Copyright Board Canada

Commission du droit d'auteur Canada

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Regime Collective Administration in Relation to Rights Under Sections 3, 15, 18 and 21 *Copyright Act*, subsection 70.15(1)

Members Mr. Justice William J. Vancise
Mr. Stephen J. Callary
Mrs. Francine Bertrand-Venne

Statement of Royalties to be collected by CMRRA/SODRAC INC. for the reproduction of musical works, in CANADA, by online music services in 2005, 2006 and 2007

Reasons for decision

I. INTRODUCTION

[1] Online services are changing the way we listen to and use music. More than ever, music listening is moving from the home or car to the street, to the metro, to the jogging track or to the office. Everywhere one looks, young people, old people and people in-between are going about their business hooked up by ear buds to iPods or MP3 players.

[2] Online services are also changing the way people buy music. CDs still hold the lion's share of the market, but paid downloads are growing at an exponential rate. In 2005, permanent downloads represented $28.6 million or 3.6 per cent of Canadian retail music sales; this more than doubled in 2006. Apple sold more than 20 million iPods over the 2006 holiday season. One market research firm predicts that worldwide revenues from mobile full-track downloads will increase by more than 600 per cent between 2006 and 2011.[1]

[3] On March 31, 2004, CMRRA/SODRAC Inc. (CSI) filed, pursuant to subsection 70.13 of the *Copyright Act* (the "*Act*"), a statement of the royalties it proposes to collect for the reproduction, in Canada, by online music services in 2005, 2006 and 2007, of musical works in the combined repertoires of the Canadian Musical Reproduction Rights Agency (CMRRA) on the one hand, and

[1] Exhibit CSI-27.A, Tab C, *Mobile Music, Juniper Research*, at page 157.

of the *Société du droit de reproduction des auteurs, compositeurs et éditeurs au Canada* and SODRAC 2003 Inc. (SODRAC) on the other. The statement was published in the *Canada Gazette* on May 1, 2004. Potential users and their representatives were notified of their right to file an objection no later than June 30, 2004.

[4] Apple Canada Inc. (Apple), Napster LLC (Napster), Bell Canada (Bell), the Canadian Association of Broadcasters (CAB), the Canadian Broadcasting Corporation (CBC), the Canadian Cable Telecommunications Association (CCTA), the Canadian Recording Industry Association (CRIA), CHUM Ltd., EMI Music Canada (EMI), Archambault Group Inc., Moontaxi Media Inc., MusicNet Inc., RealNetworks Inc., Sirius Canada, Sony BMG Music Canada (Sony), TELUS, Universal Music Canada (Universal), Warner Music Canada (Warner) and Yahoo! Canada filed timely objections. *L'Association québécoise de l'industrie du disque, du spectacle et de la vidéo* (ADISQ) and Rogers Communications Inc./Rogers Wireless Partnership (Rogers) were granted leave to intervene. Before the hearings started, ADISQ, Archambault Group Inc., CCTA, CHUM Ltd., Moontaxi Media Inc., MusicNet Inc., RealNetworks Inc., Sirius Canada and Yahoo! Canada withdrew from the proceedings, while CBC and TELUS withdrew their objections but applied for leave to intervene; these applications were denied.

[5] The hearings started on September 6, 2006 and extended over ten days. Those who participated in the hearings were CSI on the one hand, and Apple, Bell, Rogers, CRIA and its Class A members (EMI, Sony, Universal and Warner), as well as CAB (collectively "the Objectors") on the other. The record of the proceedings was closed on September 29, 2006, when CSI and the Objectors filed their written arguments.

II. BACKGROUND

A. THE TARGET OF THE TARIFF

[6] The development of the technology used to store sounds in a digital format began in the late 1970s. The first digital musical product, the prerecorded CD, was launched in 1983. Over the next decade or so, it radically changed the music business. We are now in the midst of experiencing the next radical change: the authorized download over the Internet of digital files containing sound recordings of musical works. These reasons deal with three types of online music offerings: permanent downloads, limited downloads and on-demand streaming.

[7] A permanent music download is a file that contains a sound recording of a musical work. That file is generally sent to and stored on the device (computer, cell phone) used to purchase it. The purchaser is then authorized to copy the recording onto MP3 players or other devices, such as a computer or digital audio recorder, or onto a blank CD. The number and kind of copies that can be made is determined by the terms of purchase and controlled through the digital rights management (DRM) software attached to the file.

[8] Limited downloads are generally offered with on-demand streams, as part of a subscription service. From a technical point of view, limited and permanent downloads are identical. The difference lies in what the DRM software allows the user to do. The subscriber may copy the recording onto other computers, sometimes even onto a portable music player. The DRM software allows the use of the original file and copies as long as the subscription is maintained; if it expires, the user will retain the file and copies but the DRM will prevent the user from listening to the recording or from making further copies of it. The DRM also prevents the user from putting the recording onto a blank CD at any time, since that would thwart the limited nature of the download.

[9] On-demand streams are not downloads. The service's server never sends the complete file containing the sound recording. It only transmits or streams enough data to allow the user to listen to the recording seamlessly at the time of transmission; that data is erased from the device used to receive it as the recording is played. The DRM software prevents the user from copying the recording onto a recording medium or device.

B. THE CANADIAN AND AMERICAN ONLINE MUSIC MARKETS

[10] Online music services developed in the United States much earlier than in Canada and in most other countries. MusicNet was founded in 1999 and launched two years later, with investment from EMI, BMG, Real Networks and AOL Time Warner. Pressplay was launched as a joint venture of Sony and Vivendi Universal. It was subsequently purchased by Roxio Inc. and is the vehicle that launched Napster as a legitimate online supplier of music.

