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I Want My MP3: Legal and Policy Barriers to a Legitimate Digital Music Marketplace

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I WANT MY MP3: LEGAL AND POLICY BARRIERS TO A LEGITIMATE DIGITAL MUSIC MARKETPLACE

Shane Wagman, Future of Music Coalition *

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* About the Future of Music Coalition: Founded in June 2000 by musicians, artist advocates, technologists, and legal experts, Future of Music Coalition works to ensure that musicians have a voice in the issues that affect their livelihood. FMC’s work is rooted in the real-world experiences and ambitions of working musicians, whose perspectives are often overlooked in policy debates. Over the years, FMC has provided an important forum for discussion about issues at the intersection of music, technology, policy, and law.

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I. INTRODUCTION

In the summer of 1999, eighteen-year-old Shawn Fanning introduced Napster, a new peer-to-peer (P2P) file-sharing software platform, onto the internet.\(^1\) In that moment, the business paradigm that had driven the modern music industry since the early twentieth century was forever changed. No longer could musicians and record label executives rely on controlling the manufacture and sale of physical recordings to generate revenue. Instead, since 1999 the music-consuming public has increasingly desired digital music,\(^2\) and most have wanted it for free.\(^3\)

Future of Music Coalition (FMC) is an organization launched around the same time as Napster. Since 2000, FMC has provided a voice in Washington, D.C. for musicians. One of our principal beliefs is that creation, both artistic and technological, is valuable and that artists deserve to be compensated for their work. The amount of this compensation and the mechanisms to facilitate payment are, of course, subject to contracts, market value, and other factors, some experimental or technological in nature. FMC also believes that music fans should be able to lawfully access the music they want without undue barriers or restrictions. Needless to say, finding the appropriate balance between creators’ rights and public benefit in the digital age has been challenging. Yet, it’s a discussion that must continue, and FMC is committed to facilitating these important conversations.

In 2000, FMC took the position that the only antidote to an illegal Napster is a legal Napster.\(^4\) The events of the last decade have demonstrated this statement’s truth. Terrestrial music sales have dropped, and digital sales have risen.\(^5\)

\(^1\) Greg Kot, Ripped: How the Wired Generation Revolutionized Music 25 (Scribner 2009).


\(^3\) Internet Piracy: Thanks, Me Hearties, Economist, July 17th, 2008, at 87, available at http://www.economist.com/business/displaystory.cfm?story_id=11751035 (“For every song that is bought legally, in shops or online, around 20 songs are illegally downloaded . . . .”).


Although digital sales have not increased enough to make up for falling physical album sales, it is increasingly clear that the future of music distribution is online.

Since 2000, numerous new music business models have attempted to monetize music in the new digital marketplace. A few have succeeded, but many have failed. Some failures could be blamed on poorly constructed schemes. However, some workable business models have struggled not because their model is unworkable, but because of the law’s inability to adapt to the internet age. Tensions between existing copyright law and current consumptive trends—facilitated by technological developments that were unimaginable even ten years ago—are hampering the effort to build new business models that compensate artists, meet consumer demand, and create an economically sustainable cultural community. Much of the problem stems from the lack of a stable legal framework governing the digital use of creative content.

This Article will highlight some unresolved legal tensions surrounding the creation of new, viable digital music business models, effective artist compensation, and maximum public benefit. We believe Congress and the new administration should address these tensions in order to encourage the creation of a vibrant, viable digital music marketplace.

Part II will provide background on the purpose of the Copyright Act and examine its relationship to digital technologies.

Part III will outline the licensing issues facing those who attempt to create legitimate, lawful digital distribution models. The current licensing system engenders unacceptably high transaction costs. Moreover, copyright owners sometimes request outlandishly high royalty rates. These costs create barriers to innovation and entry into the market. Licensing reform is needed to lower transaction and overhead costs and give digital businesses greater economic flexibility.

Part IV will demonstrate the need for network neutrality and highlight some potential pitfalls that could hamper independent distribution and fair use rights. Tiered pricing schemes for content delivery would damage an independent digital music business’ ability to compete with entrenched corporate interests. Additionally, failure to implement network neutrality principles may inadvertently allow incumbent telecommunications providers to control the fair use of copyrighted music.

Part V concludes the Article and sets forth FMC’s recommended potential best practices for a way forward on these complex issues. The new administration in Washington has an opportunity to address these tensions through carefully
considered policy, but it must do so with certain principles in mind in order to be effective.

PART I

The Copyright Act’s (the Act) purpose is to encourage a vibrant, accessible public culture, as well as incentivize artists to create, and reward them for their work. It achieves these twin goals by giving creators a limited monopoly over their works, and then releasing those works into the public domain. The artists’ monopoly was originally composed of five specific rights: the rights to distribute, reproduce, create derivative works, publicly perform, and publicly display their creations.

Attempts have been made to adjust copyright law in response to digital technologies. The Digital Performance Right in Sound Recordings Act of 1995 (DPRSRA) amended the Act and added a sixth exclusive right—a public performance right for “digital audio transmissions” of sound recordings. Prior to the DPRSRA, sound recording copyright owners did not have the right to receive public performance royalties for broadcasts of their work. The DPRSRA gave them this right, albeit restricting it to digital broadcasts.

Three years later, Congress made another change to the Copyright Act. In response to fears about increasing digital piracy, it passed the Digital Millennium Copyright Act of 1998 (DMCA). The DMCA sanctioned content restrictions by criminalizing the act of circumventing Digital Rights Management Technology

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7 Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975) (“The limited scope of the copyright holder's statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and other arts.”); Eldred v. Ashcroft, 537 U.S. 186, 219 (“Indeed, copyright’s purpose is to promote the creation and publication of free expression. ... [T]he Framers intended copyright itself to be the engine of Free expression. By establishing a marketable right to the use of one’s expression, copyright supplies the economic incentive to create and disseminate ideas.”) (quoting Harper & Row Publishers, Inc. v. Nation Enters., 471 U.S. 539, 557 (1985)).

8 U.S. CONST. art. I, § 8, cl. 8 (“The Congress shall have Power ... To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries ... ”).


