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Student Note

***393** WEBCASTER II: A CASE STUDY OF BUSINESS TO BUSINESS RATE SETTING BY FORMAL RULEMAKING

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I. INTRODUCTION

The Copyright Royalty and Distribution Reform Act (the Act) of 2004 is unsuccessful at achieving its goal of an effective administrative system for determining copyright royalty rates between the private parties that make up copyright owners and copyright users. [FN1] In particular, the Act fails to create an environment that promotes efficient rate-setting and does not encourage private negotiation as intended by Congress. This note will focus on the Copyright Royalty Board's rate-setting in the proceeding, coined *Webcaster II*, announced February 16, 2005, [FN2] the final rule and order determined on May 1, 2007, [FN3] and the subsequent decision of the D.C. Circuit Court of Appeals issued on August 7, 2009. [FN4] The *Webcaster II* proceedings covered rate-setting for the period beginning January 1, 2006, and ending on December 31, 2010. [FN5]

The Act was the product of ongoing legislative efforts to reform the federal regulatory process. [FN6] Federal agencies are authorized to issue regulations (in this case, rate-setting) by their enabling statutes. [FN7] Most regulations are issued informally under the notice-and-comment procedure established by the Administrative Procedure Act (APA). Less commonly, rate-setting systems, like that under the Act, go beyond notice-and-comment by increasing the involvement of private parties under the *394 premise that such a change would facilitate and encourage private settlement agreements for determining royalty rates. [FN8]

To demonstrate the ineffectiveness of the Act in the context of *Webcaster II*, this note begins with background in Parts II and III which discuss the legislative history of the Act, including the rationale behind the administrative rate-setting structure, and the economic rationale behind using an administrative system for copyright royalties. Part IV includes a history of the rate-setting process in the *Webcaster II* proceedings. Part V will then analyze the failings of the system.

II. LEGISLATIVE BACKGROUND

Prior to the Copyright Royalty and Distribution Reform Act, the Librarian of Congress was empowered to convene Copyright Arbitration Royalty Panels ("CARPs") to determine copyright royalty rates whenever private negotiation among affected parties failed to establish rates. [FN9] The CARP system suffered from being inconsistent, unnecessarily expensive, and the arbitrators lacked appropriate expertise to render decisions. [FN10] Additionally, legislators were unhappy with CARP determinations and believed that the rates were overly burden-

some on copyright users. [FN11]

The Act replaced the CARPs with the permanent Copyright Royalty Board (“Board”). [FN12] The Board is comprised of three administrative law judges, known as the Copyright Royalty Judges, appointed by the Librarian of Congress. [FN13] The extent of its authorization is to make determinations of binding copyright royalty rates and to publish those rates in the Federal Register. [FN14] The rates set by the Board are constrained by policy requirements to maximize the availability of creative works to the public, afford copyright owners a fair return for the creative work and copyright users a fair income, and to minimize the disruptive impact of royalty disputes. [FN15] Additionally, the determined rates are required to represent the terms that would have been negotiated by willing buyers and willing sellers. [FN16]

Typically, administrative boards are delegated with the authority to adopt regulations and establish rates as a means of governing industry *395 sectors that change rapidly in a dynamic economy. Legislative power may be delegated to an administrative body where there is agreement that a task must be performed and it cannot be effectively performed by the legislature without the assistance of outside authorities or the expenditure of effort so great as to lead to the neglect of equally important business. [FN17] The Supreme Court has recognized that delegation to administrative boards helps to ensure decisions based upon evidential facts under the particular statute are made by experienced officials with an adequate appreciation of the complexities of the subject that is entrusted to their administration. [FN18] Delegation is most commonly used where the industry sector to be regulated is highly technical or where their regulation requires a course of continuous decision. [FN19] Boards are able to adjust regulations and rates within their policy constraints as the realities of the industry sector change more quickly than statutory controls established by legislatures.

