How Will the Radio Industry Be Affected by Pre-1972 Music Performers' Fees

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Introduction

Recent court cases have raised the issue of the application of a performance fee for sound recordings made prior to 1972 under state laws. This fee is different and would be in addition to the fees currently paid for musical composition to organizations such as BMI and ASCAP. In a series of cases "Flo and Eddie" have filed suit against the subscription satellite service Sirius, seeking payment under state law for music recorded prior to 1972. Cases have been filed in other states as well.

While the litigation involves Sirius, local terrestrial radio stations have been watching the cases closely. The application of a performance fee recognized under state law and enforced through individual lawsuits significantly changes the underlying model presently used to clear copyrights. Enforcing rights to broadcast sound recordings of pre-1972 recorded music by an assessment of damages in state courts fundamentally alters this business model. It would inject significant uncertainty into the process. This paper addresses the impact on local radio stations if a performance fee for pre-1972 recorded music was applied under state law.

While there has been considerable discussion regarding the economic implications of establishing a performance fee on radio stations under federal law, little has been written on the implications of state law copyright fees. The imposition of such fees raises significant issues about the continued viability of certain radio programming and advertising outlets in local markets. It also raises concerns regarding the ability of some local stations to continue as a source of public interest programming, news and emergency information. The following analysis addresses just a few of the economic issues surrounding the problems associated with extending a performance fee for pre 1972 recorded music. For the purpose of the analysis BIA/Kelsey[1] will focus on New York, which has a wide variety of radio stations in markets of varying size. Focusing on New York is appropriate because it is one of the states that are currently addressing the issue of extending performance rights to pre-1972 recorded music.

In assessing the impact on local radio stations we first examine the universe of stations potentially affected by the application of a performance fee for pre-1972 recorded music. According to BIA/Kelsey's Media Access Pro™ database,[2] there are approximately 86 local radio stations in New York broadcasting formats that could easily include pre-1972 recorded music.[3] This number represents stations that have specific formats, such as oldies, classic rock, or Nostalgia/Big Bands. These stations exist in a variety of different radio markets ranging from New York City to small markets upstate as well as stations not located in any defined radio market.

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[1] The author has been retained by the New York State Broadcasters Association to consult on this matter.

[2] BIA/Kelsey Media Access Pro™ database is a widely used database of all commercial and non-commercial radio and television stations, as well as daily and weekly newspapers. In addition to major broadcast companies as users of this database, government agencies such as the FCC and the U.S. Department of Justice use this service as well.

[3] This count does *not* include the 14 multicast streams that are being broadcast by these stations that carry format that could easily include pre-1972 recorded music.

This number actually underestimates the total number of local stations that may rely on pre-1972 recorded music. There are also a number of stations that play multiple formats in various dayparts. Such stations may include an "Oldies" or "Nostalgia/Big Band" format for only several hours a day. These stations would be adversely affected by the imposition of a performance tax for airing pre-1972 music.

Local Radio Stations Face Highly Competitive Listening and Advertising Markets

Local radio stations find themselves in a very competitive economic environment. They compete for listeners with other local radio stations; satellite delivered audio services, and several online radio streaming services. At the same time, local radio stations compete with other local media for advertising dollars. In the BIA/Kelsey's Media Ad View Plus product sold to many different local media, advertising estimates are provided for twelve different local media that compete for advertiser expenditures targeting local markets.[4] In that wider local advertising market, local radio stations achieve approximately one-ninth of all advertising revenue, trailing direct mail, newspapers, and local television stations.[5] At the same time, other online/digital media are seeing their shares increase providing even more competition in the future for local radio stations.[6]

In such a highly increasingly competitive market, local radio stations select their program type, *i.e.*, format, that will maximize revenue and ultimately profitability. In other words, a station will try to select the most popular program format for its market to attract advertisers, taking into consideration other stations' programming and the ability of the station to profitably provide a particular program format.