11 Id.
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It also provided a safe harbor for internet service providers who block access to infringing material on their sites.  

Although the Act itself has dual goals, the philosophies concerning these goals' relation to each other have changed over time. Initially, the Act was meant to balance artist compensation with public access to creative works. Over the last four decades, however, lawmakers have placed more emphasis on providing incentives for artist creation and less emphasis on positive measures to ensure public access. FMC recognizes that both artist compensation and public benefit are important to maintaining a vibrant and sustainable cultural community. These two aims are inextricably interwoven throughout copyright law. FMC believes that in order for the emerging digital music marketplace to reach its potential, current laws and policies must adjust to allow for digital businesses that achieve both of these objectives to the fullest possible extent.

PART II

One key area that the new administration should evaluate is the current music licensing system. Licensing reform would encourage a variety of legal options for buying music and thus provide consumers with a broader array of viable, attractive, and lawful alternatives to piracy. The proliferation of blogs, social networking sites, and other content-sharing platforms means that more people and businesses are able to quickly reproduce, distribute, and publicly perform songs. This ease of use, coupled with the difficulty of licensing works, also increases potential liability for infringing activity. It is therefore necessary for rights holders and music services to increase licensing efficiency in order to reduce the risk of litigation, build a robust and competitive catalog of songs, and save business resources from the countless complexities accompanying contemporary music uses. Without a comprehensible, navigable, and streamlined licensing system, a legitimate digital music marketplace may remain difficult to sustain and grow.

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15 Id.
16 Reforming Section 115 of the Copyright Act for the Digital Age: Hearing Before the Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. of the Judiciary, 110th Congress 1–2 (2007) [hereinafter Peters Statement 2007] (statement of Marybeth Peters, Registrar of Copyrights) (“If music licensing reform is successful, consumers will be able to access more legal music online, through a variety of competing services, and be less tempted by piratical services that today can already offer every song ever written for free.”).
A BRIEF OVERVIEW OF LICENSING

Copyright exists in a world of dualities. There are two separate copyrights within each musical work: the sound recording copyright and the musical composition copyright. Each type of copyright work is licensed separately depending on whether it is being “publicly performed” (i.e., broadcast) or reproduced and distributed. To further complicate matters, these two types of copyrights operate differently in the terrestrial world versus the digital world. A digital music service must obtain separate licenses depending on the means of distribution it facilitates. There are two primary means of digital distribution: “streaming” and “downloading.” Each requires a different set of licenses. However, these two distribution types can be further segmented into interactive streaming, tethered downloads, and limited downloads. It is sometimes unclear what types of licenses digital music services need to have the proper permission to distribute music via these methods.

Digital music services that offer music downloads or “DPDs” must obtain mechanical licenses from the musical composition copyright owner and master use licenses from the sound recording copyright owner. A download is a complete transfer of audio content from the internet onto a computer hard drive, where it can then be listened to on demand. It is the digital equivalent to buying a physical recording, such as a CD, from a brick and mortar record store.

18 Id. § 102(a)(2).
20 An interactive stream is a broadcast based on user-inputs or selected by the recipient. A tethered download is a music download from a subscription that can only be played on an authorized computer, while a limited download can only be played for a specific period of time. See Skyla Mitchell, Note, Reforming Section 115: Escape from the Byzantine World of Mechanical Licensing, 24 CARDOZO ARTS & ENT. L.J. 1239, 1246 n.41 (2007).
22 iTunes, however, does not pay mechanical licenses directly. Since iTunes acts like a retailer, the record labels pay the mechanical royalties instead.
Therefore, a digital download triggers the reproduction and distribution rights granted to the copyright owner by the Copyright Act. Section 115 of the Copyright Act provides a compulsory mechanical license for the musical composition, i.e., it allows anyone to obtain permission to reproduce and distribute "nondramatic musical works" so long as they abide by certain requirements, most notably paying a royalty rate, set by law, to the composition's owner. There is no compulsory license for sound recording copyrights. The digital music service must negotiate with the sound recording copyright owners—usually the record labels—individually.

Digital music services that provide broadcasts or "streams," such as webcasters, must obtain public performance licenses from both the sound recording copyright owner and the musical composition copyright owner. A stream is a broadcast of music where no copy is made on the listener's hard drive. A digital music service can obtain a blanket license from musical composition copyright owners via various Performance Rights Organizations (such as ASCAP, BMI, and SESAC). However, prior to 1995, only musical composition copyright owners had the right to receive royalties for the public performance of their works. Sound recording copyright owners obtained this right from the Digital Performance Royalty in Sound Recordings Act of 1995 (DPRSRA). This right does not extend to terrestrial radio play—it only covers digital public performances. As a result of this change in the law, digital music services must also obtain blanket public performance licenses from sound recording copyright owners via SoundExchange, a digital-only Performing Rights Organization that exclusively collects and distributes digital performing rights royalties to sound recording copyright owners and performers. Section 114 of the Copyright Act outlines exemptions to the sound recording copyright owner's exclusive public performance right.

B. THE MAIN ISSUES

Although it is true that many current music services successfully offer music downloads and streams, their future is far from certain. Many have reported facing immense licensing difficulties. Moreover, there are many other music services that have offered innovative, creative ways of listening to and enjoying

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25 Tune, supra note 23, at 302.
music, but have been driven out of business partly or entirely due to licensing difficulties. A major stumbling block to business model innovation is the transaction costs associated with the current licensing system for musical works and sound recordings.

Rhapsody is one of the more successful online music subscription services. Rhapsody offers its users interactive and non-interactive streaming of millions of licensed songs, as well as tethered and permanent downloading options. While this means that Rhapsody subscribers are presented with an array of options as to how to interact with the songs, it did require Rhapsody to obtain virtually every type of license for each song. Rhapsody creates multi-column spreadsheets for every album, with each column denoting whether permission has been granted for each use for both the sound recording copyright and the musical composition copyright, as well as the licenses' territorial restrictions. Although much of their catalog was acquired through bulk licensing deals with major labels, songs can be taken down at any time if rights holders have contract and licensing disputes. Moreover, Rhapsody had to negotiate the publisher's royalty for digital downloads for eight years before they could agree on a rate. During that time, they kept millions of dollars in escrow until an agreement could be reached. This demonstrates the tremendous amount of effort required in order to acquire and sell content.

