

Heads Up Royalties Up: Notice Required Before Copyright Royalty Board Adopts Divergent Rate Structure

***Johnson v. Copyright Royalty Bd.*, No. 19-1028, 2020 WL 4596810 (D.C. Cir. Aug. 7, 2020)**

By: Lisa Holubar & Manon Burns | August 21, 2020

On August 7, 2020, the D.C. Circuit remanded the Copyright Royalty Board’s (“CRB”) Final Determination setting royalty rates for certain rights to reproduce and distribute musical works. Though administrative agencies are generally given significant discretion by courts, the Court found that the CRB failed to provide notice of its adoption of a brand new rate structure that no party advocated for, failed to explain why it rejected a prior settlement agreement as a benchmark for establishing royalty rates, and re-defined a material term after it had already provided a definition without identifying its statutory authority for doing so.

As an initial matter, the songs that you hear on the radio or a streaming service embody two different copyright rights—the right to the musical composition and lyrics on the one hand, and the right to the specific sound recording of that composition on the other. The CRB initiates ratemaking proceedings every five years to set the amount of a mechanical license, also known as a compulsory license, for underlying musical compositions. This compulsory licensing scheme allows other parties to create covers of the musical work by paying a certain amount to the copyright holder of the musical composition. However, the license *only* covers the composition right, and not the sound recording. Thus, for streaming services like Spotify and Apple Music, the services pay the rate set by the CRB for the musical composition right and then must negotiate with the individual copyright holders of the specific sound recording rights for the right to interactively stream such works.

During this particular round of ratemaking proceedings, the CRB adopted a rate structure that “deviated substantially and unforeseeably from the parties’ pre-hearing proposals, the arguments made at the evidentiary hearing, and the preexisting rate structures.” The rate structure also significantly increased the royalties that streaming services would be required to pay and effectively tied that amount to the amount of sound recording royalties that had been negotiated separately, with no cap on the amount. Thus, mechanical royalties would increase proportionally to sound recording royalties, giving copyright owners incentive to increase the negotiated sound recording rates. The D.C. Circuit rejected this approach, noting that no party had been given notice of the CRB’s intentions, and thus no party had been prepared to advocate for or against adopting such an unforeseeable, extreme deviation from prior rates. The CRB further rejected a prior royalty settlement as a benchmark for considering current rates. However, the CRB did not adequately explain that rejection, and thus the D.C. Circuit remanded that issue to the CRB to provide further explanation.

Finally, certain streaming services also include services other than streaming music, which should not be counted towards the royalties owed. After the CRB had defined “Service Revenue” in its Initial Determination as the price paid for a bundle that included services other than streaming minus the cost of those other services, it changed its definition in its Final Determination to the lesser of (i) the revenue of the bundle, and (ii) the aggregate of standalone prices for the licensed music products included in the bundle. However, the CRB may only change its determinations on rehearing, to correct clerical errors, and in response to unforeseen circumstances, and its redefinition was none of those.

In determining new royalty rates, the CRB has to consider a multitude of factors and settle on a determination that it believes is reasonable. However, what is reasonable clearly varies greatly depending on the motivations of each party. Rather than the uncertainty that a Board determination may bring, advocates may consider compromise on settlement rather than further surprise and a long, drawn out battle before the CRB.