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PUBLIC PERFORMANCE RIGHTS IN THE DIGITAL AGE: FIXING THE LICENSING PROBLEM

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Recent technological advances have allowed consumers to reinvent the mixtape. Instead of being confined to two sides of an audiocassette, people can now create playlists that stretch for hours and days on their computers, tablets, mobile devices, and MP3 players. This, in turn, has affected how people consume and listen to music, both in isolation and in groups.

As individuals and business owners in the United States use devices to store, organize, and listen to music, they inevitably run up against the boundaries of U.S. copyright law. In general, these laws affect businesses more often than private individuals, who can listen to the latest hit single on their iPod or play music to a large audience in their home without running afoul of copyright law, presuming that the audience is composed of family members and social acquaintances.[1] In contrast, as soon as a business plays music in a public space where strangers might listen, it risks infringing the public performance right granted to rightsholders by copyright law.[2]

This Essay examines how business practices attributable to the rise of digital music conflict with the public performance right that the Copyright Act grants to creators. This Essay begins by examining the ways in which many commercial businesses might violate public performance rights by using digital music players in their establishments, and discusses how the public performance right governs such use. For example, under the Copyright Act, businesses that broadcast a radio station and are relatively small in scale do not infringe the exclusive rights granted to rightsholders; however, a parallel exemption does not exist for music played from a digital music player. Next, the Essay builds on the work of scholars who propose a tax to compensate rightsholders for public performances, rather than using

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1. 17 U.S.C. § 101 (2006).

2. Id. §§ 106(4), 106(6).

infringement suits or blanket licenses. Finally, this Essay concludes by discussing possible objections to a mandatory tax regime, how a mandatory tax regime might be implemented, and the likelihood of adopting such a regime.

I. Origins and Management of the Public Performance Right in Music

Section 106 of the Copyright Act grants exclusive rights to copyright holders.[3] Of the six exclusive rights enumerated in section 106, two involve public performance.[4] The specific boundaries of the public performance right depend on what one considers a "public performance." The Copyright Act defines public performance as performing or displaying a work in a manner open to the public or where persons besides family members and social acquaintances might witness it.[5] Under the terms of the Act, one could perform a work for 200 family members and social acquaintances in an expansive backyard and not publicly perform the work under the statutory definition.[6] Even looking only at the text, the statute's concept of public performance might defy common conception—some Americans would certainly consider a backyard performance to 200 people to be "public."

The Copyright Act's public/private distinction raises the normative issue of why public performance even deserves special protection via the grant of an exclusive right. If a family brings a portable stereo to play music at a private family picnic, American copyright law deems such action legal until the volume becomes loud enough for a stranger to overhear it, at which point the performance of the music becomes "public." In practice, this scenario is probably legal under various exceptions granted by the Copyright Act.[7] But why is this determination made on the basis of a "public" / "private" audience distinction, rather than the location, for example? While some line drawing is necessary in separating "public" from "private," the current statutory definition implicates complex metaphysical questions and makes enforcement of the public performance right seemingly arbitrary in some circumstances.

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3. *Id.* § 106.

4. *Id.*

5. *Id.* § 101.

6. Because the statutory definition of public performance only implicates performances attended by "a substantial number of persons outside of a normal circle of a family and its social acquaintances," confining an event to friends and family will not implicate the public performance right. However, allowing even one stranger (or a friend of a friend) to attend could conceivably transform the event into a public performance. *See id.*; 17 U.S.C. § 106(4) (2006).

7. The most obvious exception would be the fair use right granted by 17 U.S.C. § 107, but the language in 17 U.S.C. § 110(4) probably inoculates this type of performance.

In practice, performance rights organizations ("PRO"s) have become the preferred method for licensing and enforcement of public performance rights. There are three PROs in the United States: the American Society of Composers, Authors and Publishers (ASCAP); Broadcast Music, Inc. (BMI); and SESAC. Rightsholders grant their public performance rights to a PRO, which then licenses and enforces those rights. These PROs are collective rights agencies: they grant blanket licenses to businesses permitting them to play all of their clients' music in a public setting, rather than requiring the businesses to negotiate with each individual rightsholder. These license agreements provide for the collection of fees from business owners. In turn, the PROs pass on those fees to rightsholders (after deducting administrative fees).