The policy decision to restrain businesses, particularly in rate-setting, reflects an interest in the public at large deciding what prices “ought” to be. [FN20] In recent years, the administrative determination of what prices “ought” to be is being replaced by processes that are designed to simulate private contracting. [FN21] The rationale for transitioning to systems which emphasize competitive markets in traditionally regulated industries is economic welfare theory. [FN22] The economic welfare theory suggests that prices developed through competitive markets and private contracting ought to be those that make the system economically efficient. [FN23] The system established by the Copyright Royalty Distribution and Reform Act is consistent with this understanding of economic welfare theory by encouraging private contract negotiation between entities in regulated sectors while maintaining a regulatory backstop. [FN24] However, liberalized rate-setting schemes, like that of the Copyright Royalty Board, require modifications and adjustments to improve implementation due to the fact that rate-setting has been such an established feature in certain markets that there is only a very general understanding of the true, underlying competitive structure. [FN25]

As a result of the Act, the Copyright Royalty Board's authority to set statutory payment rates between market participants is significantly *396 constrained as a result of the willing buyer-willing seller standard and the supremacy of private agreements. Rate-setting reflects a policy decision by the administrative body. [FN26] Here, the policy decision is how to maximize the availability of creative works to the public and to afford the copyright owner an undefined fair return for his or her creative work. [FN27] However, the Act declared that private negotiation between copyright owners and copyright users for determining royalty rates and establishing distribution of royalties is the desired outcome. [FN28] Thus, the Board's policy decision is complicated by the policy goal of creating a private market for copyrighted materials. Under the system, license agreements negotiated between copyright owners and webcasters, at any time, even after the Judges' rate-setting determinations become final, shall be given effect in lieu of any determination of the Board. [FN29] By facilitating and encouraging set-

tlement agreements for determining royalty rates, the Act aims to reduce the need to conduct full-fledged rate-setting and distribution proceedings and encourage the development of a private market. [FN30]

As part of the effort to move away from administrative rate-making to a private market, the Copyright Royalty Judges serve more as common law judges than agency regulators advancing rate proposals of the Board's own design. [FN31] The Judges preside over adversarial, on-the-record litigation between copyright owners and users, in which each participant attempts to prove that its own proposed rates and terms best satisfy the statutory standard. [FN32] Copyright owners and users attempt to prove the value of the property interest at stake. The Judges are put in the position of fact finder of the property value of the copyrighted works. They are required to make their determinations based solely on the basis of the factual record developed through the adversary process and may not enter material into the record using administrative notice, thereby limiting the effective and efficient use of their own expertise. [FN33] The Judges have neither the authority nor the responsibility to address matters beyond the record assembled in the proceedings. [FN34]

***397 III. BACKGROUND AND ECONOMICS OF STATUTORY LICENSES FOR WEBCASTING**

From November 2007 until February 2008, the Writers Guild of America staged a strike against Hollywood studios. [FN35] The strike lasted three months at a collective cost to the industry of two billion dollars. [FN36] The sole issue in the dispute was when and how revenues from Internet and other digital transmissions of the writers' work would be allocated. [FN37] While writers are not the exact equivalent of composers and performers of musical works, the desire to protect their right to payment for dissemination of intangible assets over digital media is similar. The writers resorted to extreme measures to secure through private contract with the studios what they considered to be a fair return when their work is disseminated through digital transmissions.

The modern music industry is one of the larger consumer markets in the world with digital music sales amounting to \$4.2 billion in 2009. [FN38] Commercial webcasting is an industry growing in popularity. [FN39] Internet webcasters play to an audience ranging from 51 million to 70 million listeners per month. [FN40] As webcasting business models develop, the webcasting industry has experienced increased profitability. [FN41] The industry generated \$500 million in advertising revenue in 2006, a ten-fold increase from 2003. [FN42]

In the United States, the music industry is heavily dependent on statutory licenses. [FN43] Statutory licenses permit copyright users, upon compliance with the statutory conditions of the license, to transmit the musical work without obtaining consent from, or negotiating license fees with, the copyright owners. By protecting the rights of artists, composers, and performers, copyright law has enabled copyright owners to control the exploitation of their work and to earn rewards for their creations. [FN44] The *398 Digital Performance Right in Sound Recordings Act of 1995 and the Digital Millennium Copyright Act of 1998 created a statutory license in performances disseminated by Internet broadcasters and provided a means of payment to copyright owners. [FN45] Internet broadcasting, or "webcasting," is the transmission of radio programming over the Internet or through wireless networks as digital audio signals. [FN46] Section 114 of Title 17 in the United States Code ("Section 114") provides for statutory licenses and grants of royalties to copyright owners for the digital public performance of sound recordings. [FN47] Statutory licenses under Section 112 of Title 17 ("Section 112") cover the ephemeral, temporary copies of the copyrighted work created to facilitate the transmission of sound recordings during webcasting. [FN48]

