Digital Music

Don’t Believe the Hype: Spotify Is Right to Challenge Mechanical License Demands for Interactive Streaming

Spotify incurred the wrath of the music publishing industry when it suggested recently that it did not need mechanical licenses for on-demand music streaming. While Spotify’s position has been portrayed as a radical break from industry consensus, both history and the law are on Spotify’s side.

BY TODD LARSON

Spotify has come under withering attack from the music publishing industry in past weeks for taking the position, in response to yet another music publisher lawsuit, that on-demand streaming does not require mechanical licenses from songwriters and music publishers.

David Israelite, president of the National Music Publishers Association, led the charge, arguing that it was a “settled legal issue” that such licenses were required and declaring that to argue otherwise was an act of “war.” The plaintiffs’ brief responding to Spotify’s motion called Spotify’s argument “knowingly frivolous” and at odds with “universal authority on the subject” and “industry consensus.”

The music press uncritically joined the pile-on, echoing the argument that Spotify is brazenly rewriting settled law and disrespecting songwriters.

This is wrong. There is no such settled view of the law on this front. For years, the music streaming services have acceded to mechanical licensing requirements for on-demand streams not as a result of any binding legal decisions or shared understanding of the law, but because they were able to negotiate private agreements with the music publishers that offered significant concessions in exchange—concessions that allowed fledgling streamers to avoid costly rate-setting litigation and mitigate copyright infringement exposure.

While the streamers had good reasons for entering into those deals, the law remains on their side that on-demand streaming does not require mechanical licenses where copies of songs are not delivered to users.

The Rights in Dispute

Before discussing why Spotify is right to challenge the music publishers’ position, it is important to review the copyrights at issue.

Section 106 of the Copyright Act gives music publishers the exclusive right to reproduce and distribute their songs in the form of “phonorecords”—what is commonly referred to as the “mechanical” right. Section 115 makes this mechanical right subject to a compulsory license that allows not only for traditional distribution in vinyl and CDs, but as “digital phonorecord deliveries” (DPDs), which it defines as “each individual delivery of a phonorecord by digital transmission of a sound recording which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording.”

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What this means is that online services that distribute copies of recordings to consumers in the form of DPDs (downloads from the iTunes store, to take a less controversial example) must obtain mechanical licenses from music publishers, and can rely on the Section 115 compulsory license to do so in the absence of a negotiated license. It is Spotify’s alleged failure to secure mechanical licenses for certain of the songs available on its service—and its subsequent claim that such licenses may not actually be necessary—that has caused the recent eruption.

It also is useful, before continuing, to recall that on-demand, or interactive, services (the two terms tend to be used interchangeably) typically offer two distinct forms of delivery that are quite different from a technical (and, as we’ll see, copyright) perspective.

The first, on-demand streaming, involves a real-time transmission of a song from service to listener that does not store a copy of the song on the listener’s computer or phone for post-stream listening: the bits flow in, the user’s device “plays” them audibly, and they flow out, replaced by new bits corresponding to later portions of the song or other content.

The second form of on-demand delivery is what traditionally has been referred to as “limited” or “conditional” downloads. Here, the service delivers a full copy of the song that remains resident on the user’s device, not unlike a download offered by iTunes or Amazon except that the track is deleted and/or disabled when the user’s subscription ends (and hence is “limited” rather than permanent). When the user chooses to listen to that song, she listens from that local copy, not from a stream delivered by the service. (This innovation was originally intended to accommodate bandwidth limitations and slow internet streaming speeds, and now allows users to avoid data charges and to enjoy their playlists while on subways, planes, and in other offline locations.)

It is imperative to separate these two activities in any analysis of copyright license requirements. Limited downloads constitute private copies stored on user devices that can be listened to repeatedly after being transmitted. They are deliveries of a phonorecord—DPDs—that clearly implicate the reproduction and distribution rights. (They do not implicate the performance right, but that’s a topic for another day.)

On-demand streams, by contrast, are public performances. Aside from song fragments momentarily stored in buffers during the stream (an important “aside” we’ll return to below), they result in no fixed copy available for later listening, begging the question—now appropriately raised by Spotify—as to why mechanical license payments are necessary in addition to the public performance license royalties Spotify already pays to the very same publishers for those very same streams.

The arguments made by music publishers, which we turn to next, have not yet answered that question.