Impact of Performance Fees on Stations

Given this increased competition faced by local radio stations, any increase in programming costs resulting from an imposition of a pre-1972 music performers' royalty fee may yield several possible responses from local stations. Station may: 1) attempt to pass costs on to advertisers; 2) seek to screen out pre-1972 recorded music; or 3) shift the programming on the station to a different format. All these alternatives have significant costs associated with them.

Passing Increased Programming Costs on to Advertisers is Unlikely

[4] Those twelve media are: local cable systems, direct mail, email services, Internet Yellow Pages, local magazines, mobile services, pure-play online companies, out-of-home companies, newspapers, Print Yellow Pages, radio stations, and television stations. See http://www.biakelsey.com/Research-and-Analysis/Forecasts/Media-Ad-View/

[5] See http://www.biakelsey.com/Company/Press-Releases/131112-Local-Radio-Maintains-Competitive-Position-in-Local-Ad-Market-with-11.5-Percent-Share-of-Local-Ad-Revenues.asp

[6] See "Mobile Will Grab 11.5% of Total Local Media Revenues by 2019", http://www.biakelsey.com/Company/Press-Releases/150422-Mobile-Will-Grab-11.5-Percent-of-Total-Local-Media-Revenues-by-2019.asp

One potential response of a local radio station to the assessment of performance fees costs could be to pass those additional costs on to its advertiser/customers. As noted above, radio stations find themselves in very competitive markets in selling advertising, and that competition is continually increasing with new media entering the market. Hence, even if radio stations would increase their prices slightly, it would likely lead advertisers to shift to other stations in the market or audio service.

This type of significant response to a price increase is what economists refer to as elastic demand curves. Local as well as national advertisers have a significant number of advertising platforms available to them. Given the availability of these platforms, it is highly unlikely that local stations would simply be able to recoup performance fees by increasing their advertising prices. To the contrary, it is more likely that many local stations facing this situation would not be able to pass these costs on and be forced to internalize these costs. This scenario becomes more likely when, as discussed below, the potential costs may be extremely high, variable and uncertain.

Screening Out Pre-1972 Recorded Music is Problematic

Another alternative action would be for a local radio station to take steps to reduce its risk by attempting to eliminate all pre-1972 recorded music that could lead to increased liability. A few stations may have the technical ability to continue with an "Oldies" "Classic Rock" or "Nostalgia/Big Bands" format by having employees at the stations screen all music before it is broadcast. For music that has been coded by recording date, an employee may be able to screen out such music by computer. Even with this capability, stations will need to devote resources to the screening. For many stations, the issue is whether they can absorb the personnel costs of hiring additional people to pre-screen music. In these instances oldies and classic rock formats would evolve into post-1972 recorded music. (Other formats, such as Nostalgia/Big Bands could be eliminated altogether.) For most stations, especially stations located in medium and small markets, it would be economically challenging to hire additional personal to pre-screen all pre-1972 recorded music.

Additionally, local radio stations also rely on nationally distributed programming services. This music is distributed nationally, and in some cases broadcast immediately once the station receives that network feed. Depending on the terms of the contract, stations attempting to eliminate pre-1972 recorded music from these nationally distributed programming may face a possible suit for breach of contract for such action. Since most states have no liability for pre-1972 recorded music, it is unlikely that these national services would provide an "oldies" or "classic rock" service that excluded such music. In this regard it is unlikely that a nationally distributed radio programming services would simply provide 'New York" stations with a unique feed. Simply stated, stations employing these services would be unable to "sift out" pre-1972 recorded music. Given these difficulties, it is more likely that profit maximizing radio stations would shift and explore other radio formats as discussed below.

Shifting Program Format to a Second Choice

As noted above, local radio stations exist in a highly competitive marketplace for advertising. This translates into a highly competitive environment for securing programming that will maximize audiences. Over the years, the radio marketplace has evolved into a highly "niched" programming marketplace. In such a marketplace there are very few "generalist" formats. To the contrary each station seeks to maximize revenue by focusing on a specific market segment.