Copyright owners are represented by SoundExchange, Inc. ("SoundExchange") in matters involving Section 114 and Section 112 statutory licenses. [FN49] SoundExchange is a non-profit performance rights organization

designated as the sole entity to collect and distribute royalties from digital transmissions of copyrighted work on behalf of featured and non-featured recording artists, master rights owners (usually record labels), and independent artists who record and own their masters. [FN50] Copyright users subject to Section 114 and Section 112 statutory licenses are represented by an assortment of groups with distinct interests. One such group is the Digital Media Association (“DiMA”) which is an advocacy organization focused on creating a regulatory environment that enables business model innovation for commercial webcasters. [FN51] Other interests may be represented by the Corporation for Public Broadcasting or the Intercollegiate Broadcasting System which primarily focuses on the regulatory environment impacting not-for-profit, education focused webcasters. [FN52] Still others are represented by separate groups and organizations.

The core of the dispute between copyright owners and copyright users is how to set the rates and terms of the statutory licenses. SoundExchange is most interested in a per-performance system of pricing that compensates owners for every song played. In the Webcaster II proceedings, SoundExchange sought monthly fees from commercial and non-commercial webcasters equal to the greater of 30% of gross revenues or a per-performance rate that doubles within five years. [FN53] Commercial webcasters, on the other hand, desire a percentage of revenue system in order to protect against the possibility that the costs of the copyright licenses would exceed revenues. Specifically, large commercial webcasters sought license fees equal to 5.5% of gross revenues while small commercial webcasters only wanted to pay 4% of gross revenues. [FN54] Noncommercial webcasters, on the other hand, preferred a flat fee in order to simplify their cost structures. [FN55]

The rates and terms of statutory licenses affect the allocation of musical works as a productive resource. [FN56] The Court of Appeals for the District of Columbia Circuit has recognized that “billions of dollars and fates of entire industries can ride on the Copyright Royalty Board’s decisions.” [FN57] The large volume of musical performances used by webcasters results in a situation where fractions of a cent per performance may make the difference between the viability of a commercial webcaster or its demise. [FN58] Nonetheless, copyright markets do not function well. [FN59] Transaction costs to achieve optimal market behavior are extremely burdensome for the disparate copyright owners and users. [FN60] As a result, the involved parties generally consider the imposition of statutory license rates and a statutory scheme for payment and collection, enforceable by federal law, to be beneficial. [FN61] Most copyright users want unplanned, rapid, and indemnified access to any and all of the repertory of copyrighted worked, and the owners want a reliable method of collecting for the use of their copyrights. [FN62]

In the absence of a statutory licensing system, copyright owners and users would incur numerous transaction costs that could make webcasting uneconomical. Eliminating or reducing transaction costs is the conventional economic justification for statutory licensing because setting a legislatively predetermined or administratively prescribed rate for specific uses removes certain transaction costs as an element of copyright transactions. [FN63] These transaction costs include: search costs--buyers and sellers finding each other in increasingly broad and distributed markets; information costs--learning about the products of sellers and the needs of the buyers; negotiation costs--determining the terms of individual agreements; decision costs--comparing the terms of the seller to other sellers and vice versa; policing costs--buyers and sellers taking steps to ensure that the goods or services and the terms under which the sale was made are transformed into behavior; and enforcement costs--buyers and sellers agreeing to remedies for incomplete performance. [FN64]