Rhapsody has managed to stay in business, but other sites were not as fortunate. SpiralFrog, an ad-based music service, shut down in 2009. Although DRM restrictions and a shrinking ad market were clearly contributing factors, SpiralFrog's failure was also due to an inability to license an attractive catalog quickly enough to become competitive. Licensing difficulties also plague Pandora, another ad-based streaming music site. The last few years have been spent waging a battle with the Copyright Royalty Board (CRB), the entity that sets rates for compulsory mechanical licenses, over the royalty rate for webcasters. The rates CRB initially set were extraordinarily prohibitive, so Pandora advocated for a rate structure that could allow it to continue its business. Additionally,
Pandora had to block overseas access in 2007 due to the lack of blanket licensing structures in foreign countries, although this is an international issue outside the scope of this Article.37 Despite Pandora’s growing popularity, it has struggled to stay afloat.38

Muxtape presents another interesting case. The service, which launched in 2008, allowed fans to upload songs from their personal collections to create digital “mixtapes” to share with other users. Muxtape quickly became a music fan favorite, but was forced to shut down later that year after major labels threatened the developer, Justin Ouellette, with copyright infringement lawsuits.39 Ouellette did not have enough funds to pay the legal fees it would cost to fight the suits. He entered into licensing negotiations with major labels, but eventually “walked away” because the negotiations were too prohibitive and complicated.40 In an open letter posted on the Muxtape site, Ouellette explains why the service had to shut down: “[The licensing negotiations] had become too complex for a site founded on simplicity, too restrictive and hostile to continue to innovate the way I wanted to.”41 Muxtape has since relaunched with a vastly different business model. It lacks the expansive catalog it had hoped to amass, a goal that had initially led Ouellette to attempt licensing negotiations in the first place.42

Digital start-ups face significant hurdles to obtaining licenses. The time and resources necessary to negotiate and obtain licenses are prohibitive, yet licensing is the key to avoiding legal liability. Administrative difficulties often deter many businesses from licensing works, as was the case with Muxtape. Moreover, as we discuss below, the lack of clarity as to what rights are implicated and what licenses are needed as technologists innovate new ways of reproducing, distributing, and performing music adds to the transactional cost of licensing negotiations. Furthermore, the sustainability of digital music services can also be affected by

37 Posting of Tim Westergren to Pandora Radio Blog, http://blog.pandora.com/pandora/archives/2007/05/breaking_pandor.html (May 3, 2009, 21:16 EST) (“It’s hard to think of anything more anathema to who we are than turning off someone’s radio, but the current legal realities leave us no choice. While the DMCA provides us a blanket license in the U.S., there is no equivalent in other countries.”).
40 Id.
41 Id.
42 See id. (“I had to make a decision. As I saw it I had three options. The first was to just shut everything down, which I never really considered. The second was to ban major label content entirely, which might have solved the immediate crisis, but had two strong points against it. The first, most visibly, was that it would prevent people from using the majority of available music in their mixes.”).
excessive royalty rates. FMC wants to ensure that musicians, songwriters, and record labels are fairly compensated, yet complications in the rate setting process often arise.

C. TRANSACTIONAL COSTS

The time and effort it takes to find a copyright owner, negotiate a licensing agreement and rate, and establish what type of license is needed, often deters many people from starting digital music businesses, or leads them to run these businesses illegally. In either case, musicians and rights holders are not compensated. Although there are many different complexities associated with the problem of licensing transaction costs, this paper focuses on two issues: reforming section 115 of the Copyright Act \(^{43}\) and determining which music services implicate which rights.

1. Section 115. Section 115 provides a compulsory mechanical license for the reproduction and distribution of copyrighted songs, thus eliminating the need to negotiate royalty rates with the owners of each individual song. However, unlike obtaining public performance licenses, there is no way to obtain a blanket mechanical license for the rights to multiple songs. Although this license is compulsory, digital businesses must provide notice of their intent to license to each individual copyright owner or their rights agency. The Harry Fox Agency is the organization that administers mechanical licenses, but 40% of rights holders are not registered with them, including many popular music songwriters. \(^{44}\)

Copyright owners rarely use the compulsory mechanical license because of the administrative red tape, instead preferring to directly license the work. \(^{45}\) This means that digital start-ups must individually contact many rights holders to secure licenses. Moreover, obtaining a compulsory mechanical license requires the licensee to fill out multiple-page forms for each song. \(^{46}\) This requirement is not feasible for a business which, in order to be competitive, must license hundreds of thousands, even millions, of songs before opening its virtual doors. Section 115 acts mainly as a price ceiling, effectively setting the statutory licensing rate, but still has failed to eliminate significant transaction costs. \(^{47}\) Virtually all

\(^{47}\) See id. ("[T]he ‘statutory rate’ is the benchmark for setting mechanical rates in the industry.");
music industry groups agree that reforming section 115 is an essential step towards mending the digital music licensing system. The current administrative procedures for obtaining these licenses have been described as “so cumbersome as to be dysfunctional.”

The Harry Fox Agency attempted to address this problem by creating a blanket mechanical licensing system called Songfile. However, this service is only available for those who want to make 2,500 copies or fewer. Considering the international reach of the internet, one would imagine digital music services would not favor restricting the amount of digital downloads offered. Additionally, this blanket license is not technically a section 115 compulsory mechanical license. Theoretically, one still has to negotiate the royalty rate for this license, although in practice, the section 115 price ceiling artificially sets this rate at 9.1 cents per song.

2. Which Rights Are Implicated? Even if the administrative procedures for obtaining licenses were streamlined, it is often unclear what rights are implicated by a particular digital use. Businesses are building new models that continue to blur the line between mechanical distributions and performances, and further push the possibilities of cloud-based music distribution. Take, for example, the development of Twitter-based music streaming services. Twitter users can simply type a song into a search bar on blip.fm, and if the song is hosted anywhere on the internet, blip.fm generates a shortened URL link that allows the Twitter user to share that song with his or her followers. Is this an infringing use? If so, who would obtain the license, and how would performances be tracked? Twitter-based music sharing is just one example of music distribution that doesn’t fit neatly into the existing music licensing structure.