**Industry “Consensus”?**

The publishers’ primary argument appears to be that everyone in the industry, Spotify included, agrees that interactive streaming requires a Section 115 license. Spotify, they point out, has in fact taken such licenses, represented to the Copyright Royalty Board and Copyright Office that it does so, and settled nearly identical previous lawsuits for its failure to do so.

The CRB, for its part, has twice set compulsory mechanical license rates for interactive streaming, and is about to do so again (for the 2018-2022 license period) in a proceeding in which Spotify and the other leading interactive streamers participated and proposed rates applicable to on-demand streams.

An initial and obvious response to this argument is that the mere fact that digital streamers have agreed to take certain licenses in the past—or that publisher-aligned entities like the Harry Fox Agency administer them—does not mean the services need such licenses as a matter of law, are infringing without them, or believe that to be the case. Such concessions and bargains happen all the time for obvious reasons—avoiding litigation costs, getting concessions that run in the other direction, removing any hint of statutory damage exposure—without “settling” the law.

As it turns out, precisely such concerns, and not any real agreement on legal principal, are in fact what drove the purported “industry consensus” now trumpeted by the publishers. For years, through a series of privately negotiated, industry-wide agreements, on-demand services have grudgingly agreed to take service-wide mechanical licenses and acceded to recitations that such licenses are necessary only because they needed, and obtained, valuable contractual concessions from the publishers that allowed them to operate with some confidence they would not be sued out of existence.

Such a tradeoff was evident in the 2001 agreement between the RIAA, NMPA and the Harry Fox Agency that allowed the first subscription on-demand services, Pressplay and MusicNet (then owned by RIAA-member major labels) to launch. That agreement allowed the services to obtain mechanical licenses on a “bulk” basis, retroactive to the date of request, from any one owner, and thus to avoid the incredibly burdensome track-by-track notice process required under Section 115 (the very process that has now tripped up Spotify).

The 2001 agreement also came with the understanding that server and other intermediate copies made during the streaming process, whether or not distributed to end users, would be covered under the statutory license without additional fees or license requirements. Finally, NMPA agreed that noninteractive webcasting did not require reproduction licenses and could be pursued solely with performance licenses.

The price for these concessions was a $1 million advance from the streaming services, an agreement that mechanical licenses were required for such services, and a promise (via a “silencer” clause in the agreement) that the digital services wouldn’t argue the contrary in other cases.

The same basic tradeoffs were reflected in the industry-wide agreement that settled the Copyright Royalty Board Phonorecords I proceeding—the first such proceeding to address interactive streaming—in 2008. The streaming services got mechanical rates they could live
with (and that netted out performance-rights payments) and avoided the cost and unpredictability of CRB litigation.

The services also obtained the continued promise that noninteractive streaming did not require mechanical licenses and could be pursued solely with performance licenses, regardless of server and buffer copies. This represented a particularly valuable concession given the greater popularity of webcasting at the time, not to mention the fact (discussed in more detail below) that both the Cartoon Network litigation and the Copyright Office’s Section 115 rulemaking proceeding were, at that very moment, questioning that conclusion.

Given the value of the publisher concessions, accepting that on-demand streams required mechanical licensing wasn’t all that much of a “give” by the streamers, especially when interactive services already needed to obtain such coverage for their limited downloads. Nor would prevailing on the point have saved the services any money in the end: the agreed-upon royalty formula was based on a percentage of service revenue (roughly 10.5 percent less performance payments) that did not fluctuate based on the number or scope of covered plays.

The Streamers’ Take

Despite their willingness to sign on to industry-wide settlements, the on-demand streaming services never disguised their view that mechanical licenses were not actually required as a legal matter for pure on-demand streaming. In fact they made that argument repeatedly and publicly.

For example, prior to settling the Phonorecords I proceeding, the Digital Media Association (the trade organization representing the digital streaming community) took the position before the CRB that the royalty for on-demand streams should be zero. They then asked the Copyright Office to take up the “novel question” of whether a mechanical license for on-demand streaming was required at all (a motion denied for procedural reasons). DiMA and groups such as the Electronic Frontier Foundation likewise opposed publisher efforts to “reform” Section 115 to specify that interactive streaming involved a delivery or distribution right.

When the Copyright Office opened a rulemaking specifically questioning the applicability of the Section 115 license to digital streaming, the digital services (at least those who weren’t contractually gagged) were united in their view that on-demand streaming did not require mechanical licenses as a matter of law: “That some commercial entities may have agreed to take Section 115 licenses for interactive music audio streaming as an alternative to litigation,” stated Google and its fellow streaming services, “does not change the status of such interactive streaming as a matter of statutory construction” (Comments of Ad Hoc Coalition of Streamed Content Providers, at 3 (Aug. 28, 2008)).