IV. THE CURRENT COPYRIGHT ROYALTY BOARD SYSTEM AND HOW THE PROCESS WORKED FOR WEBCASTER II

The Copyright Royalty Board begins its rate-setting proceedings by publishing in the Federal Register a clear notice of the proceedings and request for petitions to participate. [FN65] The Board will determine each petitioner's qualifications to participate in the proceedings. Unqualified petitioners are those without significant interest in the proceeding. [FN66] After the window for submitting petitions to participate has closed, the Board informs each qualified participant of all the other participants and requests that participants engage in voluntary negotiation. [FN67] The voluntary negotiation period lasts for three months. [FN68] If the participating parties report that a settlement has been reached by some or all of the parties, the Copyright Royalty Board will publish the settlement in the Federal Register for notice and comment from those parties bound by the terms, rates, or other determination set by the agreement. [FN69] At the close of the voluntary negotiation period, the Board instructs participants to file written direct statements and subsequent responses to the statements of opposing participants. [FN70] Following the submission of written direct statements and rebuttals, the Board determines a schedule for conducting and completing discovery. [FN71] Participants in royalty rate proceedings may request nonprivileged documents from opposing participants that are directly related to the written direct statement or written rebuttal statement of that *401 participant. [FN72] Broad, nonspecific discovery requests are not acceptable. [FN73] Participants are also limited to take no more than ten depositions and secure responses to no more than twenty-five interrogatories. [FN74] The discovery period is limited to sixty days. [FN75] A post-discovery settlement conference is held among the participants within twenty-one days after the close of discovery outside of the presence of the Copyright Royalty Judges. [FN76] In absence of a settlement, the Board will move on to hearings that consist of opening statements by each party and testimony from witnesses familiar with copyright ownership and use. [FN77] The Board issues its determination in the proceedings not later than eleven months after the conclusion of the post-discovery settlement conference. [FN78]

Subsequent to the Board's determination, participants may file motions to order a rehearing before the Board. [FN79] The Board may grant a rehearing upon a showing that any aspect of the determination may be erroneous. [FN80] Judicial review of the Board's determination is provided by the United States Court of Appeals for the District of Columbia should any aggrieved participant appeal within thirty days of the publication of the determination in the Federal Register. [FN81] The Copyright Royalty Board bears the initial responsibility for interpreting the statute. [FN82] The Court of Appeals is limited to assessing the reasonableness of the Board's interpretation of the inherent ambiguity in the statute. [FN83] The Court of Appeals will uphold the results of adversarial agency proceedings unless they are arbitrary, capricious, contrary to law, or not supported by substantial evidence. [FN84] If the court determines that it will not uphold the Board, it has the power to modify, vacate, or remand any portion of the Board's determination. [FN85] However, courts are particularly deferential to administratively determined rates because of the highly technical nature of administrative proceedings. [FN86]

Forty-two parties filed motions to participate in the Webcaster II proceedings, but the Board reduced that number to twenty-eight after it *402 determined the qualifications of each potential participant. [FN87] Broadly, the participants can be defined as either copyright owners or copyright users. Copyright owners were represented in the proceedings by SoundExchange, the entity that has been appointed by the Copyright Royalty Board to be the sole entity to collect and distribute digital performance royalties. [FN88] Copyright users were Internet webcasters or broadcast radio simulcasters that employ streaming technology. [FN89] These users comprised a range of different business models and programming, [FN90] and were further classified by the Board as commercial webcasters (e.g., DiMA) and noncommercial webcasters (e.g. The Corporation for Public Broadcasting). [FN91]

The voluntary negotiation period proved to be unsuccessful. [FN92] The Board ordered the participants to

conduct discovery and then to begin live testimony. [FN93] Testimony was taken from May 1, 2005, through August 7, 2006. [FN94] SoundExchange presented the testimony of fourteen witnesses and the webcasters collectively presented the testimony of twenty-four witnesses. [FN95] The participants filed written rebuttal statements to the live testimony on September 29, 2006, which was then followed by additional discovery on the rebuttal evidence. [FN96] Rebuttal testimony was taken from November 6 through November 30, 2006. In all, the Board heard forty-eight days of testimony, which filled 13,288 pages of transcript. [FN97] One hundred and ninety-two exhibits were admitted. [FN98]

After the evidentiary phase of the proceedings, the Board ordered participants to file Proposed Findings of Fact and Conclusions of Law by *403 December 12, 2006, with responses due by December 15, 2006. [FN99] The Board also ordered the participants to submit stipulated terms. [FN100] However, no stipulated terms were filed and the proceedings moved into closing arguments on December 21, 2006. [FN101] Board regulations do not provide for procedures relating to stipulated terms and the Board did not state why it asked for such terms. [FN102] In keeping with the willing buyer/willing seller standard, the Board may have been trying to give the participants one more opportunity to indicate where they might be in agreement.

