standards.

Lastly, since panelists are typically not the same from hearing to hearing, parties who are dissatisfied with one panel are tempted to return and try a different panel.

C. INEFFICIENCY WITH WHICH SMALL CLAIMS ARE HANDLED

"Claimants with small claims have been able to use existing CARP rules to prolong CARP proceedings and derail settlements at virtually no cost to themselves, but at substantial cost to all other interested parties." The inefficiency of small claims in CARP proceedings is obvious when one looks at the arbitrator costs of a proceeding compared to the amount-in-controversy. In many cases, the fee exceeds the disputed amount. For instance:

[T]he costs of the arbitrators in the 1992-94 Digital Audio Recording Technology ("DART") distribution proceeding, which resulted in an award of $11.03 to two individual claimants were more than

96 CARP Hearings, supra note 17, at 17.
97 The current process will lead to panels constantly "reinventing the wheel." CARP Hearings, supra note 17, at 4 (statement of Rep. Rick Boucher). Furthermore, the process results in decisions that "neither build meaningfully on prior precedent, nor establish the kinds of first principles that typify decisions by Federal courts." Id. at 23.
98 CARP Hearings, supra note 17, at 26 (statement of Bruce Rich, attorney-at-law). In addition to a lack of consistency, the fact that new panelists are chosen for each proceeding also leads to an increase in cost, as the arbitrator often must spend considerable time getting up to speed on the subject matter.
99 Id. at 23. Compare this to the body of federal jurisprudence where, "first principles" tend to guide the resolution of cases.
100 The Register of Copyrights, Marybeth Peters, reports that the Librarian [of Congress] tries to select arbitrators who have served on previous panels, but the panelists are rarely the same. See CARP Hearings, supra note 17, at 35.
101 Id. at 12 (prepared statement of Michael J. Remington, attorney-at-law).
$12,000 (more than one thousand times the amount-in-controversy); the costs of the arbitrators in the 1995-98 DART distribution proceeding, which resulted in a total award of $6.06 to the same two individual claimants ($5.04 to one and $1.02 to the second) were in excess of $21,000 (almost three thousand times the amount-in-controversy); and in the 1991 Cable Distribution Proceeding (Phase II), the arbitrators awarded $63.74 to an individual claimant, yet the costs of the arbitrators were more than five hundred times that amount. 102

In addition, each of the matters above was appealed to the U.S. Court of Appeals for the District of Columbia (and greater costs incurred). 103 Furthermore, the above costs are not inclusive of outside attorneys’ fees, in-house attorneys’ fees or staff time. 104 When costs are this substantial in relation to the amount-in-controversy, “the CARP system is not an efficient and effective dispute-resolution device.” 105

IV. PROPOSALS FOR CHANGE TO CARP STRUCTURE AND PROCESS

The House Subcommittee on the Courts, the Internet, and Intellectual Property recently held an oversight hearing (the CARP hearing) in which both Subcommittee Members and industry participants and representatives provided comments on possible changes to CARP structure and process. 106 Most of the proposals centered on trying to alleviate the aforementioned problems (i.e., the cost of proceedings, the instability and inconsistency of decisions, and the inefficiency with which small claims are handled). The following ‘system wide’ proposals were offered by various parties to the CARP Hearing: 107

102 Id. Mr. Remington is an attorney-at-law and partner at Drinker Biddle & Reath LLP, where he is Washington, D.C. counsel for Broadcast Music, Inc. (BMI), “a performing rights organization representing hundreds of thousands of songwriters, composers and music publishers in the licensing of the public performance right in their musical works.” Id at 7; “Arbitrators [in CARP proceedings] are typically compensated at between $200 and $400 an hour for their work.” CARP Hearings, supra note 17, at 35.

103 Id. at 12.

104 Id.

105 Id.

106 See generally CARP Hearings, supra note 17, at 1-48.

107 In addition to these ‘system-wide’ proposals, numerous specific proposals aimed at different processes within CARP were proposed and considered. See infra Section IV.C.
A. ELIMINATION OF COMPULSORY LICENSES

One of the more drastic proposals offered includes the elimination of statutory licenses altogether. This 'marketplace' solution to royalty disputes would enable copyright owners to seek the highest royalties the market would bear. Representative Berman suggests, "CARP participants, both licensees and copyright owners, would have found a far more satisfactory outcome had they chosen to spend their money and effort negotiating a reasonable settlement in the marketplace rather than in a CARP."109

This solution would certainly reduce the cost of CARP proceedings (i.e., eliminate the proceedings altogether). It would also address another problem of statutory licenses, in the fact that they tend to outlive their purpose and create marketplace dislocations.110

However, this proposal is not necessarily airtight. It is unclear whether small webcasters would be adequately protected from anti-competitive behavior by copyright owners. While U.S. antitrust laws would presumably protect these smaller players, the costs of bringing an antitrust action may make protection unavailable, or at least impractical for many.111

B. TRANSFER OF CARP FUNCTION TO A COURT OF LAW

Several commentators have suggested that the function currently performed by ad hoc panels should be transferred to a court of law.112 It is argued that these
functions (rate-making and distribution of royalties) do not require the expertise of the Library of Congress. Instead, what is required is

[A] facility with macroeconomics and with basic principles of antitrust law, the ability to assimilate facts concerning multiple media marketplaces, the ability to evaluate complex statistical and economic data put forth by the parties’ experts, and the ability to sift through and properly evaluate record evidence, including making judgments on issues such as witness credibility.