Importantly, many of the formats that rely on pre-1972 recorded music are not, from a revenue perspective, the most profitable formats. In terms of revenue, an "Oldies" or "Nostalgia/Big Band" format ranks fairly low (10th and 14th, respectively). In Table 1 we provide advertising revenue generated with the different general format in the 272 Nielsen Audio radio markets.[7]

Table 1 - Radio Station Revenue by Format in Nielsen Audio Markets

Format Category	2014 Advertising Revenue(000s)	Number of Stations
Adult Contemporary	$1,624,325	669
Country	$1,276,050	842
Contemporary Hit Radio / Top 40	$1,275,950	470
News	$1,213,300	859
Spanish	$889,335	818
Urban	$855,775	329
Rock	$702,425	528
Sports	$628,375	551
Album Oriented Rock / Classic Rock	$620,900	309
Oldies	$524,825	500
Religion	$252,995	1,539
Talk	$189,775	232
Ethnic	$64,625	123
Nostalgia/Big Band	$18,150	100

Source: BIA/Kelsey Media Access Pro™

We see this precarious position of these formatted stations in New York when examining their individual revenue. Of the 86 stations that carry one of the formats that could easily include pre-1972 recorded music; we have 2014 revenue estimates for 61 stations.[8] These stations are in markets that range from market ranked 1 (New York City) to market ranked 262 (Watertown, NY), and most of

[7] BIA/Kelsey Media Access Pro™ estimates the revenue for all local commercial radio stations in only the Nielsen Audio radio markets.

[8] The other stations either are not located in Nielsen Audio radio markets or not receive any measurable listening reported by Nielsen Audio.

these stations are ranked in the lower half of all the commercial stations in those markets.[9]The median revenue for that group of radio stations was only $375 thousand.

Many of the stations affected by the imposition of a performance fee on pre-1972 recorded music are not in an economic position to shoulder the additional expense of acquiring more popular formats. As a result, if a performance royalty fee was to be imposed, these stations would have to shift to a less desirable format. As a result, those stations shifting format could be expected to see declines in revenues.

While other formats may be available in the local markets,[10] the formats that these radio stations are currently broadcasting are the ones in which they see the most financial opportunity. The application of a performance fee, and "economically forcing" these stations to a less desirable format would impose additional costs (of switching formats) and reduce the financial viability of these radio stations

The impact of assessing a performance fee on these stations may result in those stations becoming less effective competitors and devoting fewer resources to news or public interest programming in their local markets. From an economic perspective, local markets, especially smaller markets in upstate New York, depend on local advertising platforms to stimulate local economies. Every dollar spent on advertising yields 22 dollars in economic activity.[11] Every million dollars spent on advertising creates 81 jobs.[12] While there are a plethora of advertising platforms nationally, local radio stations are important to stimulate local businesses and job growth. Applying a damages based performance fee for pre-1972 recorded music is likely to undermine the competitive posture of a number of stations in these markets.

The impact would be felt by listeners in local markets. There is a direct link between station profitability and its ability to afford news and public service activities in the community. For example, during emergencies such as Hurricane Irene or Superstorm Sandy radio stations often forego traditional advertising (and revenue) to provide news 24 hours a day. According to Arbitron, during Superstorm Sandy radio listenership increased by 245% in storm ravaged Nassau and Suffolk Counties and by 70% in Manhattan.[13] FEMA Administrator Craig Fugate has consistently told

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[9] Media Access Pro™ BIA/Kelsey.

[10] The variety of formats in any particular market will depend on the size of the market. Larger markets will have a greater variety of radio formats and other media options.