The Board issued its final determination on May 1, 2007. [FN103] The Board designated per play rates for commercial webcasters that increased gradually over the five-year covered period. [FN104] All webcasters were charged an annual minimum fee of \$500 to cover administrative costs. [FN105] For noncommercial webcasters, the \$500 minimum fee covered 159,140 aggregate tuning hours (calculated by the total number of hours of programming multiplied by the number of listeners per hour). [FN106] For any month in which the noncommercial webcasters aggregate tuning hours exceeded this threshold, they must pay the same per-performance rates as commercial webcasters for the excess. [FN107] All royalty fees are paid to SoundExchange to be distributed to the copyright owners. [FN108]

SoundExchange and the copyright owners were perceived by industry analysts to be the winners of the contest before the Board. [FN109] The mood of webcasters was summed up by Joe Kennedy, Chief Executive of Pandora, a mid-sized webcaster, in his statement that he was “not aware of any Internet radio service that believes they can sustain a business at the rates set by [the Board's] decision.” [FN110] The webcasters appealed the determination to the Court of Appeals as being arbitrary and not supported by the record of the proceeding. [FN111] The court found the \$500 minimum fee to cover SoundExchange's administrative costs for both commercial and noncommercial webcasters to be arbitrary because there was no evidence in the record indicating the actual administrative costs of SoundExchange. [FN112] *404 Other provisions of the determination were affirmed, but the court remanded the entire determination to the Board for reconsideration. [FN113]

During the pendency of the Court of Appeals decision, webcasters and the general public using webcasting services voiced strong feelings about the fairness of the Copyright Royalty Board determination and provoked a legislative response. The fundamental concern for legislators was that the Board's determination would put too many webcasters out of business and stifle emerging new media technology businesses. [FN114] Congress adopted the Webcaster Settlement Acts of 2008 and 2009 in order bring copyright owners and copyright users back to the negotiating table. [FN115] As a result of the acts, in January 2009, the Corporation for Public Broadcasting reached an agreement with SoundExchange. [FN116] Commercial webcasters and SoundExchange reached agreement in July 2009. [FN117] However, SoundExchange did not consider its agreed terms to be indicative of fair market rates, insisting that the Board's determination was appropriate and fair. [FN118] The agreements differentiated between the distinct webcasting products, such as pure-play webcasting, simulcasting, and on-demand performances. [FN119] Other agreements between SoundExchange and webcasters were reached during

the pendency of the Court of Appeals decisions. [FN120] The specific terms in the various privately negotiated agreements show an attention to detail not associated with the record produced during Board proceedings. The record produced by participants did not distinguish different webcasting products.

*405 V. INEFFECTIVENESS OF THE COPYRIGHT ROYALTY BOARD SYSTEM

A. Efficiency and Expertise of the Board

The procedures of the Copyright Royalty Board are neither efficient nor do they exploit the subject matter expertise that warrant the use of administrative agencies to supplant private contacting. The Board engages in formal rulemaking as defined by the Administrative Procedure Act. [FN121] Formal rulemaking, which is analogous to judicial proceedings, has always been the exception rather than the norm. [FN122] Normally, agencies engage in informal rulemaking, characterized as notice-and-comment rulemaking. To satisfy the requirements of informal rulemaking, the agency must publish notice of the rule in the Federal Register with opportunity for comment by interested parties and revision by the agency before the final rule is published. [FN123] This type of procedure is very efficient and allows the agency to make use of its own expertise in the regulated area. Formal rulemaking, on the other hand, necessarily involves a full hearing on the record with interested parties invited to submit evidence and make formal arguments. [FN124] The most infamous formal rulemaking case is the ten year process of the Food and Drug Administration (“FDA”) to determine what exactly constitutes “peanut butter.” [FN125] Parties to the rulemaking who believed they would no longer be able to advertise their products as “peanut butter” after the final rule, acted to obstruct a final determination. In all, the evidentiary hearing produced 7,736 pages of testimony, of which only a very small portion was useful to the FDA. [FN126] Much of the testimony came during cross-examination in which attorneys asked questions to produce minor concessions that were more verbal than real. [FN127] As a result, a great amount of effort was expended to reach a determination that could have been reached with less formal procedure.