There have also been arguments about the rights implicated by tethered downloads, permanent downloads, interactive streaming, non-interactive streaming, and ringtones. In 2008, Sony/ATV Publishing stopped all future licensing of their repertoire for streaming or limited downloads in reaction to a debate over whether an interactive stream should trigger a mechanical license. This dispute affected the song catalog of sites like Rhapsody, which provides

see also Peters Statement 2007, supra note 16.


49 Potter, supra note 46, at 7.


52 Susan Butler, Sony/ATV Stops Future Licensing of Digital Services, BILLBOARD MAG., Jan. 08, 2008, available at [http://www.billboard.biz/bbbiz/content_display/industry/e3i21e063665e000c69f051af0c36f6dfe](http://www.billboard.biz/bbbiz/content_display/industry/e3i21e063665e000c69f051af0c36f6dfe).
interactive streaming services. Moreover, it is often difficult to determine whether or not a digital broadcast is interactive. Recently, the U.S. Court of Appeals for the Second Circuit issued an opinion suggesting that the ability to choose or predict specific songs on a playlist may contribute to a finding that the service is interactive.\textsuperscript{53} Underlying this holding was consideration of the extent to which the service "provides a service so specially created for the user that the user ceases to purchase music."\textsuperscript{54}

Additionally, there have been legal disputes about whether buffer copies of a song invoke a performance or a mechanical right. Digital music services offering streaming must make "buffer copies"\textsuperscript{55} or "ephemeral copies"\textsuperscript{56} of the song on their hard drives. These copies are destroyed after a fraction of a second and are only used to facilitate the creation of the stream transmission. In the recent past, copyright owners have insisted that these transitory copies constitute a reproduction, and thus require mechanical royalties. Similarly, publishers have argued that every online transmission of a musical work constitutes a public performance, even if the work was downloaded instead of streamed. These contentions—which have thus far been largely unsuccessful—constitute what some call "double dipping," as copyright owners seek to receive both mechanical and public performance royalties for a single digital broadcast or download of their work.\textsuperscript{57} Recent court cases have established some rights implication guidelines, but new technologies often are developed faster than the courts can adapt.

In 2007, the judiciary provided much-needed clarification about the licenses required for digital broadcasts. During rate-setting negotiations for digital licensing, various digital music services and ASCAP asked the District Court for the Southern District of New York to issue an opinion on whether digital downloads are public performances. The resulting decision in \textit{United States v. ASCAP} held that a stream of a musical work constituted a public performance, while a download of the work did not.\textsuperscript{58} However, ASCAP has recently

\textsuperscript{53} See Arista Records, LLC v. Launch Media, Inc., 578 F.3d 148 (2d Cir. 2009).
\textsuperscript{54} Id. at 164.
\textsuperscript{55} Posting of Sherwin Siy to Public Knowledge, http://www.publicknowledge.org/node/1700 (Aug. 7, 2008, 18:15 EST) ("A buffer copy is a copy that is made in the course of digital transfer. It's not intended to be directly viewed, accessed, or used by anyone. It's just a step in the relay of information from one source to another.").
\textsuperscript{58} United States v. Am. Soc'y of Composers, Authors and Publishers, 485 F. Supp. 2d 438, 442 (S.D.N.Y. 2007) ("Although, as Applicants concede, the streaming of a musical work does constitute a public performance, we conclude that the downloading of a digital music file, in and
challenged that ruling's application to ringtones. ASCAP claims that ringtone downloads are capable of "streaming or pseudo-streaming" and thus require an ASCAP license. The U.S. Copyright Office, however, ruled in 2006 that a ringtone was a "digital phonorecord delivery"—essentially, a download—and was subject to section 115 licensing. The Southern District of New York rejected ASCAP's claim and ruled that ringtone providers do not need public performance licenses. However, there are suggestions that ASCAP will continue to seek a broader definition of public performance rights in Congress.

Moreover, it remains unsettled whether ephemeral, server, and buffer copies made to facilitate music streaming infringe on copyright owners' reproduction and distribution rights. Courts were forced to deal with this issue in 2008 when London-Sire Records v. Doe addressed the definition of "fixation" as it refers to phonorecords or copies triggering the distribution right. The court held that an electronic transmission that "permits the work to be perceived . . . or to be reproduced, or to be further communicated, for a period of more than transitory duration," is sufficiently 'fixed' to be considered a copy implicating the distribution right. This definition, however, failed to settle the debate over whether buffer copies trigger the distribution right. In Cartoon Network v. CSC Holdings, Inc. the Second Circuit also tackled the issue of "fixation" as it applies to buffer data. At issue was Cablevision's remote DVR, which allow cable subscribers to record programs and store the recordings on a central hard drive on Cablevision's property. The court established a two-prong test to evaluate
fixation consisting of the "embodiment requirement" and the "duration requirement." The buffer copies Cablevision made met the embodiment requirement, but failed to meet the duration requirement, and thus were not sufficiently "fixed" to implicate the distribution right. However, the court did not clarify what length of time would meet the duration requirement, restricting their duration analysis to the facts at hand and stating, "our inquiry is necessarily fact-specific, and other factors not present here may alter the duration analysis significantly." While the case does provide some clarification, it would do much to facilitate technological innovation if the requirements for the embodiment and duration requirement were more clearly articulated. That way, new digital businesses would have more guidance in creating legal distribution models.

The enormous amount of time and money digital music start-ups must invest to properly license musical content is burdensome and suppresses the digital music industry's growth. FMC recommends that Congress and the new administration address these issues. Simplifying the licensing system by reducing transaction costs and clarifying what licenses are required for music transmissions would reduce initial overhead and allow innovators to lawfully enter into the digital music marketplace and either rise or fall on their own merits.