According to Nimmer on Copyright, most PRO infringement suits follow the same procedural posture. A PRO will repeatedly warn an alleged offender that it is violating the public performance right. If the business refuses to sign a contract granting it blanket rights in exchange for paying fees to the PRO, the PRO will file suit and generally will win.[8] However, the Copyright Act creates special exemptions and conditions under which a PRO license is not necessary for public performance of copyrighted material.

One such exemption is particularly relevant for small businesses.[9] If the business meets certain requirements—most notably, if they play music transmitted via a radio or television station licensed by the Federal Communications Commission and meets certain physical restrictions—it will not need to purchase a public performance license. Business owners might have once been content to tune their stereos to a radio station, thus falling within a section 110 exemption. But the rise of digital music and portable music devices has made this option less appealing. The power to control the next song via a digital music player may be more enticing than relying on the whims of a DJ. Unfortunately, such practices open the door to an infringement suit.

II. The Problem of Digital Public Performance

A. *The PROs and Digital Music Enforcement*

The § 110(5)(B) exemption to the public performance right generally does not apply to playing songs off of devices like iPods, smartphones, and laptops in a business. Unfortunately, business owners who supply music to

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8. 2-8 Melville B. Nimmer & David N. Nimmer, Nimmer on Copyright § 8.19 (2011).

9. 17 U.S.C. § 110(5)(b).

customers via such devices often do not realize that they are violating copyright law. Perhaps business owners believe that by playing music files that they own, they can rely on the first sale doctrine (allowing them to do whatever they wish with music, once that music is acquired). However, this belief is contrary to the Copyright Act. The first sale doctrine, defined in section 109 of the Act, applies only to the distribution right, not to the public performance right.[10] Public performance rights remain with the creators of music beyond the point of sale.

The PROs currently spend much of their time, as described by John Bowe in a recent New York Times Magazine article, going after infringers for violations of the public performance right and encouraging them to purchase license agreements permitting them to public perform music in exchange for fees.[11] Business owners do not need to purchase license agreements from the PROs for each device or style of retransmission; the licenses cover all forms of the public performance right that the PROs can license on behalf of the rightsholders they represent.[12] Of course, because no single PRO can license all of the public performance rights for music under copyright in the United States, business owners often have to enter into licensing agreements with at least two, and probably all three, of the PROs. Those annual costs are often at least in the hundreds, and perhaps even thousands, of dollars, as reported by the *New York Times*.[13]

It has been difficult for the PROs to vigorously enforce their rights, in part due to the reactions of business owners and in part due to the PROs' own practices. Few business owners react to PRO requests for payment positively. For example, in one case a business owner told a BMI account executive that he would come into her office and spray her down with a machine gun in response to her conversation regarding getting a public performance license.[14] Other business owners choose to infringe and take a chance that the PROs will not pursue them, due to the practical limitations of tracking down each infringing establishment. Even when the PROs do locate infringing business owners, current PRO practices do not require the owners to immediately sign a license agreement and usually do not lead to expensive infringement suits for business owners.[15] As a result, business owners do not seem to feel a strong need to sign up with the PROs, and

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10. *Id.* § 109(a). The language of the statute gives an owner of a copy the ability to "sell or otherwise dispose of" possession, rather than perform it.

11. John Bowe, *The Music-Copyright Enforcers*, N.Y. TIMES MAG. (Aug. 6, 2010), *available at* http://www.nytimes.com/2010/08/08/magazine/08music-t.html?pagewanted=all.

12. *See, e.g.,* Lydia Pallas Loren, *Paying the Piper*, 3 J. SMALL & EMERGING BUS. L. 231, 233 (1999).

13. Bowe, *supra* note 11.

14. *Id.*

15. *Id.*

some may not even realize that they need to pay for public performance rights when using digital music devices to play music.

As Congress seems unlikely to reduce liability for business owners who violate the public performance right, it seems unlikely that the law will come in alignment with consumer understanding anytime in the near future. Thus, the PROs must continue to track down infringing business owners and enter into licensing agreements, a practice which consumes resources and creates resentment. As discussed above, business owners generally have an attitude that paying for PRO licenses is at best a discretionary expense and at worst a drain on revenues, especially for businesses with lean profit margins. Preserving the current system seems especially untenable for the two largest PROs, which each have a large catalog of artists whose public performance rights are constantly being infringed and therefore waste a great deal of employee time and administrative expense on enforcing those rights. The need for an alternate model is clear.