Where’s the Copy?

Another common refrain from publishers is that interactive streaming requires mechanical licensing because, well, it’s interactive. As opposed to noninteractive webcasting, the argument goes, on-demand streams are the future of music distribution, a growing substitute for mechanical-royalty-generating CD and download sales, and thus more valuable (to both streamers and content owners) than its radio-like counterpart. Technical niceties about copies made during delivery shouldn’t jeopardize a dependable income stream. (And did we mention it’s interactive?)

Whatever the attraction of this argument as matter of policy, both the Copyright Office and Copyright Royalty Board have been clear that the music publishers’ legal entitlement to a mechanical royalty “is not dictated by the characterization of the transmission that delivers the phonorecord as interactive or noninteractive,” but is instead a question of fact very much predicted on technical details: namely, does the stream result in the delivery of a phonorecord (a “specifically identifiable reproduction”) to the user? Depending on the answer to that question, “a stream—whether interactive or non-

2008 CRB settlement agreement was in the process of being extended by the various industry participants through 2017.

As the new kid on the block, the company was not in a position to scotch that settlement or to press forward with CRB litigation on its own. Its willingness to pay the settled rates reflected that hard reality (and the attendant benefits and tradeoffs of the settlement) more than any concession of the underlying legal principles.

Nor does the fact that the CRB codified the industry-wide settlement in the Section 115 regulations (which state that services offering interactive streams “shall comply” with such regulations) suggest that the CRB itself somehow settled the issue. The interactive streaming rates and regulations were drafted by the parties involved and submitted to the CRB for publication and adoption, nothing more. And while those regulations specify rates for services who choose to avail themselves of the compulsory license, the regulations do not purport to opine on whether a particular service or activity does or does not implicate the rights at issue or require the license in the first place.

To the contrary, 37 C.F.R. § 385.10(c) makes clear that “neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.”

Indeed, when the parties to the 2008 settlement tried to include language in the proposed regulations affirmatively stating that “[an] interactive stream is an incidental digital phonorecord delivery,” the Copyright Office called that an “erroneous” and “overbroad” proposal that “would include interactive streams that do not result in the delivery of a DPD.” 74 Fed. Reg. 4537, 4541. The Judges promptly struck the offending language from the proposed regulations—and with it any possible suggestion that those regulations offered a binding legal conclusion about the licenses required for any given service category.
interactive—may or may not result in a DPD.” 74 Fed. Reg. 4539.

The publishers identify no such phonorecords. They do point out, to be sure, that Spotify makes and distributes copies in the form of limited downloads. But they use that to argue that Spotify and other interactive services need mechanical licenses across the board, including for on-demand streaming, bypassing any consideration of whether such streaming itself results in a licensable reproduction and distribution of a phonorecord to the user.

The reason for this shortcut is not hard to discern: there are no such copies. Whether non-interactive or interactive, whether the user selects the song or the service decides, there is no full-song copy accessible to the user after the stream unless the user actively initiates a download. As the Copyright Office memorably noted in its 2001 DMCA Section 104 Report, “at the end of the transmission the consumer is left with nothing but the fond memory of a favorite song.”

The Copyright Office stated this more pointedly in its Prepared Statement addressing the Section 115 Reform Act of 2006 (SIRA), in which it said that a “stream does not . . . constitute a ‘distribution,’ the object of which is to deliver a usable copy of the work to the recipient,” and thus “should not be considered a DPD as that term is presently defined by 17 U.S.C. 115(d), because it most likely does not result in ‘a specifically identifiable reproduction by or for any transmission recipient of a phonorecord.’”

“Characterizing streaming as a form of distribution is factually and legally incorrect and can only lead to confusion in an environment where the concept of distribution by means of digital transmission is already the subject of misguided attacks,” the agency said.

The Case for Buffer and Server Copies

This returns us, finally, to the incidental copies created in the course of on-demand streaming: buffers, server copies, and the like. Absent a download of a track, such “copies,” it would seem, represent the only possibility of a reproduction and/or distribution of a song requiring a license. For several reasons, this is a challenging and unattractive argument for the music publishers.