[11] INS Global Insight, "*The Economic Impact of Advertising Expenditures in the United States 2012-2017*," January 2014 at 2., found at http://images.politico.com/global/2014/01/13/economicimpact.pdf

[12] *Id.*

13 Sisario, Ben, "*After Hurricane Sandy, People Flock to Radio for Information*," November 18, 2012 at http://mediadecoder.blogs.nytimes.com/2012/11/18/after-hurricane-sandy-people-flock-to-radio-for-information/?_r=0; All Access, *"Radio Listening Explodes During Superstorm Sandy in New York Metro Area"* November 19, 2012 at http://www.allaccess.com/net-news/archive/story/112711/radio-listening-explodes-during-superstorm-sandy-i

Americans that in all markets radio may be the only source of information during emergencies.[14] Moreover, public service by radio stations is not limited to emergency situations. Every day, New York radio stations are providing local news, public service programs as well as helping to support local charities in their communities.[15] Applying court imposed performance fees for pre-1972 sound recordings makes it less likely that stations affected by the new fees will be able to afford these important public service efforts.

The potential impact on local radio stations by imposing a fee on pre-1972 recorded music will depend on the amount of the fee. While it is impossible to predict possible jury awards, there are some indications that the fees could be significant.

Imposition of Performance Fees for Pre-1972 Recorded Music Under New York Law Could Be Significant

Damage Assessments Unpredictable

Unlike copyright fees paid pursuant to federal law, damage fees assessed by local juries for broadcasting pre-1972 recorded music in New York will be unpredictable and could easily be extremely high. There would be no overarching federal entity that would establish rates that would try to balance the conflicting goals of promoting distribution of sound recordings while ensuring copyright holders receive payment. There is no schedule or administrative mechanism in New York to rationally assess and allocate the fees, unlike fees paid through the federal copyright royalty board to the producers and performers of sound recordings. Rather the amount of performance fees to be paid for broadcasting pre-1972 recorded music will be based on an assessment of damages as determined by local juries. As with any litigation, it is often difficult to assess how any one particular jury arrive at a damages calculation. Nonetheless several aspects of a "damaged-based" performance fee system are certain:

- Awards will vary considerably depending on the county and court in which the case is brought. Even in cases brought within the same county, awards may vary considerably from case to case. There is no rational way a station could anticipate the actual costs of broadcasting sound recordings of pre-1972 recorded music.
- Most common law copyright actions are accompanied with other causes of action, such as unfair competition which may raise a different set of damage parameters.
- A station licensed to states bordering New York may be confronted with suits filed in New York because its signal crosses state lines.

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[14] The Hill, "*FEMA Administrator Warns of Cellphone Vulnerabilities During Disasters,*" October 20, 2014 at http://thehill.com/policy/technology/221301-fema-administrator-warns-of-cell-vulnerabilities-during-disasters

[15] For example, over the past three years hundreds of radio stations in New York have been recognized for their public service activities. *See* e.g., New York State Broadcasters Association, *Serving New York A public Service Campaign*" 2014 Recipients at http://nysbroadcasters.org/serving-new-york-a-public-service-campaign/ ;

- Because traditional statutes of limitations may apply, stations may be liable for the broadcast of sound recordings up to 3 years prior to the date on which the lawsuit is filed.
- Regardless of actual outcome, radio stations will bear enormous litigation costs, defending themselves from multiple lawsuits that may be filed by numerous performers or companies that own the rights to these sound recordings.

Because there has never been a case involving a performance fee under New York Common law, it is impossible to know how any particular jury will assess damages in any particular case. Nonetheless, there are some data which may provide some insight as to the industry-wide economic impact of imposing a performance fee on pre-1972 recorded music under state law. At best these analyses provide a range of possible economic costs. By no means would they be predictive of possible damage claims in any particular case.