B. *Invisible Rights and Invisible Taxes*

The PROs are of course aware of the challenges in ensuring that business owners respect their clients' public performance rights. One interesting solution to the current problems is the Pandora for Business product sold by DMX, a branding firm focused on music.[16] Pandora for Business is a special version of the web service Pandora, which is an Internet radio service that allows users to choose a genre of music to listen to but does not allow users to control the songs that are played.[17] However, the monthly fees associated with Pandora for Business do not make it appealing for all business owners, despite the product's immunization of businesses from public performance liability. When faced with the option of taking one's chances with the PROs versus paying for a relatively expensive third-party service that may not be cheaper than a PRO contract, it seems plausible that a business owner would be willing to risk the PROs' wrath.

A sweeping solution that reduces the financial effects on individual payees would more effectively solve the problem of enforcing public performance rights. In his book Promises to Keep, copyright scholar and Harvard law professor Terry Fisher discusses several possible solutions to the general crisis that the digital revolution caused for the music industry. His favored proposal replaces the major parts of current copyright law with a taxation system that rewards creators.[18] Broadly, the new system would

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16. *See* Pandora for Business by DMX, http://www.dmx.com/pandora/.

17. Pandora has entered into licensing fee arrangements with the PROs in order to avoid infringing public performance rights.

18. William W. Fisher III, Promises to Keep: Technology, Law, and the Future of Entertainment 202–03 (2004).

allocate the proceeds from the tax to rightsholders by determining roughly how much each copyrighted work was heard or watched by consumers.

The scope of Fisher's proposed regime makes it politically unfeasible for now, but it is a fruitful starting point for more modest legislative reforms. Applying the concept of taxation in the public performance context would solve many of the problems facing the current PRO licensing model. By levying taxes on devices that can circumvent the public performance right and redistributing the proceeds from such taxes to the PROs, rightsholders (via the PROs) would receive revenue from all of the currently infringing business owners. The new system of taxation would eliminate the need for PRO licenses.

Taxing devices has clear precedent and some obvious benefits. In the copyright context, the government has already implemented statutory taxation schemes on consumer products for the benefits of rightsholders—one such scheme is taxing digital audio recording devices, such as Slingbox, and digital audio recording media.[19] Those royalties are administered by the Copyright Office, which remits them to the Alliance of Artists and Recording Companies ("AARC").[20] This basic structure could be imported to the public performance context, using existing bodies to implement the system. The federal government has the strongest ability to levy and collect a nationwide tax, and collective artist organizations like the AARC or the PROs are in the best position to remit those proceeds to artists. Preserving and using the PRO structure seems practical given that the PROs do more than grant blanket licenses for public performance rights; they also handle individual licensing of music compositions. Given these other roles, changing the PROs revenue model from licensing agreements to taxation should not drastically affect the organizations' staffing and would reduce enforcement costs. Further, allocating taxation revenues fairly among rightsholders is not an insurmountable challenge. PROs already do so with revenues from licensing arrangements, and as the *New York Times* described, they are already experimenting with tracking models that effectively estimate the play counts and fee allocations of public performances of copyrighted material.[21]

C. *Implementing a Taxation Regime*

Broadly, the new taxation scheme would function as follows. Devices that facilitate public performance of copyrighted material—digital music

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19. 17 U.S.C. § 1003(a). The rate is set at 2 percent for devices and 3 percent for media, with limitations on the maximum cost for devices. *Id.* § 1004.

20. 17 U.S.C. § 1005; *see also What is AARC?*, ALLIANCE OF ARTISTS & RECORDING CO.'S, http://wp.aarcroyalties.com/what-is-aarc/ (last visited Apr. 17, 2012).

21. Bowe, *supra* note 11.

players, television sets, laptops, tablets, and smartphones—would be taxed at a specified rate. There are three obvious levels of revenue that the tax could seek to raise. The first system would generate an amount equal to the revenue generated by all PRO contracts. The second would generate an amount equal to the revenue lost when establishments refuse or neglect to enter into a license with the PROs. The third would generate an amount achieved by proportionally taxing all compliant and non-compliant businesses that are similar to restaurants, bars, and nightclubs. The third system would exclude sophisticated businesses like radio stations and concert venues, neither of which is likely to violate copyright law as often or as unwittingly.