As to buffer copies, the Second Circuit has already held, in the leading case on the topic, that fragments of a copyrighted work buffered in the process of on-demand video streaming were not licensable reproductions because they were not held in the buffer “for a period of more than transitory duration,” were “rapidly and automatically overwritten” once processed, and therefore were not “fixed” under Section 101 of the Copyright Act. See Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121, 127-130 (2d Cir. 2008). That holding would appear to apply to audio streaming as well.

To wit, in the wake of the Second Circuit’s decision, the Copyright Office pulled back a draft rule it previously had proposed that would have declared “Recipient-end Buffer Copies” created in the process of on-demand music streaming to be DPDs subject to the Section 115 statutory license. The Copyright Office cited the “uncertainty” around the topic engendered by the Cartoon Network case, and returned again to its 2006 Prepared Statement on SIRA, in which it had written that “the buffer and other intermediate copies or portions of copies that may temporarily exist on a recipient’s computer to facilitate the stream . . . simply do not qualify” as distributions. Since that decision to “take no position” and “leave open the question whether buffer copies may be DPDs” (73 Fed. Reg. 66,173), the Copyright Office has not opined on the issue again.

The Copyright Office has also taken the position that such buffers, even if amounting to cognizable reproductions, would be a fair use. In its 2001 DMCA Section 104 Report, it said that the de minimis portion of a song resident in the buffer at any given time was necessary “solely to render a performance that is fully licensed,” had “no economic value independent of the performance it enables,” and “merely facilitates an already existing market for the authorized and lawful streaming of works.”

Worse, the Copyright Office noted that by seeking a mechanical royalty in addition to performance fees, “copyright owners are seeking to be paid twice for the same activity.” “Demanding a separate payment for the copies that are an inevitable by-product of that activity appears to be double-dipping,” the DMCA report said.

That same logic would appear to apply equally to server copies, which, although constituting persistent copies of entire songs, likewise exist solely to enable a licensed performance for which the publisher is already paid, and for which there has never been any separate licensing market or assigned economic value apart from the performance license fees.

Going after server copies (and buffer copies, for that matter) would also run publishers headlong into an even more daunting political obstacle: to the extent they were to succeed in arguing that such copies give rise to a separate reproduction license requirement for interactive streamers, such arguments would very likely apply to noninteractive audio and video streams as well, potentially creating new license obligations for a wide range of services outside the narrow context of interactive streaming.

As a technical matter, buffer and server copies aren’t materially different regardless of whether the song streamed is chosen by the user or for the user. As the Copyright Office has explained, “if phonorecords are delivered by a transmission service . . . it is irrelevant whether the transmission that created the phonorecords is interactive or non-interactive” (73 Fed. Reg. 66,173, 66,180).

The Copyright Office has also shot down the suggestion that DPDs created by non-interactive streamers should—if created—be exempted from mechanical license liability because they have less “economic impact” than interactive streams, stating in no uncertain terms that “any such distinctions can and should be handled by different rates rather than being based on an unfounded assertion that non-interactive streaming cannot involve the making and distribution of phonorecords” (Id. at 66,181).

If that view were to hold, any attack on interactive services for their server and buffer copies effectively would be an attack on noninteractive services for their server and buffer copies—something the publishers previously have refrained from doing, and something that could have seismic implications for a wide range of digital services. For example, every webcaster that de-
pends on the Section 114 statutory license to cover its
sound recording performances might find itself needing
to obtain an individual mechanical license for each and
every musical composition embodied in those record-
ings before launching or continuing to operate.

On-demand video streamers, for their part, might
likewise need to obtain reproduction licenses for each
of the millions of songs included in the programs they
offer—and do so without the benefit of any statutory li-
cense. (Section 115 does not cover audiovisual uses.)
Such examples abound.

Concluding Thoughts

The above discussion is not meant to suggest there
aren’t buffer copies of streamed music that could rise to
level of a copy, or server copies that a court might find
to require separate licensing even if made solely in aid
a licensed performance; the publishers certainly have
arguments they could muster to support such holdings.

But they have not done so, likely because that is
much harder to argue—and much messier to litigate—
than just saying everyone has always agreed such li-
censes are required, or pointing to limited downloads
that are obviously delivered.

Among other things, the publishers would need to
demonstrate that there are cognizable reproductions
that are fixed for non-transitory duration, that are more
than de minimis in nature, that aren’t excused as a fair
use, and that don’t sweep in all the other forms of
streaming that occur in our smartphone-dominated, 4G-
connected world.

Until they take on that fight and convince a court
they are right, the only thing “settled” is that the issue
remains unsettled.