Economic Estimates Show a Range of Significant Costs

In 2010 the GAO was asked to assess the potential impact of enacting a performance fee on local radio stations under a legislative proposal providing for a flat statutory fee for stations with revenues under $1.25 million.[16] Accordingly, it does not provide insight as to the impact on small stations. Nonetheless, radio stations with revenues of $1.25 million or more were required to negotiate their fees based on several statutory factors. To assess the impact on stations, the GAO study examined the impact of a performance fee assessed to stations based on a "zone of reasonableness" for performance fees in the 2006 rate proceeding for satellite digital audio radio services (SDARS).[17] In that analysis, GAO assumed that the cost to stations may range from 2.35 percent to 13 percent of annual station revenues for a performance fee.[18] Indeed the median range of payments was 7.25 percent of annual revenues. The total impact on all radio stations could range from $258 million to $1.3 billion annually. Each percentage increase the rate could cost the industry and additional $101 million in total royalties annually.[19]

A number of other sources have attempted to assess the potential costs of performance fees. While the estimates vary considerably, they may provide a range for assessing the potential impact on an industry wide basis. For example, the Congressional Research Service found that the performance fees currently paid by entities for streaming amounted to 22.5% or $1.7 billion of the major record companies' revenues.[20]

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[16] Government Accountability Office, "Telecommunications: The Proposed Performance Rights Act would result in additional costs for Broadcast Radio and Additional Revenue for Record Companies, Musicians and Performers," August 2010.

[17] *Id.* at 23.

[18] Id.

[19] Id.

[20] Scherer, Dana, Congressional Research Service, *Money for Something: Music Licensing in the 21st Century, April* 16, 2015 at 6 and 11.

Another study estimated that applying the performance fee currently applicable for streaming to terrestrial radio stations could increase station costs in the range from $2.5 to $4.7 billion per year. [21] Performance fee payments could represent approximately 37.8 percent the radio industry's revenues.[22] SNL Kagan examined the performance fees paid for digital streaming, and estimated that performance fees paid by radio stations may average about 3% of total station revenue, but could climb to 6% of total station revenue.[23]

A third way to look at the possible economic impact on radio stations is to consider the most recent "settlement" involving music recorded prior to 1972. The record labels represented by the Recording Industry Association of America announced a settlement with Sirius for $210 million. The settlement with Sirius would allow the satellite service to broadcast RIAA's pre-1972 recorded music catalogue through 2017.

We recognize that extrapolating the proposed Sirius settlement to local broadcast stations in far from precise. There are a number of important factors that differentiate local radio stations from a nationally distributed subscription satellite service. Moreover, the settlement may not accurately reflect the costs involved in damage awards by juries throughout the state of New York. While such an extrapolation is not perfect, it may be somewhat instructive on the possible impact on local radio stations.

Assume that the "national" settlement with Sirius reflects the potential fee for the nationwide distribution of "oldies" content. Based on BIA data, there are approximately 1,850 local radio stations nationwide broadcasting oldies, classic rock or Nostalgia/Big Band formats which could include pre-1972 recorded music. Simply dividing the number of radio stations broadcasting this music nationwide into the "national" settlement cost of $210 million over a two year period, reveals a potential cost of $113.5 thousand per station over a two year period or approximately $57 thousand per year.

Applying this assessment to New York stations reveals that there could be a significant economic problem for local stations. When compared to the median income for these stations of $375,000, obtaining the rights to broadcast sound recordings of pre-1972 recorded music could amount to 15 percent of a station's revenue. Even this amount may dramatically underestimate the potential costs to stations. Assessing damages for local radio broadcasts may give rise to different considerations. Moreover, the settlement does not include the entire universe of potential "rights holders" that may seek to file a claim. For example, the settlement apparently does not include Flo and Eddie claims. Other performers and companies that have obtained these rights would no doubt seek similar arrangements. In addition, there is the question of retroactive payments. Because the New York statute of limitations is 3 years, stations could be responsible for paying performance fees for a three

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[21] People Glen, Billboard "Business Matters If Big Radio had Pandora Rates It would Owe billions, November 20, 2012 (Quoting and analysis by David Touve available at http://davidtouve.com/2012/11/19/2-5-billion-the-big-numbers-that-big-radio-could-owe-each-year-if-it-paid-music-royalties-at-pandoras-rates/

[22] Id.