D. LICENSING FEES

Even after securing copyright owners' permission, the licensing fees sometimes prove to be so prohibitive that online music distributors cannot raise enough revenue to pay them. While FMC wants to ensure that all content owners and songwriters are fairly compensated for their work, FMC recognizes that many digital businesses find it difficult to pay for content, particularly when copyright holders request egregious licensing fees.

Perhaps the most recent example was the rate battle between webcasters and the Copyright Royalty Board (CRB). The CRB sets rates for digital performance royalties for webcasters. In 2007, the CRB increased public performance royalty

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66 See id. at 127 ("We believe that this language plainly imposes two distinct but related requirements: the work must be embodied in a medium, i.e., placed in a medium such that it can be perceived, reproduced, etc., from that medium (the 'embodiment requirement'), and it must remain thus embodied 'for a period of more than transitory duration' (the 'duration requirement')).

67 Id. at 130.

68 Antony Bruno, Digital Entertainment: Profits From Profiles, BILLBOARD MAG., Dec. 15, 2007, at 14 ("While popular services like Last.fm and Imeem have managed to strike deals with record labels allowing such sites to stream copyrighted music in full in return for a share of advertising revenue, not all music-based social networks find this an attractive model. For most, it's just too expensive.")
rates for streaming radio stations. The new rates were mainly based on a per-performance structure, and would equate to 100% of webcasters income in some cases. After a massive outcry from webcasters (most notably Pandora) claiming that these new rates, in some cases, exceeded their entire incomes, Congress passed the Webcaster Settlement Act of 2008. That legislation would vacate the CRB’s decision if webcasters and copyright holders could agree on a royalty rate by February 2009. The two sides failed to reach an agreement, but the Act was extended on July 1, 2009. Six days later, SoundExchange, the collection agency for digital public performance royalties, reached a settlement with so-called “pure-play” webcasters—those entities whose entire online business models are built on the digital broadcast of music content. Large webcasters with significant advertising revenue will pay the greater of 25% of their revenue or a per-song rate, while smaller webcasters whose advertising revenue is less than $1.25 million per year pay royalties amounting to 12% to 14% of their revenue. Although an agreement was finally reached, it took years to accomplish, and its suitability has yet to be determined.

On the mechanical composition side, in 1998, the Copyright Royalty Board (CRB) increased the mechanical royalty rate for both physical music sales and digital phonorecords to 9.1 cents per song. However, various trade associations

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70 The rate increases applied retroactively, and increase the price per performance from $0.0008 in 2006 to $0.0019 in 2010. This increase could equate to 100% of total revenue in some cases. See Daniel McSwane, Webcast Royalty Rate Decision Announced, RAIN, Mar. 2, 2007, http://www.kurthanson.com/archive/news/030207/index.shtml.

71 Pandora allows users to customize their own streaming radio stations, effectively generating endless simultaneous performances that would trigger royalty payments.


for songwriters were unhappy that the rate for permanent downloads\(^ {77}\) had been set so low, and argued that the rate should be as high as 15 cents per song.\(^ {78}\) Furthermore, stakeholders had difficulty agreeing on a rate for limited digital downloads.\(^ {79}\) It took close to a decade for music publishers, songwriters, digital subscription services, and record labels to come to an agreement approved by the CRB.\(^ {80}\) This significantly delayed artist compensation since digital music services had to keep royalty payments in escrow until a rate could be decided.

Legal music services are always competing with the specter of “free.” When Rhapsody, an online music service, experimented by offering song downloads for $0.49 instead of $0.99, their sales jumped six fold, which has led some to suggest cheaper is better.\(^ {81}\) Even cheaper than “cheaper,” Wired magazine editor Chris Anderson, contends that content-based businesses should not charge for their product at all.\(^ {82}\) However, no business model has yet profited by giving away free music. In fact, major labels recently have had to cut their licensing fees in order to accommodate iMeem and other digital distribution services that could not afford to pay the licensing fees, despite the decreasing costs of overhead and production.\(^ {83}\) Even though pricing disagreements may fuel arguments over rate-setting, it would benefit emerging businesses enormously to have a stable, predictable licensing scheme that makes it easy to anticipate licensing costs and obtain licenses.

Rate-setting is clearly a complicated economic practice, especially in an industry with so many stakeholders. These stakeholders often expect a piece of the digital revenue pie equivalent to, or greater than, what they had been receiving in the physical realm. It is becoming increasingly clear, however, that nascent business models cannot succeed if copyright holders demand exorbitant licensing rates. Asking for high rates up front can frustrate the ultimate goal—the development

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\(^ {77}\) “Permanent downloads” is used interchangeably with “digital phonorecord deliveries” for the purposes of this Article.

\(^ {78}\) Paul Williams, Royalty Rates Raking Reaps Rewards, MUSIC WK. MAG., Oct. 11, 2008, at 13.

\(^ {79}\) A limited digital download exists in subscription services like Rhapsody that allow you to download songs as long as you pay a subscription fee. Once you stop paying the fee, you no longer have access to the download. Limited digital downloads are also called “tethered” digital downloads.

\(^ {80}\) The rate was finally set at 10.5% of service revenue. Williams supra note 78, at 11; Agreement Royale, http://futureofmusiccoalition.blogspot.com/2008/10/agreement-royale.html (Oct. 1, 2008, 14:47 EST).


\(^ {82}\) E.g., CHRI\% ANDERSON, FREE: THE FUTURE OF A RADICAL PRICE (2009).

of a robust and legitimate digital marketplace that can properly compensate stakeholders, including artists.

PART III

Another key area deserving of Congress’s and the administration’s attention is network neutrality. The internet is often thought of as an ephemeral, non-corporeal reality, but it actually operates via a large and complicated physical infrastructure. Although clearly more complex than a “series of tubes,” the internet is essentially delivered through cables designed to carry a certain amount of bandwidth. Large telecommunications companies claim that if too much information is pushed through these cables, the network can become congested and internet connectivity can be compromised. Rather than invest in better last-mile and middle-mile connections, these companies would prefer to charge content providers a fee for faster delivery of their sites and services and engage in “deep packet inspection” and other network management practices to target and delay the transfer of high-bandwidth content like videos and music. This type of network management has already taken place in some instances.