[11] The American market did not expand rapidly until Apple launched its *iTunes Music Store* in 2003 (iTunes). Until then, online services focused on offering subscription packages that provided on-demand streams and limited downloads. iTunes changed the landscape in at least three ways. It offered permanent downloads, as single tracks for 99¢ or as albums for $9.99. The number of titles it made available was much larger and it made possible the use of downloads in many more ways.

[12] In Canada, PureTracks launched its online music service in October 2003, offering permanent downloads of sound recordings from the major record companies (or "labels") as well as a number of independent Canadian labels. It is currently the second largest player in the Canadian market. In January 2004, Archambault Group Inc. launched *Archambaultzik*; this Quebec-based online service offers a wide range of French language and Quebec sound recordings. Napster began operating in Canada in May 2004. iTunes followed in December of that year and quickly came to dominate the Canadian market.

[13] Subscription services, offering only limited downloads and on-demand streams, have not grown as rapidly as services that offer permanent downloads. The fact that originally, it was not possible to transfer music to portable players no doubt contributed to this lack of success. Those restrictions disappeared with the introduction of *Yahoo! Music Unlimited To Go* and *Napster To Go*. Time will tell how this market will grow.

[14] Most online services, including those offered through the Internet service providers or wireless carriers of Bell, TELUS and Rogers, rely on technology operated by others such as PureTracks or MusicNet for a number of back-room operations that must be performed in order to offer music to consumers. These include software management, maintenance of digital track libraries, digital rights management and reporting issues. These "white label" services may also perform other functions, such as clearing the right to use the record labels' master recordings or to communicate and reproduce the musical works embedded in the recording. Bell, TELUS and AOL use PureTracks while Rogers-Yahoo! relies on MusicNet.

III. THE PARTIES

[15] CMRRA sometimes refers to itself as a music reproduction licencing agency but it is a collective society as defined in the *Act*. CMRRA only acts for publishers. Those publishers who wish to be represented by it sign an affiliation agreement appointing CMRRA as their licencing agent for some or all of various types of reproduction activities, including those targeted in the tariff under examination. Other publishers have signed "stand-alone" agreements dealing specifically with online licensing. In these proceedings, CMRRA represents all or part of 38,240 publishing catalogues. In approximately 80 per cent of instances, CMRRA acts as exclusive agent.[2]

[16] SODRAC is a collective society whose objects include the collective administration of the right to reproduce musical works. SODRAC 2003 Inc. has been progressively taking over the rights, assets and activities of SODRAC since 2003. Authors and publishers represented by SODRAC assign to it the right to authorize or prohibit all forms of reproduction of their musical works throughout the world. SODRAC currently acts for more than 4,100 authors and 1,600 publishers. It also represents in Canada the interests of a vast number of foreign authors and publishers, through its reciprocal agreements with a number of foreign collective societies.

[17] CSI is a corporation created in 2002 by CMRRA and SODRAC for the purpose of collecting royalties on their behalf for the reproduction of musical works by commercial radio stations. CSI now has an exclusive mandate from CMRRA and SODRAC to licence the reproduction of musical works in their respective repertoires for uses targeted in the tariff under examination.

[18] CSI has entered into licencing agreements with all the online services currently operating in Canada as well as a number of those who are contemplating to do so. CSI requires a tariff because the agreements only provide for interim payments. The final royalties are to be set by the Board, in the tariff.

[19] Apple, Bell, CAB, CRIA, EMI, Rogers, Sony, Universal and Warner are, or represent, corporations that offer, purport to offer or intend to offer some form of online music service. As such, all require a licence to reproduce musical works onto their servers and to authorize their

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[2] When CMRRA is not a publisher's exclusive agent, it is possible to obtain a licence directly from the publisher.

customers to make their own reproductions onto personal computers, portable music players and recordable CDs.[3]

IV. POSITIONS AND EVIDENCE

A. CSI

[20] CSI's original proposal asked for the greater of: (a) 7.5 per cent of gross revenue or 75¢ per month per subscriber for services that only offer on-demand streams; (b) 10 per cent of gross revenue or one dollar per month per subscriber for services that offer limited downloads, with or without on-demand streams; and (c) 15 per cent of gross revenue or 10¢ per permanent download of a single musical work.

[21] In its statement of case, CSI modified its proposal in two respects. For category (a), CSI asked for 5.8 per cent of gross revenue or 45¢ per month per subscriber. For category (b), it asked for 8 per cent of gross revenue or 60¢ per month per subscriber if the service does not allow reproductions onto portable devices and $1.40 if it does. Originally, category (b) targeted only limited downloads that could not be reproduced further on other readable media. Some subscription services now allow subscribers to make "portable limited downloads", that is to copy music tracks onto portable devices. CSI proposed to amend the definition of limited downloads to reflect this. In final argument, CSI again modified its proposals to 6.7 per cent and 45¢ for category (a), and to 9.8 per cent, 72¢ and $1.75 for category (b), to reflect a change in the way to account for the use of works that are not in CSI's repertoire.

[22] CSI called several persons involved with CMRRA and SODRAC as well as a number of experts to support its proposed tariff.

[23] Mrs. Claudette Fortier, President of CSI, described its corporate structure and that of its shareholders. She explained the differences in the way CMRRA and SODRAC secure their repertoire generally, and for the purposes of the tariff under examination specifically. She emphasized that the licences they grant to record labels do not allow them to use their repertoire in connection with the operation of an online music service. She also explained the practical reasons behind the collectives' practice to mostly deal with the person who actually uses a musical work, and not with an intermediary.

[24] Mr. David Basskin, President of CMRRA and Vice-President of CSI, described Canadian online services and the ways in which they offer music to consumers. He dealt at some length with the terms of the Mechanical Licencing Agreement (MLA) entered into between CMRRA and CRIA, which licences record labels to reproduce musical works onto prerecorded CDs; in

[3] At least to the extent that those are not private copies within the meaning of Part VIII of the *Act*.

particular, he discussed the various discounts the agreement allows in respect of promotional products, budget goods and the like.