It is argued that transferring this function to a court of law would increase continuity among decisionmakers, and thereby increase the consistency of decisions. There are numerous Constitutional issues which must be considered if this proposal were adopted.

C. OTHER PROPOSALS

Several other measures have been proposed to alleviate many of the aforementioned problems. While many of these proposals do have merit, none taken individually would be likely to ameliorate the CARP structural or procedural flaws.

1. Elimination of Evidentiary Hearings and Discovery. It has been proposed that evidentiary hearings should be eliminated (or at least greatly restricted in scope). This would result in a paper proceeding, which is typical of many administrative agency proceedings. Some argue that the evidentiary hearing is the single largest

113 Id. at 28.
114 Id. (suggesting that a traditional court of law, such as a Federal District Court, would meet these requirements).
115 CARP Hearings, supra note 17, at 11.
116 Id. at 28 (contemplating that transferring the functions of CARP Panels (rate-making and royalty distribution) to a Federal district court would certainly raise separation of powers concerns. Since rate-making is arguably not a judicial function, Article III judges may be tasked with conducting non-Article III functions. There is precedent for resolving rate disputes in district courts (ASCAP and BMI rate courts, e.g.), and certain steps could be taken (i.e. retention of certain powers by the Copyright Office itself) which would mitigate some Constitutional concerns.).
117 The author has adopted the view that a significant change is needed to permanently address the structural and procedural flaws with the CARP. Note, however, that a combination of these proposals would certainly provide a ‘patch’ and may be sufficient under the circumstances.
118 CARP Hearings, supra note 17, at 15.
119 Id.
cost to clients in a CARP Proceeding. It has also been proposed that discovery be eliminated or restricted.

2. Establishment of a Filing Fee. An industry representative to the CARP hearing suggested that there should be a uniform filing fee analogous to the filing fee for a federal civil action. This filing fee would ensure that each party “share[s] a base-level burden of the costs of the proceeding.” This fee would help defray some of the administrative costs incurred by the Copyright Office in connection with these proceedings. Most importantly, the filing fee would discourage the filing of frivolous claims and encourage settlement of claims.

3. Offering Judgment to Small Claimants. In cases where the costs of arbitration proceedings may exceed the amount-in-controversy, an offer of judgment may be appropriate. This would “encourage settlement of small claims, and would promote the imposition of sanctions in instances of abuse.”

4. Elimination of Oral Hearings in Small Claim Proceedings. Mr. Remington states, cases involving small claims (defined statutorily) should automatically be subjected to a paper proceeding. In matters where no genuine issues of material fact exist, the Office should be statutorily authorized to make a summary judgment decision based on facts not in dispute, applicable law and precedents, before the CARP is empanelled.

V. RECENT LEGISLATION

The legislature has been active in the past year addressing issues relevant to royalty proceedings, particularly webcasting. Several pieces of legislation have been introduced, including the Internet Radio Fairness Act, the Small Webcaster Settlement Act, and the Copyright Royalty and Distribution Reform Act of 2003.
A. THE INTERNET RADIO FAIRNESS ACT

Washington Representative Jay Inslee introduced H.R. 5285, the "Internet Radio Fairness Act," on July 26, 2002, in response to the Librarian of Congress' webcasting decision and the resulting shut-down of many web radio broadcasts. The Act is designed to make the CARP process fairer for smaller entities. Inslee stated

Congress should support creative and innovative uses for new technology, not drive small web radio broadcasters out of business with huge fees. We need to refine the current law on digital technology quickly, before more small web radio broadcasters are forced out of business. Changing the standard for setting royalty rates is crucial to the survival of this innovative sector. We seek a balance between just compensation and Internet development. This process must be fair but not free.

Representative George Nethercutt, a co-sponsor of the measure, stated, "No one wins under the current CARP standard—webcasters will close shop, consumers lose access to a wide selection of programming, and copyright holders collect nothing. Our legislation protects small businesses from the onerous CARP ruling, ensuring the continuation of webcasting. . . ."