Network neutrality—or “net neutrality” as it is commonly known—is the principle that preserves the internet’s open protocol foundation. It guarantees that all users can access the content and run the applications or devices of their choice. Network infrastructure is divided into four categories: backbone, middle mile, last mile and last 100 feet. Backbone consists of underground fiber optic cables, satellite systems or radio spectrum that handle high-speed transmission of high-content data. Middle mile and last mile are the two intermediate sections of the network. The middle mile usually consists of fiber optic cable, while the last mile is either a digital modem facility, DSL facility, satellite facility, or terrestrial wireless facility. The last mile connects the middle mile to the last 100 feet leading to the end-user's terminal.


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choice. Net neutrality prevents large telecommunications companies from giving preferential treatment to wealthier content providers who can afford to pay for faster delivery of their sites and services. It also precludes ISPs from blocking access to certain sites, either for political reasons or because they are owned by competitors.

Net neutrality is essential for new business growth and innovation. It allows small businesses and local organizations to operate on the same technological playing field as the largest national and international companies. Unequal access to the internet could severely undermine economic development, particularly in the nascent digital music marketplace. FMC recognizes that there are other barriers to digital innovation on the internet, but the presence of other issues does not diminish the importance of enacting enforceable net neutrality principles that clearly outline standards of conduct for all market participants.

A. HISTORY OF TELECOMMUNICATIONS AND INTERNET REGULATION

The telecommunications industry has historically been regulated by the principle of "common carriage,"88 which prevents discriminatory service and compels telecommunications companies to allow other carriers to use their lines.89 A common carrier—a company subject to common carriage regulations—cannot evaluate the content received from its customers or treat customers differently.90 They must provide their users equal access to their service.91 Common carriage was originally imposed on the railroad industry,92 and its application to telecommunications was first codified in the Communications Act of 1934.93 Common carriage, however, does not apply to cable and broadband internet companies.94 In 2005, the Supreme Court's Brand X decision (announced the

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88 Communications Act of 1934, 47 U.S.C. § 153(10) ("The term 'common carrier' or 'carrier' means any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio or interstate or foreign radio transmission of energy, except where reference is made to common carriers not subject to this chapter; but a person engaged in radio broadcasting shall not, insofar as such person is so engaged, be deemed a common carrier.").


90 Kevin Werbach, Only Connect, 22 BERKELEY TECH. L.J. 1233, 1246 (2007).


94 See Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 973 (2005) (holding that the Federal Communication Commission's classification of broadband as an
same day as *MGM v. Grokster*)\(^5\) upheld the FCC’s classification of cable broadband as an “information service,” not a “telecommunications service.”\(^6\) This decision is more than mere semantics—the “information service” classification exempted cable and broadband internet companies from common carrier regulation.\(^7\)

Since *Brand X* defined the internet as an information service, common carriage principles cannot be applied to achieve non-discrimination over the internet. Net neutrality principles are a viable alternative to gain non-discrimination regulation, and it has significant support in the FCC. In 2004, former FCC Chairman Michael Powell articulated four necessary internet freedoms: (1) the freedom to access content, (2) the freedom to run applications, (3) the freedom to attach devices, and (4) the freedom to obtain service plan information.\(^8\) These four principles have come to define net neutrality’s core doctrine. The four principles were subsequently reinterpreted by FCC Chairman Kevin Martin, who modified the principles to read:

(1) consumers are entitled to access the lawful Internet content of their choice; (2) consumers are entitled to run applications and services of their choice, subject to the needs of law enforcement; (3) consumers are entitled to connect their choice of legal devices that do not harm the network; and (4) consumers are entitled to competition among network providers, application and service providers, and content providers.\(^9\)

However, Martin also added that “[a]ll of these principles are subject to reasonable network management,”\(^10\) which alters the net neutrality framework. By supporting only devices that “do not harm the network” and endorsing

\(^{5}\) *Metro-Goldwyn-Mayer Studios Inc. v. Grokster*, Ltd., 545 U.S. 913, 941 (2005) (holding that file-sharing sites could be found, to have violated the Copyright Act by intentionally inducing copyright infringement).

\(^{6}\) *Brand X*, 545 U.S. at 967.

\(^{7}\) Id.


\(^{10}\) Id.
"reasonable network management," Martin left the door open for telecommunications companies to discriminate in the name of traffic management. This leaves private citizens and public interest groups to produce evidence of possible violations, which the FCC can choose to investigate through lengthy hearing processes.

Neither Martin's nor Powell's "four freedoms" framework, however, has regulatory authority. Although, the FCC has begun rulemaking proceedings, no official regulations have been passed, nor has Congress passed any enforceable legislation that would regulate cable and internet companies according to net neutrality principles. Telecommunications companies are theoretically able to manage their networks by creating a tiered system of content delivery or by blocking or delaying content transfers. What does this mean for music?

B. NETWORK MANAGEMENT

Without government oversight, cable and internet companies could carve up the internet into fast and slow lanes with those content providers who are able (or willing) to pay an ISP toll receiving preferential service. In such a scenario, labels, independent musicians, and technological innovators may have difficulty achieving a competitive presence in a legitimate digital music marketplace. The internet allows both the smallest independent label and the largest international media company to compete on a technological playing field. Without enforceable net neutrality principles, telecommunications and cable companies could discriminate against content providers—particularly those who deliver products or services that compete with the ISP's own offerings.

One method of discrimination is access tiering. Access tiering is the practice of selling preferential content delivery rates to those who can afford to pay for it. Currently the internet operates on a "best efforts" delivery system, meaning that packets of information are delivered on a first-come, first-serve basis, with no


103 However, the Comcast decision and Internet Policy Statement may provide some regulation.

104 Lawrence Lessing & Robert W. McChesney, No Toll on the Internet, WASH. POST, June 8, 2006, at A23 ("The current legislation, backed by companies such as AT&T, Verizon and Comcast, would allow the firms to create different tiers of online service."); see also Tim Wu & Christopher Yoo, Keeping the Internet Neutral?: Tim Wu and Christopher Yoo Debate, 59 FED. COMM. L.J. 575, 578 (2007).
guarantee that they will actually arrive at their destinations. All packets are indiscriminately subject to this delivery system. Access tiering would modify this process and allow telecommunications companies to prioritize some content over others, generally giving preference to content provided by sites that pay for faster delivery speeds.