[25] Mr. Basskin and Mrs. Fortier testified on the operation of the so-called controlled composition clause (CCC) in the music industry. The CCC originated in the United States in the 1970s, and is more prevalent there than in Canada. This clause is found in agreements between a record label and a performing artist. It allows the label to obtain a mechanical licence at a reduced rate when the artist owns or controls some or all of the copyright in the works the artist records. Typically, it reduces the rate per track by 25 per cent, freezes royalties at the rate in effect at the time of entering into a contract, caps the number of tracks for which royalties must be paid and treats up to 15 per cent of CDs as "free goods" for which no royalties are payable.

[26] The MLA limits the impact of the CCC in Canada through a number of mechanisms. Its influence with respect to SODRAC's repertoire is much less significant. SODRAC has never included the CCC in its agreements with Quebec independent record producers and has refused since 1995 to renew its contract with CRIA precisely to avoid the application of such a clause.

[27] A panel representing the Canadian music publishing industry consisted of Messrs. Mark Jowett of Nettwerk One, Daniel Lafrance of *Éditorial Avenue* and Jodie Ferneyhough of Universal Music Publishing Canada. They provided an overview of the industry and of the role it plays in talent development.

[28] Mr. Paul Audley, President, Paul Audley and Associates Ltd., reviewed a study he prepared with others regarding the Canadian music publishing industry. The study documented, among other things, that sales of prerecorded albums declined by 25 per cent between 1998 and 2003 and that revenues decreased by 24 per cent over the same period.

[29] Mr. Audley also prepared with Professor Douglas Hyatt of the Rotman School of Management, Centre for Industrial Relations, at the University of Toronto and Division of Management, University of Toronto at Scarborough, a report that proposed a method to determine the royalties payable for the uses targeted in the tariff under examination. They testified that the market for mastertones[4] was in effect part of the same digital market as online music and proposed to derive a rate for permanent downloads by comparing the prices paid for copyright protected inputs in both markets. Their fundamental assumption was that, given the similarities between mastertones and permanent downloads, the ratio between the royalties paid for the reproduction of musical works and of sound recordings should be the same for both. The New Digital Media Agreements (or NDMAs) between American record labels and American music publishers set the price to be paid to reproduce the musical work and the sound recording into a mastertone.[5] The

[4] Ringtones that use the original sound recording of a musical work. Throughout the hearings, parties referred to them as "ringtunes".
[5] Though the parties to NDMAs are American, they do apply to Canadian transactions.

witnesses applied the ratio between those prices to what online services pay to labels for the use of their sound recordings, to arrive at a rate to be paid for the reproduction of musical works. The resulting rate is higher than what CSI is seeking. Messrs. Audley and Hyatt then used the rate they developed for permanent downloads to derive the royalties to be paid for limited downloads and on-demand streams.

[30] In their reply evidence, Messrs. Audley and Hyatt looked at three other ways of deriving a tariff for permanent downloads. The first was based on information provided by CRIA on the breakdown of the cost of a CD purchased in Canada, the second on information on the breakdown of revenues from CD sales in Quebec and the third on the income record labels receive from pressing and distribution agreements. All started from the existing mechanical royalty rate for the reproduction of musical works onto a physical medium. All were based on comparing the percentage of retail price that record labels receive in a variety of transactions involving prerecorded CDs to the equivalent percentage that labels receive in the online market. The fundamental assumption in those instances was that if the remuneration of labels increases in the online market, the remuneration of authors should increase at the same rate. These alternative approaches resulted in rates between 13 and 15 per cent.

[31] Mr. Marcel Boyer is Bell Canada Professor of industrial economics, Department of Economics, *Université de Montréal* and Fellow of the Centre for Interuniversity Research and Analysis on Organizations, of the *Centre interuniversitaire de recherche en économie quantitative* and of the C.D. Howe Institute. He reviewed the valuation evidence offered by CSI and the Objectors. He discussed issues such as the notion of option value, patent pools and sharing of benefits. He testified that the relative value of the reproduction rights of labels and authors should be similar between mastertones and permanent downloads and that, since the music market seems to be expanding, this should result in equal pressure to increase the cost of all of these input prices in the permanent download market.

[32] Mr. Clark Miller, General Counsel Worldwide, EMI Publishing and Mr. Frank P. Scibilia, Partner at Pryor Cashman Sherman & Flynn LLP testified about the content and impact of various agreements that license the use of EMI's repertoire of musical works, including the NDMAs that allow the use of that repertoire in mastertones. They described section 115 of the U.S. Copyright Act, which provides for a compulsory licence for the mechanical reproduction of music onto sound recordings and explained in detail the operation of CCCs in the United States.

[33] Ms. Caroline Rioux, Vice-President Operations, CMRRA, testified on the extent of the CSI repertoire, the extent of its use and the challenges created by the delivery of musical works in the digital environment generally, and through online services particularly. The CMRRA and SODRAC databases, which were consolidated in 2005, list approximately 1.1 million musical works. The consolidated database is updated daily, to add new compositions and to reflect the fact that publishers' catalogues are regularly bought and sold. In 2005, CSI began issuing licences to eight online services. Ms. Rioux described the licensing process, noting that CSI has invested over

a million dollars to design and implement a computerized system to expeditiously assess the applications of services and to grant them licences. She stated that in the first 18 months of operations, 1.5 million licences were issued, which is more than the total number of licences issued for prerecorded media (vinyl, cassettes and CDs) since the creation of CMRRA some 30 years ago. At the time of the hearings, online services had filed some 5.7 million applications.