The peanut butter proceeding demonstrates that formal rulemaking is inherently inefficient when the dispute involves a policy question rather than a factual determination. Formal hearings and testimony are effective to elicit facts from the participants that are not easily accessible to agencies (e.g., when environmental regulators need to know what effect industrial *406 waste water temperature has on marine life). However, when the core of the proceeding is to determine the policy that best serves the statutory standard and public interest, the benefits of formal rulemaking are diminished. The facts of the Webcaster II proceeding were easily ascertainable; the dispute was over how to implement a policy that would maximize the availability of musical works to the public while ensuring a fair return to the copyright owners and reflect the rates and terms that would be agreed to between a willing buyer and willing seller. Informal rulemaking by notice and comment provides a more efficient procedure by which to make policy decisions. [FN128] Informal rulemaking would give the Copyright Royalty Board better ability to control the agenda and define the focus of the proceeding. [FN129] Rather than relying on the parties to produce the evidence necessary for a final determination, the Board itself would be able to request the necessary evidence to ensure that it satisfies its public policy standard. Additionally, the essential reason for the development of informal rulemaking in administrative actions is that the agencies and parties under the jurisdiction of those agencies have found that justice can be realized while saving time and expense by limiting the formal administrative process. [FN130]

The ineffectiveness of the Board is exacerbated because it must rely on the evidence and arguments submit-

ted by adversarial parties. The Board does not act as an administrative rate-maker. [FN131] The Judges understand their role to be akin to common law judges presiding over civil litigation between private parties. [FN132] As a result, each participant comes before the Judges as an adversary attempting to prove that its own proposed rates and terms best satisfy the statutory standard. [FN133] The burden is upon the parties in the proceeding, and not the Judges, to provide the evidence for the Judges to make their determination. [FN134] While the Judges may draw from different rate proposals advanced by the parties, a party's failure to present evidence necessary to achieve the policy goals of the Act will result in a poor rate determination. [FN135]

Further, since the Board is making a policy decision, the copyright owners in Webcaster II, represented by SoundExchange, had a decided advantage over the multiple copyright users with divergent interests. Even if the webcasters are able to present their evidence that would enable the Board to set rates favorable to their industry, webcasters are at a *407 disadvantage based upon the interest group theory of politics. During the creation of public policy, concentrated interest groups have substantially greater political influence than groups larger in number, but with smaller per capita stakes, even though the total stakes for the larger group may significantly exceed that of the smaller. [FN136] As a unified voice for copyright owners, SoundExchange is able to present a more forceful message of its needs and requirements before the Copyright Royalty Board. Copyright users, on the other hand, have divergent interests that dilute their message before the Board.

B. Reduced Incentives for Private Negotiation

Copyright Royalty Judges are required to make rate determinations that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller. [FN137] However, the very nature of the formal administrative proceeding demonstrates that the parties are not willing buyers and willing sellers. [FN138] Were the parties willing buyers and willing sellers, they would have come to agreement without the presence of the Copyright Royalty Board. The Judges in Webcaster II recognized that rates for the license, negotiated under the constraints of a statutory license scheme, do not reflect those that would arise in the marketplace. [FN139] In the marketplace, parties that do not desire to work together are not required to. If they do have interest in working together, explorations of joint interests may produce better outcomes. Here, statutory constraints have forced parties into proceedings before the Board and have constrained the negotiation to the terms of the Section 114 and Section 112 licenses. As such, the terms that are proffered by the participants do not reflect the terms of willing buyers and willing sellers. [FN140]

In Webcaster II, the notion that there could be willing buyers and willing sellers in the webcasting market was impaired by the relative lack of history for the webcasting marketplace. [FN141] Webcasting became broadly feasible in 1995 with the release of RealAudio software which allowed for compressing digital files for Internet transmission while maintaining sound quality. [FN142] Only three years later, in 1998, the Digital Millennium *408 Copyright Act established statutory licenses for use of copyrighted material in webcasts. [FN143] As a result, there was no significant opportunity for a marketplace of willing buyers and willing sellers to develop.