Inslee noted the flaws in the current CARP process, "[T]he result of this . . . webcasting CARP demonstrated some structural flaws in the process that Congress must remedy." Some of the provisions of the Act indicate that:

(1) Small businesses will be exempted from the most recent royalty decision;
(2) All future CARPs must change the royalty rate standard from the "willing-buyer/willing-seller" to the traditional standard under the 1976 Copyright Act.

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129 Id.
130 Id.
131 Id.
132 Id.
133 Small businesses are defined as those that receive $6 million or less in gross revenue. Inslee, supra note 128.
134 Id. The traditional standard under the 1976 Copyright Act refers to the "fairness" standard,
THAT CARP IS NO KEEPER

(3) Small businesses will be exempted from the payment requirements for participation in future CARP proceedings.\(^{135}\)

(4) All future CARPs must eliminate fees for ephemeral recordings that web broadcasters create to facilitate the transmission of the song to users.\(^{136}\)

(5) All future CARPs must comply with the Regulatory Flexibility Act.\(^{137}\)

This Bill was referred to the House Subcommittee on the Courts, the Internet, and Intellectual Property on August 20, 2002, but did not result in any further legislative action.\(^{138}\)

B. SMALL WEBCASTER SETTLEMENT ACT

On November 15, 2002 the United States Senate passed a revised version of H.R. 5469, the "Small Webcasters Settlement Act of 2002."\(^{139}\) The Bill was originally blocked by Senator Helms, who eventually played an active role in crafting the new version.

Highlights of the Bill include:

—The Bill enables small Internet radio services and the recording industry to enter into settlement agreements.

—The recording industry and small webcasters, including non-commercial webcasters, can now agree to rates, notwithstanding the CARP's decision.

—This legislation authorizes the RIAA and small webcasters to go through with a previously agreed-upon measure. The measure

as opposed to the "willing-buyer, willing-seller" standard used in the Webcasting decision.

\(^{135}\) During the webcasting CARP, all participants were forced to pay an equal share of the total costs, therefore many small businesses were unable to participate. Inslee, supra note 128.

\(^{136}\) An ephemeral recording is a temporary recording made to facilitate webcasting. These recordings have no independent economic value, and accordingly they should not be subject to a royalty payment. Id.

\(^{137}\) Id.


called for a percentage-of-revenue royalty system that differs significantly from the CARP decision.\textsuperscript{140}

—This Bill also requires that artists be paid their share of royalties directly (instead of paying the royalty to record companies).\textsuperscript{141}

This Bill essentially overrules the royalty rate dictated by the earlier CARP decision, and allows parties to privately negotiate lower royalty rates.

The Bill’s approval was seen as a victory for all involved. Jonathon Potter, executive director of the Digital Media Associations said, “[t]oday’s congressional approval of the Small Webcaster Settlement Act is a victory for all consumers and providers on Internet radio.”\textsuperscript{142} Likewise, “[T]he Senate’s approval was met with a sigh of relief from industry players who have already been negotiating with the music industry to set lower royalty rates.”\textsuperscript{143} Finally, “The ultimate victory here is for consumers . . . this will maintain the maximum diversity of Internet radio and programming.”\textsuperscript{144}

C. COPYRIGHT ROYALTY AND DISTRIBUTION REFORM ACT OF 2003

On March 25, 2003, Texas Representative Lamar Smith introduced H.R. 1415, the “Copyright Royalty and Distribution Reform Act of 2003.”\textsuperscript{145} This very significant piece of legislation seeks to address the CARP structure and process problems by eliminating the CARP system altogether, and replacing it with a Copyright Royalty judge.\textsuperscript{146}

\textsuperscript{140} “The proposed rate plan would allow the small broadcasters to pay royalties worth 10 percent of their revenues, or 7 percent of their expenses, depending on which is higher, on revenue up to $250,000 a year. For revenues exceeding $250,000 a year, the small webcasters would pay 12 percent of royalties or 7 percent of expenses in royalties.” Scarlet Pruitt, Congress Approves Bill to Help Small Webcasters, at http://archive.infoworld.com/articles/hu/xml/02/11/15/02115hnwebcasters.xml?s =IDGNS.


\textsuperscript{142} Pruitt, supra note 140.

\textsuperscript{143} Id.

\textsuperscript{144} Id. (quoting Jonathon Potter, Executive Director of the Digital Media Associations (DiMA)).

\textsuperscript{145} H.R. 1417, 108th Cong.