[34] A panel consisting of Ms. Rioux, Mr. Joël Martin, Project Manager, SODRAC and Mr. Benoît Gauthier, President, *Réseau Circum*, explained the analysis that was performed to determine the relative share of Canadian air play of the CSI repertoire. For reasons that will become clear, this analysis is now irrelevant and as a result, there is no need to set out the evidence in detail.

[35] CSI contends that the offering of music on line increases the value of its repertoire and that right holders are entitled to a share in the value of this new economic activity. The right to reproduce musical works and to authorize subscribers to make their own copies is essential to online services. Indeed, without it, they could not operate. The use made of the reproduction right is much more extensive here than in the market for prerecorded CDs. For example, online services allow subscribers to make multiple copies. That ability to make additional copies gives services a competitive edge and provides added value to consumers. Rights holders should benefit from that added value.

[36] CSI proposes: that the tariff set minimum rates; that the rate for limited downloads be one-third lower than for permanent downloads; and that the rate for on-demand streams be somewhere between what is set for limited downloads and what pay audio services have agreed to. Finally, it proposes that the licences be issued only to online services and opposes the possibility of allowing record labels to obtain a licence from CSI and then sub-licence the use of CSI's repertoire by those services.

B. OBJECTORS

[37] The Objectors filed a joint statement of case. They propose royalties of 5.3 per cent for permanent downloads, 3.5 per cent for limited downloads and 0.5 per cent for on-demand streaming. They ask that the rate base be what subscribers pay, not gross income. They propose minimum rates of 3.85¢ for permanent downloads; for services that allow limited downloads and on-demand streaming, they propose a minimum of 21¢ per month per subscriber if a service does not authorize reproductions onto portable devices and 33¢ if it does. They propose either that no minimum be applied to downloads of albums or that the minimum price be reduced so as to avoid excessive royalties in the case of albums containing a large number of tracks. Finally, they seek the right for record labels to be allowed to apply for the licence so as to then sub-licence the right to reproduce the musical work to online services.

[38] The Objectors called several witnesses in support of their proposed approach.

[39] Mr. Alistair Mitchell, CEO and co-founder of PureTracks, described the development of this, the first online music service in Canada. He testified that PureTracks used the traditional physical music market as its business model, and considers online music as simply an extension of that market. In his opinion, there is a lack of understanding about the resources required to operate an online service. It requires a very costly infrastructure, which must be updated continually. It also involves the (sometimes costly) need to deal with a large number of credit card micro-transactions.

[40] Mr. Graham Henderson, President of CRIA, Mr. Mark Jones, Vice-President, Finance and Information Technology, Universal Music, and Ms. Christine Prudham, Vice-President, Legal and Regulatory Affairs, SONY BMG Music (Canada) Inc., testified on behalf of CRIA. They outlined the difficulties of growing the online music market in Canada, which they attribute to the negative effect of unauthorized downloads. They quoted figures according to which as few as 6 per cent of Canadians who download music obtain it from authorized services and that there are 14 unauthorized downloads for every authorized one.

[41] The panel outlined the significant costs that record labels have incurred to enter the digital market. These include not only the development of infrastructures and systems to manage the information, but also the digitization of the back catalogue, which requires re-mastering hundreds of thousands of sound recordings made before the advent of digital technology. It is also necessary in most instances to transform those recordings into the various formats adopted by those who retail mastertones and full-track downloads.

[42] The panel also testified about the money and resources that record labels expend on finding and developing artists and producing master recordings that can then be marketed as prerecorded CDs and music downloads. These costs are not expected to drop simply because recordings will now be offered online. The panel contrasted the role of publishers and labels, arguing that labels spend far more than publishers on finding and developing new talent.

[43] The CRIA panel outlined what they believe to be the distinctions between mastertones and online music. Mastertones are fashion statements; downloads are not. Differences in buying patterns are significant: consumers tend to buy less than two mastertones per month, as opposed to more than twenty downloads of music per month.

[44] Finally, the panel explained why it wished that record labels be allowed to purchase the licence from CSI and then deal with the online services. This would be both cost effective and administratively more efficient, and would take into account the fact that CSI does not represent all of the repertoire offered by the labels.

[45] Mr. Steven Globerman is Kaiser Professor of International Business, Western Washington University, College of Business and Economics and Adjunct Professor at the Faculty of Business Administration, Simon Fraser University. He was asked to assess which, of the mastertone and prerecorded CD markets, constitutes a better proxy for permanent downloads. He was not asked to suggest an appropriate price or rate.

[46] Professor Globerman began by examining what makes the price paid for a factor of production fair and equitable. That price should be equal to the value of the input's marginal product, which is the marginal productivity of the input weighted by the price of the product.[6] He then stated that intellectual property has characteristics that make it difficult, if not impossible, to apply to it notions that are valid when dealing with ordinary goods. For example, contrary to what Professor Boyer stated, it is difficult, if not impossible, to conceive of such a thing as marginal consumption of intellectual property. When using a divisible capital asset, it is possible to influence the end result by increasing the use of the input: thus, for example, one can use more fertilizer to increase the yield of a crop. Intellectual property is an indivisible capital asset. Either one uses it or one does not. As a result, the notion that one can use a little more or a little less of intellectual property in order to determine its value is not realistic. However, assimilating the reproduction right to a capital asset makes it possible to define a fair and equitable input price in a similar way as for ordinary goods.

[47] Professor Globerman then explained how he compared permanent downloads to other potential proxy markets. Based on his notion of a fair and equitable input price, he identified three characteristics he considered helpful to determine whether a market constitutes an appropriate proxy. Those are the price for which the good is sold (output price), the costs incurred to produce and offer the good (input prices), and the seller's discount rate. Since no information was available to determine the discount rate, Professor Globerman chose to ignore that factor, adding that this did not affect his analysis.