The advantage of the first system is its simplicity—it would eliminate the need for blanket licenses for business owners and would reduce some of the transaction costs described by Bowe. The advantage of the second system is fairness—because the second system would only seek revenues equal to those lost revenue from non-complaint business owners, the tax rate would be less than the first system. In this scenario, those business owners who pay for the public performance right via licenses would keep the same system of licenses and payments to the PROs. The third system would seek to raise revenue from the group of users that are legally required to enter into licenses with PROs and primarily use devices that facilitate infringement.

There are some drawbacks to the second system. First, it might create a free-riding incentive for business owners, encouraging them to stop paying for licenses and see the tax rate increase marginally. However, given that businesses can pass off the expense of public performance licenses to customers, business owners would not necessarily save money by abandoning the licensing system and causing the tax rate under the second system to increase. Second, consumers might balk at paying for a tax designed to compensate for the behavior of bad actors. But if the first or third systems were implemented, consumers would have to pay a higher tax, so paying for scofflaws would actually be cheaper for a consumer than paying for nearly every business owner, as in the first and third systems.[22]

In either case, a great deal of empirical analysis would be required in order to determine a rate that would generate revenue equal to the revenue from existing PRO contracts or the lost revenue from noncompliant business owners. In his 2004 calculations, Fisher arrived at a rate of approximately 11.8 percent by taxing different internet service providers.[23] It is possible,

22. This system would also remove the need for licenses from radios, concert venues, and other licensees. This could benefit consumers by lowering venue entry rates and radio advertising rates, which would create downstream benefits for consumers in those prices but also increase device prices.

23. FISHER, *supra* note 18, at 221.

using his methods, to create a rough estimate of what an appropriate taxation level would be.

The estimated tax rate for the above schemes would likely be lower than Fisher's estimate for several reasons. In the years since Fisher's estimate, internet use has exploded due to increased access capability throughout the United States and, in particular, the increase in smartphone use. Additionally, there is now a broader base of taxable devices, which would drive down the tax rate for each individual device. And further, Fisher's model was based on a tax that would raise an amount equal the music industry's *total* revenues. But in the models proposed here, the tax would need to raise only the portion that comes from public performance licenses. The Appendix provides more detail on how to estimate the appropriate taxation level, ending with a figure of approximately 1.76 percent.[24]

The tax rate of 1.76 percent is the approximate number that would be required to equal the PROs' current revenues, which is used as proxy for the current revenues from public performance blanket licenses. Each of the systems described above would have a slightly different rate. For the first system, the tax rate would have to be higher than 1.76 percent because some revenue is not being collected at present. The third system would also need to be higher, assuming that the revenue generated by radio stations and concert venues is less than the revenue lost by non-complaint businesses. For the second system, the tax rate would change depending on how much of the market is compliant—it would be higher than 1.76 percent if fewer than half of businesses are currently obtaining licenses from the PROs lower if more than half of businesses are currently obtaining licenses.

Because revenue streams and device prices are constantly fluctuating, the tax rate would need to be recalibrated based on changing economic conditions. Under current law, the Copyright Royalty Board—a panel composed of three administrative law judges—makes determinations regarding royalty rates set by provisions of copyright law.[25] Expanding the Board's responsibilities to also adjust a tax rate on devices would comport with the current legislative goals of copyright law. Alternatively, the Board could institute a dynamic rule that would recalibrate the tax rate to changing uses and prices for devices.

Finally, the tax rate need not be equivalent for all four categories of devices. In his proposal, Fisher suggests a Ramsey pricing scheme to tax specific classes of devices at different rates.[26] Fisher explains that, by designing a system, a Ramsey scheme in this context would "make the tax rates applicable to the various devices . . . inversely proportional to the

24. *See infra* Appendix.

25. 17 U.S.C. § 801(b)(1) (2006).

26. FISHER, *supra* note 18, at 222–23.

elasticity of demand for each."[27] In practical terms, this would mean that devices that consumers felt were more central to their lifestyles would be taxed a higher rate, because consumers would be willing to pay more money for those devices, reaching the Ramsey goal of minimizing changes in consumer behavior. Conversely, devices with less demand would be taxed at a lower rate.[28]

Conclusion: Taxation Criticisms and the Likelihood of Adoption

One criticism of creating a taxation system is that it would unfairly tax individuals who do not necessarily infringe the public performance right of rightsholders. If a consumer buys an iPod and uses it only for personal use, they would not be publicly performing any work, yet they would be paying the compulsory tax. In essence, consumers would be paying for a privilege that they might never exercise. This may seem an unfair or excessive solution in order to remedy the behavior of bad actors.[29]