Webcasters vary significantly in terms of sophistication, economic resources, business pressures, and a myriad of other factors. [FN144] Smaller commercial webcasters with limited resources are not in the same bargaining position as larger commercial webcasters. Noncommercial webcasters have an entirely different mission for providing content to listeners than the commercial webcasters. Small commercial webcasters, large commercial webcasters, and noncommercial webcaster have distinct interests as copyright users and different conceptions of

a fair agreement with copyright owners. The uncertainty about what is fair in the webcasting marketplace is also evidenced by SoundExchange's declaration that its private agreements did not indicate fair market rates. [FN145]

The Judges understand their role to be similar to common law judges, but in practice they act as arbitrators between the copyright owners and copyright users because they are setting policy based on the proposals presented by adversarial parties. The Judge's role is further circumscribed to that of final offer arbitrators who choose the more reasonable proposed rates at the expense of the opposition. [FN146] In theory, final offer arbitration will reduce the chilling effect on voluntary negotiation associated with the availability of conventional third-party arbitration by encouraging concessions and settlement before submitting the case to the arbitrator. [FN147] Final offer arbitration is premised on the belief that parties will settle rather than submit the case to the arbitrator because of the risk of a total loss by one party in the arbitration. [FN148] However, empirical evidence has demonstrated that the premise of final offer arbitration is flawed. [FN149] Instead, the existence of procedures to handle dispute resolution promotes their use and does not encourage voluntary negotiation. [FN150] Further, in *Webcaster II*, SoundExchange did not go into the Board proceedings believing that they would suffer a total loss. SoundExchange had a prior victory in Copyright Arbitration Royalty Panel proceedings. [FN151] The CARP *409 decisions are not necessarily controlling over the Board, but are considered for their precedential value. [FN152] The prior victory reduced SoundExchange's uncertainty about the Board's viewpoint in the *Webcaster II* proceedings. [FN153] SoundExchange had limited risk in going forward into Board proceedings rather than reaching a negotiated settlement.

Each side had specific license rate conditions that it was trying to obtain. Webcasters wanted rates that will allow them to grow and profit or to deliver quality programming to a larger audience than can be reached by radio alone. Webcasters are accessible from anywhere in the world and provide listeners with listening options beyond their local radio. SoundExchange, on the other hand, has an interest in obtaining maximum payments for the use of the musical works of its copyright owners. SoundExchange believes that the Copyright Royalty Board determined rates are fair and that setting rates below the Board determination acts as a subsidy to webcasters. [FN154] There was little room to reach an outcome that satisfied the interests of both sides. [FN155] With little room to reach a satisfactory outcome during voluntary negotiation periods, the availability of the Copyright Royalty Board as the final determiner of rates encouraged reliance on its services. [FN156]

VI. CONCLUSIONS

The statutory scheme of the Copyright Royalty Board created by the Copyright Royalty and Distribution Reform Act produced an ineffective administrative agency that fails to meet the Act's goal of encouraging private negotiation. The limited authority of the Copyright Royalty Board to depart from formal rulemaking and the limited ability to use its own expertise results in determinations that do not necessarily achieve socially desirable policy decisions. Private negotiation is not encouraged in this scheme because the parties do not come to the table as willing buyers and willing sellers. Instead, each side believes social policy favors its side, and in the case of SoundExchange, prior precedent from the Copyright Arbitration Royalty Panels supports this position.

Statutory royalty payments in a dynamic industry sector require a system in which rates can change as needed in light of changing realities. The organized nature of copyright owners versus the disparate interests of copyright users ensures the continued need for a statutory system to deliver *410 the policy goals of broad access to the copyrighted materials and fair return for the copyright owners. Simply giving statutory authority to

private contracts does not satisfy the needs of this dynamic sector. Instead, the incentives of the Copyright Royalty Distribution and Reform Act have maintained a system of uncertainty and inefficiency that it sought to do away. As Congress considers reforms to this statutory scheme or to other administrative ratemaking systems, Congress must be cognizant of the effects of improper incentives where the delegated policy makers are impotent to act.