[48] With respect to the first characteristic, Professor Globerman stated that the closer the output prices are in two markets, the more likely one is to constitute an appropriate proxy for the other. Conversely, when prices in two markets differ significantly, one probably does not constitute an appropriate proxy for the other. He then observed that the retail price for mastertones is three times that for permanent downloads. By contrast, the per-track retail price of a prerecorded CD is more or less the same as the price of a single permanent download. Using data provided in Messrs. Audley and Hyatt's reply evidence, Professor Globerman calculated the average price per track for both CDs and permanent downloads. He concluded that the per unit price was more similar between CDs and permanent downloads than between mastertones and permanent downloads.

[49] Professor Globerman then described the notion of "value chain", which is a set of activities carried out by a business to create a commercially valuable output. It is typically comprised of primary activities (logistics, operations, marketing, sales and customer services) and support activities (planning, research, human resources management). Using that notion, he disagreed with the conclusion of Messrs. Audley and Hyatt to the effect that input costs are very different between

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[6] Professor Globerman defined the value of the marginal product as "the monetary value of the increased output associated with additional usage of the input holding usage of other inputs constant".

the prerecorded CD and permanent download markets. He stated that, once costs were properly accounted for, they were closely comparable.

[50] Professor Globerman's overall conclusion was that these similarities between the input and output prices of prerecorded CDs and permanent downloads confirm that the former probably constitute the best available proxy to set the tariff for the latter.

[51] Mr. Ted Cohen, former Senior Vice-President, Digital Development and Distribution for EMI Music, has played a key role in the development of a number of online services. He described the costs associated with the delivery of a sound recording as a prerecorded CD and as a download. He admitted that there may be significant differences between the value chains in the physical and digital environments, but maintained that the business model used to market prerecorded CDs remains the closest to digital downloads. In his opinion, mastertones will cease to exist as a stand-alone business within two years and will be bundled with permanent downloads. If only for that reason, he considers that the mastertone market is not an appropriate business model to use as a proxy. Mastertones, in his opinion, are personalization products, not music products.

[52] Mr. Stephen Stohn, Partner at Stohn Hay Cafazzo Dembroski Richmond LLP and expert in the music business, was commissioned to summarize the typical contractual provisions and agreements in the music industry relevant to the reproduction right and to suggest the most appropriate proxy in the Canadian music market to determine an appropriate royalty rate.

[53] Mr. Joseph Salvo, special counsel, Weil, Gotshal & Manges LLP, and as former counsel for SONY, one of the negotiators of the NDMAs, testified about the genesis, content and impact of the NDMAs and on the relevance of the mechanical compulsory licence and of CCCs in the digital environment in the United States.

[54] Messrs. Terry Canning, Vice-President and General Manager of the Rogers Hi-Speed Internet Service, Patrick McLean, General Manager of Consumer Internet Services at Bell Canada, and Kerry Munro, General Manager of Yahoo! Canada, described the development and operations of the online music services provided by their companies. They testified to the precarious financial environment in which they currently operate and to the time that it is expected to take before these businesses can show a profit.

[55] Mr. Eddy Cue, Vice-President of Apple's iTunes, was responsible for the development and implementation of the *iTunes Music Stores*, which now operate in 22 countries. He described the development of the *iTunes Music Store*, which offers over 2 million tracks in Canada and over 3.4 million in the United States, and now include audio books, videos, movies and television shows.

[56] Mr. Cue testified that Apple established its 99¢ price point in the United States having regard to its competition, which it viewed as coming from two sources: free, unauthorized downloads and prerecorded CDs. The CD market was important in determining a price and business model because most people purchase their music on CDs and that creates an expectation of what an album

is worth. When Apple opened its Canadian online music service, it looked at all those factors, as well as considering the added advantage of not having to change the North American price, and maintained the 99¢ price.

[57] Mr. Cue acknowledged that some of the costs incurred in delivering prerecorded CDs are not incurred in delivering music online, but added that the online delivery of music involves other costs that make the overall expense of delivering a sound recording as significant in one as in the other. He rejected comparisons between mastertones and permanent downloads. In his opinion, mastertones are a different product that uses music in a different way and targets a different market.

[58] Mr. Cue compared the way in which iTunes clears rights in Canada, the United States and Europe. In the United States, record labels generally provide all necessary rights for one fee, having secured the right to reproduce the musical work. In Europe, iTunes must purchase the rights for the sound recording and for the musical work separately, but is able to purchase the right to reproduce and communicate the work in a single transaction. In Canada, iTunes must licence separately the right to reproduce the musical work, the right to communicate the musical work and the right to reproduce the sound recording.

[59] The final panel consisted of Messrs. Upinder Saini, Vice-President, New Products and Content Development, Rogers Wireless, Andrew Wright, Director of Business Development, Bell Mobility, and Nauby Jacob, Director, Browser and Messaging Services, TELUS. Rogers, Bell and TELUS offer both mastertones and permanent music downloads to their subscribers. In Canada, ringtone services were launched in 2001 and mastertones were first offered in 2003. Permanent music downloads only became available in 2005. In their opinion, mastertones and downloads are separate products and are marketed differently. Mastertones are not a music product, but a personalization tool.

[60] The Objectors contend that prerecorded CDs are the appropriate proxy for permanent downloads and, all things being equal, the price paid for the right to reproduce a musical work should be the same for both. In their submission, CDs and downloads are simply different delivery mechanisms for the same product – sound recordings of musical works. In Canada, the price paid to copy musical works onto a prerecorded medium has varied over time, but has always been the same whether the format was vinyl, cassette or CD. In the Objectors' submission, there is no reason for this to change in the digital environment.