Some point out that a complete restriction on content discrimination would prevent ISPs from giving time-sensitive services, like VoIP, video, and streaming music, priority over non-time-sensitive services like email. However, non-discrimination principles are needed to prevent discrimination between these time-sensitive services. Content delivery discrimination could severely undermine economic innovation, especially in the digital music distribution market. Tim Wu, one of the leading experts on net neutrality, asserts that access tiering distorts competition and makes market entry difficult for companies other than non-threatening business models associated with the ISPs. Net neutrality would allow innovative and unaffiliated digital businesses to attempt economic success on the web.

ISPs also have the ability to manage the content on their networks through various packet inspection procedures. "Deep Packet Inspection," or DPI, allows ISPs to inspect the content of messages in transit over the web and then choose to block or delay them, depending on the packet's content or origin. Other ISPs send forged RST packets into the network that instruct connections, such as P2P transfers, to terminate. This is the method Comcast used in 2007 to throttle BitTorrent traffic.

In the summer of 2008, the FCC ordered Comcast, one of the few telecommunications giants that control the public's access to the internet, to stop interfering with its customers' P2P transfers, specifically those that use BitTorrent protocol. In its order, the FCC noted that an Associated Press report had found

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105 Wu & Yoo, supra note 104, at 579.
106 Jonathan Nuechterlein, Antitrust Oversight of an Antitrust Dispute: An Institutional Perspective on the Net Neutrality Debate, 7 J. TELECOMM. & HIGH TECH. L. 19, 32 (2009) (“If taken seriously, [complete nondiscrimination between content] would thus preclude a broadband provider from giving any priority to real-time applications that need such priority in order to function properly (such as voice and video) over other applications that have no similar need.”).
107 Wu & Yoo, supra note 104, at 582.
109 BitTorrent is an internet protocol used by various companies to distribute legal video. P2P services also use it to illegally distribute music over the internet. See Complaint at 2–3, Free Press and Public Knowledge Against Comcast Corp., 23 F.C.C.R. 13028 (2008) (No. 07-52) [hereinafter FCC Comcast Order].
110 FCC Comcast Order at 4.
that "Comcast's interference affects all types of content, meaning that, for instance, an independent movie producer who wanted to distribute his work using BitTorrent and his Comcast connection could find that difficult or impossible." Comcast apparently throttled this traffic because BitTorrent's video transfers competed with Comcast's Video On Demand service, but at an FCC hearing on net neutrality, Comcast claimed their activities were mere "network management." However, the FCC found that Comcast specifically targeted and interfered with BitTorrent users, regardless of the level of network congestion at the time.

FMC believes net neutrality principles should be codified to promote entry into the marketplace. Certain principles of openness and access are necessary to encourage a thriving free market. Adopting net neutrality principles and clarifying what ISP activities fall within the bounds of reasonable network management would protect emerging digital music services, preserve the egalitarian nature of the internet, and encourage competition in the digital realm.

FMC commends the FCC's recent initiative in creating net neutrality regulations. On October 22, 2009, the FCC issued a Notice of Proposed Rulemaking that announced the intention to codify the four net neutrality principles announced in 2005. The FCC proposes changing the language of the four principles to more clearly and affirmatively impose an obligation on broadband internet service providers in order to clarify who bears the responsibility of adhering to these principles. Moreover, the FCC proposed these rules apply to providers of non-dial-up internet services, including wireless broadband. Most notably, the FCC has proposed adding fifth and sixth principles of nondiscrimination and transparency.

The fifth principle of nondiscrimination would prohibit broadband internet providers from treating "lawful content, applications and services in a...

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112 FCC Comcast Order at 2.
113 Lasar, supra note 86, at 12.
114 See generally FCC Comcast Order.
115 In the Matter of Preserving the Open Internet Broadband Industry Practices, at 4, 37–41, available at http://hraunfoss.fcc.gov/edocpublic/attachmatch/FCC-09-93A1.pdf ("To guide this process, [the FCC offers] draft rules, including a codification of the existing internet policy principles, additional principles of nondiscrimination and transparency, an acknowledgement that these principles apply to all forms of broadband Internet access, and a discussion of 'managed' or 'specialized' services.").
116 Id. at 37–38.
117 Id. at 5, 38.
118 Id. at 4, 41–48.
nondiscriminatory manner.\textsuperscript{119} The nondiscrimination principle would not be an extension of common carriage, but instead would be a "bright-line rule against discrimination, subject to reasonable network management and enumerated exceptions."\textsuperscript{120}

The sixth principle of transparency requires these providers to "disclose such information concerning network management and other practices as is reasonably required for users and content, application, and service providers to enjoy the protections specified in this rulemaking."\textsuperscript{121} Although not stated directly, it seems that the lack of publicly disclosed network management practices during the FCC's 2008 Comcast investigation partially motivated the sixth principle's inclusion in the Notice of Proposed Rulemaking.\textsuperscript{122}

FMC believes the FCC has taken an important step towards creating enforceable net neutrality regulation. None of the principles have yet been officially codified as of this Article's publication; however, FMC hopes that during the rulemaking process, the FCC does not stray too far from preserving the principles of openness and competition that seem to form the Notice of Proposed Rulemaking's foundation.

C. WHAT ABOUT FAIR USE?

Codifying net neutrality principles, however, may have unintended consequences. Any type of legislation or FCC rulemaking would likely specify that net neutrality principles only apply to legal content on the web, leaving room for ISPs to block or delay illegal material such as child pornography and suspected copyright infringement. During a recent Senate Commerce Committee FCC nominations hearing, now-FCC Commissioner Meredith Atwell Baker stressed that net neutrality should only apply to legal content, and that child pornography, spam, and copyright infringement should not be protected by nondiscrimination principles.\textsuperscript{123} Moreover, the FCC emphasized the distinction between legal and

\textsuperscript{119} Id. at 5. The proposed rule's language is: "Subject to reasonable network management, a provider of broadband Internet access service must treat lawful content, applications, and services in a nondiscriminatory manner." Id. at 41.