But there are several reasons why "spreading the tax" around to individuals who may not necessarily need to pay it makes sense. First, Americans already pay taxes in order to fund programs that they may never use. An obvious example of this is Social Security: some Americans will certainly die before they become eligible to receive Social Security benefits. Second, the public performance right *does* get "used" by individuals who don't directly contribute to paying for licenses—the general public. When an individual walks into a coffee shop and hears a piece of music, that individual is enjoying the song and benefitting from the public performance for free. The business owner is legally required to pay for a license to publicly perform the work, and at least theoretically could pass along the cost of obtaining a license to customers. However, given the issues surrounding supply and demand and consumer sophistication in comparing prices, it is not at all certain that the *entire* cost of PRO licenses is passed on to consumers. Additionally, noncompliant business owners almost certainly do not take into account the cost of the foregone licenses when pricing their goods and services, especially given that businesses may not even know they are infringing until the PROs track them down. Therefore, forcing individuals to pay for public performance rights more effectively allocates pricing among the actors who enjoy the right itself.

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27. *Id.* at 223.

28. *Id.*

29. For example, assuming that noncompliant businesses constitute 1 percent of the total purchases of portable music players. Then, only 1 percent of the population that "should" pay the tax actually pays it. In that sense, it seems inelegantly designed.

Another potential criticism of this proposal is feasibility. Though the taxation system is relatively easy to grasp theoretically, its construction would require a great deal of cooperation from multiple actors. The PROs, rightsholders, businesses, device manufacturers, and consumers would all need to develop new statutory language and taxation models. The current PRO system makes the taxation system somewhat easier than Fisher's proposal to put into effect, but the political difficulties in doing so would certainly make it a challenge.

There are undoubtedly more effective ways to remit revenues from public performance rights than sending PRO agents toting licensing agreements to every infringing small business in the country. And a statutory modification of the public performance right to indemnify such infringement seems unlikely in today's political climate. Instead, creating a minor change to copyright law—the creation of a tax on devices that play digital music files, with proceeds payable to PROs—would both decrease infringement and allow business owners to continue to play music off their devices by levying a modest price against owners and consumers.

APPENDIX

Echoing Terry Fisher's rough calculations, let us use the following numbers to estimate what an appropriate taxation level would be. We would need to know (1) the total revenues that PROs obtained from public performance licenses, (2) the number of digital devices sold that would need to be taxed, and (3) the "lost revenues" from noncompliant businesses. Unfortunately, exact numbers for any of these three categories is unavailable, but a rough estimate can be created for the first two.

For the fiscal year 2011, ASCAP reported revenues of $985 million and BMI reported revenues of $931 million.[30] SESAC did not report revenues, but assuming that it has a 5 percent share of the total revenues (given its much smaller size), SESAC would have had revenues of $101 million. Total revenues would be $2.017 billion. Let us assume that the tax would need to compensate for the total PRO revenue—this is an overestimate, but will give a sense of what the desired figure should be.

The number of taxable digital devices sold in the United States is also difficult to estimate with precision. The categories of digital devices that would be deemed taxable in this context would likely be smartphones, MP3 players, tablets, and computers. Prices for three categories have been roughly estimated. Total sales for each category, on either a quarterly or annual basis, were estimated as follows:

30. Press Release, BMI, BMI Reports Increased Revenues for Fiscal Year 2011 (Sept. 20, 2011), *available at* http://www.bmi.com/news/entry/552802; Press Release, ASCAP, ASCAP Reports Increased Revenues in 2011 (Mar. 8, 2012), *available at* http://www.ascap.com/Press/2012/0308_ascap-reports.aspx.

Device Type	Estimated Quarter Sales	Estimated Annual Sales	Estimated Average Price	Estimated Annual Revenue
Computers	17,929,764 units	71,719,056	$652	$46,760,824,512
Tablets	-	13,600,000	-	$8,100,000,000
Smartphones	-	420,000,000	$135	$56,700,000,000
MP3 Players	11,186,000 units	44,744,000	$67.50	$3,020,220,000
			Total Estimated Revenue	**$114,581,044,512**

With a total estimated desired revenue of $114,581,044,512 and a desired taxation revenue of $2,017,000,000, the tax rate would need to be approximately 1.76 percent (or 2,017,000,000 divided by 114,581,044,512).