[61] Consequently, the Objectors submit that the appropriate way to derive a rate for permanent downloads is to start from the MLA and then adjust it so as to determine the average net compensation paid in Canada for the reproduction of a single track onto a prerecorded CD. They then ask that this amount be converted into a percentage of the price of a download. The Objectors disagree with CSI's argument that the value of the reproduction right has increased simply because it is now possible to copy music to a hard drive or portable music player.

C. OBSERVATIONS

[62] Pursuant to the Board's directive on procedure, the *Union des artistes* and ArtistI filed written observations dealing primarily with the nature of, and limits to, the rights of performers to authorize the reproduction of their performances generally and in a digital environment. The remarks outlined the difficulties that may arise if record labels are allowed to act as intermediaries for the licensing of performers' rights. The letter also argued for the importance, where performers' rights do exist, of ensuring that fixed performances are not used "for a purpose other than that for which the performer's authorization was given" as is provided in subparagraph 15(1)(*b*)(ii) of the *Act*.

V. ANALYSIS

[63] To set a tariff in this instance, we must perform the following tasks. The first is to determine the proxy that will be used to establish the tariff for permanent downloads. The second is to adapt that proxy to the online music market and establish the tariff for permanent downloads. The third is to determine the tariff for limited downloads and on-demand streams. The fourth is to select the rate base that will be used to calculate royalties. Finally, it will be necessary to examine what role, if any, the record labels can and should play in the context of the tariff we are certifying.

A. THE APPROPRIATE PROXY

[64] Throughout this process, CSI and the Objectors adopted the same approach. First, they both contended that there is a readily available proxy that should be used to set the tariff. Second, the proxy selected should be used to set a price for permanent downloads and that price can then be used to determine royalties for limited downloads and on-demand streams. We agree with this approach.

[65] While CSI and the Objectors agree on the approach, they differ on what the appropriate proxy should be. CSI favours mastertones, but also offered some alternatives. The Objectors argue that the price paid in the online market should be derived from what record labels pay to reproduce music on prerecorded CDs.

i. The Mastertone Market

[66] CSI argues that the mastertone market is the appropriate starting point. Mastertones and permanent downloads form part of the same, broad digital market. Both involve the sale of digital files of music that are delivered electronically to consumers. Though they are not substitutes for each other, the business models are very similar. We disagree, for the following reasons.

[67] First, mastertones are not a substitute for permanent downloads. Downloads compete with CDs, not mastertones. Mastertones are not priced as a function of downloads, or vice-versa. Both products may be delivered through similar modes, but that hardly is sufficient to justify a choice of proxy. We agree with the many witnesses who testified that mastertones are a different product that

serves a different purpose. They are a personal identification medium, a fashion statement. Consumers purchase permanent downloads to listen to them; no one purchases a mastertone to listen to it on a computer or an iPod.

[68] Second, we agree with Professor Globerman that mastertones do not have the required characteristics of a good proxy for permanent downloads. Simply put, the input and output prices in these markets are too different for one to be helpful in the other. Permanent downloads sell for as little as one-third of the price of mastertones. This is a strong signal that each product may exhibit different characteristics. CSI simply failed to account for that difference.

[69] Finally, in our opinion, the mastertone market is not mature enough, and its future too uncertain, for it to serve as a reliable proxy. The industry's revenues and expenses have not yet reached a stable level of growth. Mastertones may not last as a stand-alone business. It would be inappropriate to establish a tariff using a proxy based on such uncertain grounds.

ii. Other Proxies Proposed by CSI

[70] The three alternative proposals offered in the reply evidence of Messrs. Audley and Hyatt suffer from a number of common problems. All are based on approximations; at best, they can only be used as validation measures. All compare percentages, when comparisons of actual amounts seem preferable. Finally, we agree with Professor Globerman that when the actual net amounts received by a record label are compared, all seem to confirm, not contradict, his conclusions.

iii. The Prerecorded CD Market

[71] The Objectors offer four reasons to argue that the amount paid for the right to reproduce a musical work onto a prerecorded CD is a good starting point. First, permanent downloads compete with prerecorded CDs and are priced accordingly. Second, as Professor Globerman demonstrated, the value chains for the two products, as well as their input and output prices, are sufficiently close to justify using one to set the amount for the other. Third, permanent downloads are just another form of sound recording. The media onto which a recording is reproduced has changed over time, but the price paid to reproduce a musical work has always been the same at any given time irrespective of the type of medium onto which the work has been put.[7] Fourth, online services view physical CDs as a substitute product, and CD retailers as their competitors. We agree with the Objectors.

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[7] No one alluded to the fact that when the "decision" to charge the same price to reproduce a musical work on vinyl, cassette or CD was made, that price was regulated. It still is in the United States. This might have influenced the decision to continue charging a single price in Canada even after 1989, when free bargaining was allowed to occur. In our view, this is not sufficient to allow us to ignore the historical reality of the MLA, especially since the single price continued to prevail after deregulation, which occurred at a time when all three known prerecorded formats were still competing.

[72] CSI puts forth three main arguments to support its submission that the prerecorded CD market is not an appropriate starting point. We are not persuaded by these arguments.

[73] CSI argues that the use made of the reproduction right in the online market is very different, and much more extensive, than in the prerecorded CD market. The delivery of a prerecorded CD involves only two copies: the master recording and the CD itself. The delivery of a permanent download involves at least the creation of a digital master file and its reproduction onto the online service's server, in addition to the downstream copies made by the service's customers on any number of media and devices. Insofar as this is either correct[8] or relevant, this can be taken into account through an adjustment in the rate and therefore, does not reduce the usefulness of the MLA as a proxy.