\textsuperscript{146} Id. See also Rep. Lamar Smith, An Address to ASCAP, Austin, TX, Apr. 16, 2003, available at http://lamarsmith.house.gov/News.asp?FormMode=Detail&ID=214 (noting that this legislation was introduced to “address the concerns users had with the CARP system—namely that decisions are unpredictable and inconsistent, unnecessarily expensive, and that many CARP claims are frivolous”).
Under H.R. 1417, the Librarian of Congress would appoint a Copyright Royalty Judge to a full-time salaried position for a five-year term.\textsuperscript{147} This judge would be “an attorney with 10 or more years of legal practice with demonstrated experience in administrative hearings or court trials and demonstrated knowledge of copyright law.”\textsuperscript{148} The Copyright Royalty Judge would also have a support staff consisting of two full-time staff members with “expertise in copyright law and in the business and economics of industries affected by the actions taken by the Copyright Royalty Judge.”\textsuperscript{149}

The Copyright Royalty Judge would have independent decisionmaking authority.\textsuperscript{150} The Copyright Office would “act in an administrative and advisory capacity only.”\textsuperscript{151} The legislation addresses the cost issue by creating a salaried position that would “eliminate the large per-hour arbitrator fees of the current system [CARP].”\textsuperscript{152} The appointment for a five-year term would “promote institutional stability and permit participants to gain familiarity with the decisionmaker, thereby creating reliable results and promoting settlements.”\textsuperscript{153}

This legislation seems to have broad support. “Perhaps for the first time in decades, there is a copyright matter before Congress upon which lawmakers, the Register of Copyright, as well as representatives for the content and user communities all agree: the Copyright Arbitration Royalty Panel (CARP) must go.”\textsuperscript{154} However, while now all seem to agree that CARP must go, it remains to be seen whether the appointment of a Copyright Royalty Judge would eliminate all of the current problems or just create a host of others.\textsuperscript{155}

\textsuperscript{147} Id.
\textsuperscript{148} Id.
\textsuperscript{149} Id.
\textsuperscript{150} Smith, supra note 146.
\textsuperscript{151} Id.
\textsuperscript{152} Copyright Royalty and Distribution Reform Act: Legislative Hearing Before the House Subcomm. on Courts, the Internet, and Intellectual Prop., 108th Cong. (2003) (statement of Marybeth Peters, Register of Copyrights).
\textsuperscript{153} Id.
\textsuperscript{154} Bill Holland, Smith wants judge to replace CARP, BILLBOARD, Apr. 12, 2003 (discussing H.R. 1417).
VI. CONCLUSION

There are significant problems with the current CARP process and structure, as evidenced by the result of the latest CARP decision regarding the rates webcasters must pay when they transmit sound recordings over the Internet.

The costs of CARP proceedings are astronomical and are often so large that it becomes cost-prohibitive for smaller players to participate in CARP proceedings. They are forced to negotiate deals in the marketplace (often on unfavorable terms) or to simply “live” with the decision of the CARP.

The current structure also does not produce consistent or predictable results. The ad hoc nature of the CARP’s results in panels that are rarely the same, and the results are often “narrowly-tailored.” The CARP structure is also not designed to efficiently handle small claims. In many instances, the cost of the proceeding is hundreds of times the royalty amount-in-controversy.

Several proposals have been offered by parties interested in the current and future structure of a rate-setting body (if any). Some of the more drastic proposals include the elimination of compulsory licenses altogether and the transfer of the CARP function to a court of law. The marketplace proposal of eliminating compulsory licenses would certainly reduce the cost of proceedings, but it would likely not provide adequate protection for small players such as webcasters. The transfer of the CARP function to a court of law would likely reduce the inconsistency and unpredictability problems of the current CARP structure. However, it is unclear whether this would pass constitutional muster. There are many questions left unanswered in this regard.

Some of the more “modest” proposals include the establishment of a filing fee, which would discourage frivolous claims, and may have a negligible effect on the cost problem; changing rules regarding discovery and oral hearings, which may address some of the problems with efficiency of small claims; offering judgment to small claimants, which may offer efficiency improvements; and several other proposals. Each of these individually, however, will likely only temporarily address the larger issues and problems of the current CARP process and structure. Drastic changes, like those proposed by the legislature, address these concerns.

Several pieces of legislation have been introduced in the past year, including the “Internet Radio Fairness Act,” the “Small Webcaster Settlement Act of 2002,” and the “Copyright Royalty and Distribution Reform Act of 2003.”

The most significant of these legislative proposals, the Copyright Royalty and Distribution Reform Act of 2003, calls for the replacement of the CARP system altogether. Under this legislation, the Librarian of Congress would appoint a salaried Copyright Royalty Judge to a five-year term. This legislation addresses the primary problems of the current CARP system (namely, the costs of CARP proceedings, and the instability and inconsistency of CARP decisions). While there seems to be broad support for this legislation, it remains to be seen whether it will adequately address the problems of the existing CARP structure and process, and prove to be a viable model for participants in a royalty rate dispute and distribution proceedings.

In summary, this is a quickly evolving issue that has garnered much political attention of late. There seems to be little debate that change to the CARP structure and process is needed, and drastic change at that. It is, however, still unclear how the legislature will choose to deal with the issue outside of the webcasting arena, but one thing is clear: change is right around the corner.

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