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[FN1]. Copyright Royalty and Distribution Reform Act of 2004, Pub. L. No. 108-419, 118 Stat. 2341 (2004); H.R. Rep. No. 108-408, at 18 (2004).

[FN2]. Digital Performance Right in Sound Recordings and Ephemeral Recordings, 70 Fed. Reg. 7,970 (Feb. 16, 2005).

[FN3]. Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084 (May 1, 2007).

[FN4]. *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748 (D.C. Cir. 2009).

[FN5]. Digital Performance Right, 70 Fed. Reg. at 7,970.

[FN6]. See, e.g., Rogelio Garcia, Cong. Res. Service, Federal Regulatory Reform: An Overview 2 (May 2001).

[FN7]. *Id.* at 1.

[FN8]. H.R. Rep. No. 108-408, at 24.

[FN9]. H.R. Rep. No. 108-408, at 18.

[FN10]. *Id.*

[FN11]. See, e.g., Small Webcaster Settlement Act of 2002, Pub. L. No. 107-321, 116 Stat. 2780 (2002).

[FN12]. 37 C.F.R. § 301.1 (2007).

[FN13]. 17 U.S.C. § 801 (2007). This method of appointment raises certain constitutional Appointment Clause concerns that have been noted by the D.C. Court of Appeals.

[FN14]. 17 U.S.C. § 801(b)(1) (2007).

[FN15]. 17 U.S.C. §§ 114(f)(2)(B), 112(e) (2007).

[FN16]. 17 U.S.C. § 114(f)(3), § 112 (e)(5) (2007).

[FN17]. Louis L. Jaffe, *Judicial Control of Administrative Action* 35, 37 (1965).

[FN18]. *Republic Aviation Corp. v. Nat'l Labor Relations Board*, 324 U.S. 793, 800 (1945).

[FN19]. Id.

[FN20]. Charles G. Stalon, [Regulating in Pursuit of Efficient and Just Prices](#), 8 *Admin. L.J. Am. U.* 913, 914-915 (1995).

[FN21]. Jim Rossi, *Regulatory Bargaining and Public Law 1* (2005).

[FN22]. Stalon, *supra* note 20, at 915.

[FN23]. Id.

[FN24]. Kenneth Burton & Dennis Swann, *Regulatory Reform: The Way Forward*, in *The Age of Regulatory Reform* 321 (Kenneth Burton & Dennis Swann eds., 1989).

[FN25]. Id. at 324.

[FN26]. Department of Justice, *Attorney General's Manual on the Administrative Procedure Act* 15 (1947).

[FN27]. 17 U.S.C. § 801(b)(1)(A), (B) (2007).

[FN28]. *H.R. Rep. No. 108-408*, at 24.

[FN29]. 17 U.S.C. § 114(f)(3), § 112 (e)(5) (2007).

[FN30]. Id.

[FN31]. 17 U.S.C. § 803(c) (2007); 37 C.F.R. § 351, et seq. (2007); Brief for Appellee at 25, [Intercollegiate Broadcasting System v. Copyright Royalty Board](#), 574 F.3d 748 (D.C. Cir. 2009) (No. 07-1123).

[FN32]. See generally 17 U.S.C. § 803(b) (2007); 37 C.F.R. § 351 (2007).

[FN33]. 17 U.S.C. § 803(c)(3) (2007).

[FN34]. Brief for Appellee at 25, [574 F.3d 748](#).

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[FN83]. Id.

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[FN87]. [Digital Performance Right, 72 Fed. Reg. at 24,084.](#)

[FN88]. *Id.* (Royalty Logic, Inc. also participated as a representative of copyright owners but its impact was minimal).

[FN89]. *Id.*

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[FN92]. *Id.*

[FN93]. *Id.*; [Intercollegiate Broad. Sys., 574 F.3d at 754.](#)

[FN94]. [Digital Performance Right, 72 Fed. Reg. at 24,084.](#)

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[FN109]. Musser, *supra* note 40, at 1.

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[FN137]. 17 U.S.C. 114(f)(2)(B) (2007).

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[FN146]. See Dean G. Pruitt, *Negotiation Behavior* 224 (1981).

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