[74] CSI also argues that online music services use the reproduction right in a manner that allows them to create a consumer experience that differs substantially from what occurs when a consumer purchases and uses a prerecorded CD. For example, online consumers enjoy a greater variety and choice of music, the ability to purchase individual tracks, to create their own playlists, to sample excerpts before making a purchase and to research their purchases at their leisure, much more effectively and thoroughly than in a record store. Again, be that as it may, it does not deter from the usefulness of the MLA as a proxy. Over the years, record stores have changed the way they sell sound recordings. Many times, the industry has even changed the format in which sound recordings are offered: singles have come and gone, and now appear poised to make a comeback in the digital world. And yet, the MLA has always set the same price for a track, whether sold as a single or as part of an album.

[75] Finally, CSI points out that record labels do not play the same role in the digital and physical worlds. Labels no longer manufacture or distribute finished goods. Instead, they licence their sound recordings to online services, who then reproduce them for distribution and authorize their subscribers to make further copies. This is not relevant. From an economic perspective, prerecorded CDs and permanent downloads simply are different ways of marketing sound recordings that are meant to be listened to by the same consumer in the same manner.[9] The price paid to reproduce a musical work embedded onto a sound recording should be the same, irrespective of the way in which that recording is marketed.

[76] On a related point, we reject the position developed by CSI on the differences in the respective value chains. When the Internet is used to deliver recorded music, it remains necessary to carry out important stages of the value chain such as production, distribution and inventorying. Though the input mixes may be different, marketing the product still requires performing every specific stage.

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[8] Making a prerecorded CD involves other copies that were not mentioned, including those that are used to embed the musical work onto the CD; the master recording itself is not used for that purpose.

[9] The legal perspective is altogether different however, as we point out in paragraph 84 below.

For example, inventory costs will involve renting or buying server space rather than warehouse space, while distribution will require bandwidth instead of trucks.

[77] We therefore find that the price for permanent downloads should be determined using the price currently paid to reproduce a musical work onto a prerecorded CD. This rate has been set at 7.7¢ per track, plus 1.54¢ per minute or fraction thereof over 5 minutes, since 2002. Even though the latest MLA expired at the end of June 2006, that rate continues to be used while the parties renegotiate the agreement. We will therefore use that rate as a starting point even though the effective rate may be slightly higher due to the existence of sound recordings lasting more than 5 minutes. We do not see the need to make the correction, which would probably be marginal at best.

B. Deriving a Rate for Permanent Downloads

i. A Percentage Rate

[78] In Canada, the price paid to reproduce musical works onto sound recordings has always been expressed as a number of cents per track. Attempts were made recently to harmonize Canadian practice with that of most foreign jurisdictions and set the rate as a percentage of wholesale or retail. This has not occurred to date.

[79] In these proceedings, both sides request that the rate be expressed as a percentage. The Board has alluded to the merits of this approach many times over the years. Setting the rate as a percentage permits the royalty to vary according to the value the market attributes to the final product and to the business cycles of an industry. It also avoids the need for repeated adjustments to take into account the effect of inflation.

[80] Several agreements between record labels and online services contain rates expressed in cents. Setting a rate in percentage for the use of musical works will result in variations in the relative remuneration of authors, performers and makers as the price of online music varies. This could eventually become an issue the parties will have to deal with. It does not, however, take away from the inherent merits of using a percentage in this tariff.

ii. Adjusting the MLA Rate

[81] Before deriving a rate, it is necessary to examine the various adjustments to the MLA rate proposed by CSI and the Objectors.

[82] The Objectors proposed two adjustments that are based on Mr. Stohn’s analysis. His stated objective was to ensure that the rate for permanent downloads correspond to the effective average rate being paid for the reproduction of musical works onto prerecorded CDs. Both adjustments seek to account for discounts that result from the application of CCCs. Their combined effect would be to reduce the rate by approximately 32 per cent.

[83] These adjustments are either unnecessary or irrelevant. First, Mr. Stohn admitted that not all sound recordings are subject to CCCs and that no available information would allow him to estimate the proportion of those that are. Second, though the evidence was contradictory in this respect, it would appear that the impact of CCCs in the market for permanent downloads is significantly less than in the prerecorded CD market. For example, in the United States, where CCCs originated, provisions in a record deal signed after June 22, 1995 that purport to allow a record label to obtain a mechanical licence at a reduced rate for a "digital phonorecord delivery" are in effect inoperative.[10] Third, CCCs are designed first and foremost for the physical world: it is difficult to conceive of "free goods", as this expression is used in CCCs, on iTunes. Finally, and most importantly, CCCs exist because labels designed them and ask for them. As a result, they are most able to lead cogent and convincing evidence about the relevance and role of these provisions in the digital environment. They did not. Absent such evidence, the prudent course is simply to ignore CCCs.

[84] The Objectors submit that the tariff, for the reproduction of musical works, should be discounted to reflect the value of the right to communicate these same works. The submission is based on two false assumptions. The first is that this decision will establish the price for all rights. This is simply not the case.[11] The second is that the price should be the same whether one or two rights are required to deliver a product. The Board has rejected that argument more than once.[12] In addition, the proxy that we have adopted is the one proposed by the Objectors. It involves only the reproduction right.

[85] For its part, CSI proposed two adjustments.

[86] The first would account for the fact that members of ADISQ currently pay SODRAC mechanical royalties of 8.9¢. Messrs. Audley and Hyatt proposed an adjustment based on the assumption that the SODRAC-ADISQ agreement applies to 15 per cent of the Canadian market. The Objectors argue this number is too high; in their opinion, SODRAC's overall share of the Canadian market is 15 per cent and ADISQ accounts for only one third of SODRAC's business, or 5 per cent of the total market. The rest would be governed by SODRAC's agreement with CRIA, which uses the 7.7¢ rate. In our opinion, CSI could have provided information allowing us to determine precisely the importance of the SODRAC-ADISQ agreement in the Canadian market; it did not do so. We find the figures advanced by the Objectors inherently more credible, given what the Board has learned over the years of the Canadian market for prerecorded CDs. In any event, even if we accepted CSI's submissions, it would only have a marginal impact on the result. The correction to account for the SODRAC-ADISQ agreement yields an adjusted rate of 7.8¢.