\textsuperscript{120} Id. at 43.

\textsuperscript{121} Id. at 5. The proposed rule's language is "Subject to reasonable network management, a provider of broadband Internet access service must disclose such information concerning network management and other practices as is reasonably required for users and content, application, and service providers to enjoy the protections specified in this part." Id. at 45.

\textsuperscript{122} Id. at 46–47. For more information regarding the FCC's 2008 Comcast investigation, see supra notes 110–13 and accompanying text.

illegal content on the internet in their 2008 Comcast order. Although the FCC’s
decision instructed Comcast to cease its anticompetitive network management
practices, the Commission simultaneously emphasized that anti-discrimination and
net neutrality principles only apply to legal content: “We . . . note that because
‘consumers are entitled to access the lawful internet content of their choice,’
providers, consistent with federal policy, may block transmissions of illegal
content (e.g., child pornography) or transmissions that violate copyright law.”

Most importantly, the FCC’s recent Notice of Proposed Rulemaking for
codifying network neutrality principles specifically and unequivocally states that
network neutrality principles do not apply to the unlawful transfer of copyrighted
material. The FCC, however, fails to address the fact that it is often extremely
difficult to evaluate whether or not a transmission is a copyright infringement. As
a result, the Commission’s broad statement on network management may give
telecommunications companies the power to determine what is and is not fair use.

Fair use is a defense to copyright infringement and permits certain uses of a
copyrighted work without the owner’s permission. According to the U.S.
Copyright Office, “[t]he distinction between fair use and infringement may be
unclear and not easily defined.” In general, reproducing or distributing a
copyrighted work for comment, criticism, education, scholarship, or news
reporting may be fair uses of the work. FMC recognizes internet companies
have a legitimate interest in helping to prevent copyright infringement, but those
efforts should not stamp out fair use. This Article does not purport to delve into
the debate concerning fair use in general. Instead, FMC wants to highlight fair use
as a concern for policymakers tasked with regulating the internet.

Without recognizing that the line between legal and illegal uses is often blurred,
the government may inadvertently give telecommunications companies the power
to determine what is and is not fair use. Capricious and arbitrary ISP decisions

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124 FCC Comcast Order at 31.
125 In the Matter of Preserving the Open Internet Broadband Industry Practices, 4, 37, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-93A1.pdf (“Moreover, it is important to emphasize that open Internet principles apply only to lawful transfers of content. They do not, for example, apply to activities such as the unlawful distribution of copyrighted works, which has adverse consequences on the economy and the overall broadband ecosystem. In order for network openness obligations and appropriate enforcement of copyright laws to co-exist, it appears treasonable for a broadband Internet access service provider to refuse to transmit copyrighted material if the transfer of that material would violate applicable laws.”).
126 Perfect 10, Inc. v. Amazon, Inc., 508 F.3d 1146, 1163 (9th Cir. 2007) (“The fair use defense permits the use of copyrighted works without the copyright owner’s consent under certain situations.”).
128 Id.
may unintentionally undermine the public’s fair use rights. Rob Frieden, a telecommunications expert, writes,

Fair use in an offline environment involves empirical and value judgments based on somewhat ambiguous criteria. Empowering hardware and software to establish and enforce a priori fair use policies usurps decision making by individuals and vests it with an intermediary that has every incentive to take the path of least resistance and lowest cost.

Courts have held that copyright owners must consider fair use before sending takedown notices to websites hosting music and other potentially infringing content. The preference for considering fair use rights also should apply to telecommunications companies that block potentially infringing music downloads or streams. FMC continually advocates for legislation codifying network neutrality principles, but we believe such legislation should try to avoid unintended consequences. Recognizing potential concerns regarding fair use will hopefully spur legislators to tread carefully when drafting net neutrality legislation.

V. CONCLUSION

Despite possible pitfalls, the future of music is bright. The internet has allowed unprecedented levels of access, exposure, and collaboration between musicians and fans. Music has never been more in demand, and it has never been easier for the public to experience art. However, we must be careful to foster this fertile landscape, not stifle it. Copyright law and telecommunications policy should be adjusted to make it easier for new, innovative digital start-ups to enter the market and be competitive. At the same time, we must be careful these adjustments take into account the public benefit of access to music and the need for creators to be fairly compensated. FMC recommends two best practices for policy makers to follow when tackling these issues.

First, it is vital to be fully informed as we move forward on policy initiatives. Necessary data could include surveying artist revenue streams, comparing varying royalty rates with music services’ economic success, monitoring ISP network

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130 Id. at 673.
131 See Lenz v. Universal Music Corp., 572 F. Supp. 2d 1150 (N.D. Cal. 2008) (holding that consideration of fair use is part of the initial review required by th DMCA before copyright owners can send takedown notices to potential infringers).
management practices and their effects, if any, on small business market entry, cataloging complaints regarding fair use and de minimis uses, and keeping track of music distribution innovations which could implicate multiple rights.

Second, artists must be represented in policy debates and negotiations. Often, the musician’s voice gets lost among the opinions of record labels, trade groups, policy makers, and technological innovators, and the musician’s position can often be different than the positions of other stakeholders. Those who create and perform the music must be forefront in any discussion regarding artist compensation and creating a legitimate digital music marketplace.

Ultimately, FMC advocates for clarity. The administrative process for licensing must more clearly define what rights are implicated by new digital distribution methods. The concept of net neutrality should be clarified to indicate what behaviors fall within reasonable network management practices, and what methods we will use in the future to protect fair use rights. Additionally, the processes used to reach these decisions should be inclusive, transparent, and accessible. The music ecosystem is rapidly transforming—in many instances providing hints of what sustainable models might look like. Yet some barriers stand in the way of a legitimate digital music marketplace where creators and rights holders are compensated, innovation can flourish, and public access to musical culture remains viable. FMC is confident that the new administration and Congress can address these barriers, while helping to identify mutually acceptable solutions, provided all stakeholders have a voice in shaping the future.