[23] Cheen, Bishop, "Radio v. the music business; an update on discord," SNL Kagan Financial Blog, April 12, 2015.

year period prior to the date on which the lawsuit is filed. Nonetheless, there could be significant liability for stations, thereby completely changing the current business models for these stations.

It is important to recognize that the cost analysis presented above is not definitive. The figures and amounts presented by the GAO and other economists assume an orderly regulatory model for collecting and clearing rights. The streaming analysis assumes existing, well established copyright law. These estimates do not include the additional costs that may be awarded by juries when assessing damages. As noted above, they do not include the millions of dollars that may be extended in litigating these issues. In this regard, even the Sirius analysis is based on a national subscription service, and not an assessment based on individual stations in local markets. Therefore it is entirely possible that jury awards and the costs of litigating could be much higher. Because there is no precedent under New York law for this kind of copyright liability, the real costs to individual stations remains very risky and uncertain.

Finally, we note that the radio broadcasting's economic model is vastly different from a subscription satellite service. Unlike satellite services, that can pass some of the costs on to their subscribers, local radio stations will be unable to pass most of these costs on to their advertisers. As noted above, many stations would have to absorb these costs. Nonetheless, the data seem to indicate that the costs of a pre-1972 performance fee may be beyond the economic reach of many stations.

Conclusion

The situation facing many radio stations is very challenging. Where at one time they only had to compete with other radio stations for listening, they now face many more audio options. Additionally, where once they only had to compete with their local newspapers and television stations for local advertising expenditures, they now have to compete with many more different types of media.

In order to compete in these two arenas, local radio stations choose different types of programming, i.e., formats. Given the vast number of local radio stations and other options, some of these radio stations choose formats that could easily include a substantial amount of pre-1972 recorded music. These formats are not generally the highest revenue and highest profitable types of programming, but over time, the competition in these local radio markets has led owners of local radio stations to choose such formats. While surviving, these radio stations are generally not generating large amounts of revenue, and thus, are marginally profitable.

This is the case with the radio stations airing these formats in New York. If the pending lawsuit leads to an imposition of a new performance royalty fee for all pre-1972 recorded programming, the impact on these stations could be quite dire. The amounts that may be imposed for airing this programming in the recent past may tax these stations dramatically. Moreover, these stations may be forced to either go off the air or move to a second best alternative format as a result.

About BIA/Kelsey

BIA/Kelsey is a market research and analyst firm that focuses on all things local. Local media is an increasingly dynamic area of ad spending and is quickly evolving with emerging digital platforms like mobile, social and search.

Over the past three decades, BIA/Kelsey has been an authority on these developing technologies as well as their forbearers in traditional media, which continue to transform as they likewise compete for local ad dollars and consumer affinity.

Through a suite of products that include research reports, articles, conferences and client consulting, BIA/Kelsey analyzes the financial, social and technology trends affecting local media.

Readers, event attendees and clients are given the inside track on data, analysis and tactics needed to grow and transform in a rapidly evolving media and advertising landscape.

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Mark Fratrik is a senior vice president of BIA/Kelsey. He serves as the company's chief economist and is responsible for forecasting across all local media segments. He also manages BIA/Kelsey's numerous proprietary databases and conducts primary research on various trends as they affect the broadcasting and related communications industries. Additionally, Fratrik is heavily involved in the company's strategic and financial consulting projects, conducting research and analysis for clients on matters related to the broadcasting, digital media and related communications industries.

Throughout his career, Fratrik has researched and spoken at numerous conferences on the impact of the economy on the broadcasting industries, proposed and enacted regulatory changes, and new media technologies, including DTV datacasting. He is often quoted in the media and is a leading spokesperson concerning trends and forecasts for the media industry including analyzing competitiveness of media and related industries.

Fratrik received his B.A. in mathematics and economics from State University of New York at Binghamton and his master's and doctoral degrees in economics from Texas A&M in College Station, Texas.