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[10] See U.S. Copyright Act, 17 U.S.C. §115 (c) (3) (E) (ii) (II).

[11] The tariff allowing an online music service to communicate a musical work will be set following hearings into SOCAN Tariff 22, which are due to start on April 17, 2007.

[12] See, for example, decision of October 20, 2006 certifying the NRCC Background Music Tariff, 2003-2009, at paragraph 114.

[87] The second proposed adjustment would take into account that online services expressly grant consumers the right to make several copies of a download onto any number of devices or media. Some of these copies may be private copies; others are not and therefore, require the rightsholder's permission. At first glance, one would expect that consumers get added value from being able to make more than one copy, even when that option is not being exercised.[13] It could also be argued that being able to authorize their subscribers to make more than one copy gives online services a competitive advantage over retailers of prerecorded CDs. If so, the MLA rate should be adjusted to take into account the value of these additional rights. There is evidence to the effect that the right to make extra copies is worth something in at least the wireless services market, where consumers pay less when music is downloaded only onto a PC than when it is downloaded onto both a cell phone and a PC.

[88] That being said, this is not the occasion to determine whether, or by how much, the price should be increased on this account. First, there is not enough evidence of what the right to make extra copies might be worth. Second, there may be factors that tend to considerably reduce this added value. For example, the fact that prerecorded and downloaded tracks sell at approximately the same price may indicate that the right to make additional copies is actually being given away to clinch the sale; nothing else seems important. Existing agreements between record labels and online services tend to show that labels have come to this conclusion. Third, expressing the rate as a percentage of the retail price will allow the market to implicitly attribute the value these additional rights may have, as is the case with wireless downloads.

[89] However, we reject the argument of the Objectors that it is unnecessary to account for these extra copies. To say that the MLA already takes into account that consumers are able in practice to make an unlimited number of copies is to argue that the MLA factors in a largely illegal activity. In addition, to argue that the private copying regime already takes care of these copies is to look at the issue from the wrong end of the telescope. CSI's suggestion that section 80 of the *Act* applies only to copies that have not otherwise been authorized is incorrect. A private copy is a private copy, whether or not it was authorized. However, some of the copies online services authorize clearly are not private copies. More importantly, the private copying regime exists to compensate the effects of a market failure, without being contingent on the extent of that failure. Confronted with this conundrum, and with a view to reinforcing the nexus that must exist between the regime and its stated objectives in order for the regime to remain constitutionally valid, the Board decided early on that it would discount authorized private copies from the calculation of the levy and leave it to the market to set the price for such copies.

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[13] Decision of December 12, 2003 certifying the Private Copying Tariff, 2003-2004, at page 27.

iii. The Average Retail Price of a Downloaded Track; the Resulting Rate

[90] The numerator that we will use to set the rate for permanent downloads, as indicated in paragraph 86, is 7.8¢. In order to derive a percentage rate, we now need to determine the average retail price of a downloaded track.

[91] The predominant retail price for single track permanent downloads appears to be 99¢. iTunes sells virtually all of its single tracks for that price. Some competitors sell tracks for more and sometimes offer promotions for less. Even in the unlikely scenario that 10 per cent of tracks were sold at $1.19, the average price of a track would increase by only 2¢. We find that 99¢ is a reliable estimate of the average price of a single-track permanent download in Canada.

[92] In the physical world, a reproduction triggers the same amount of remuneration whether it is sold as a single or as part of an album. On the other hand, the average price of a track is not the same when it is sold as part of an album. This price must be factored into our calculations. iTunes sells most of its albums for $9.99.[14] According to Mr. Cue, the average number of tracks on an album downloaded from iTunes is 13.[15] The average price per track on an album is then 77¢. According to numbers on sales of permanent downloads provided by CSI,[16] 55 per cent of all tracks sold as permanent downloads are singles, and 45 per cent are part of an album. Using these weighted figures yields an average price per track sold as a permanent download, either as a single or included on an album, of 89¢, resulting in a rate of 8.8 per cent [7.8¢ ÷ 89¢].

[93] Subject to an adjustment discussed later, we certify that rate. We want the tariff to generate the same amount of royalties as if online music services paid 7.8¢ per track. The following Table 1 shows that, if the relative share of album and single-track sales remains relatively stable, that result will be achieved.

TABLE 1
ROYALTY FLOW AT 8.8 PER CENT OF RETAIL

	Units	Price per unit	Total number of tracks	Sales	Royalties at 8.8% of retail price	Effective penny rate
Singles	7,258,100	99¢	7,258,100	$7,185,519	$632,326	8.7¢
Albums	464,600	$9.99	6,039,800	$4,641,354	$408,439	6.8¢
Total			13,297,900	$11,826,873	$1,040,765	7.8¢

Based on Exhibit CSI-27.A, Table 1, page 3. The number of units of singles and albums are for

[14] There are some sales at higher prices, but nothing indicates that they have a significant impact on the market.
[15] We prefer this figure to the one of 15, used by Messrs. Audley and Hyatt, which is based on data provided by SoundScan, for two reasons. First, the average number of tracks is increased by the availability of prerecorded compilation albums which are not generally available online. Second, the evidence offered by Mr. Cue as to what occurs at iTunes, the dominant player in the market, is the best evidence available.
[16] Exhibit CSI-27.A, at page 3, Table 1.

year-to-date sales for July 23, 2006. A similar result was achieved using data recently released by Nielsen SoundScan Canada on downloads of tracks and albums in 2005 and 2006.

iv. Setting a Minimum Price

[94] Both sides agree that the tariff should set a minimum fee that is two-thirds of the royalties generated by the full rate at the average price of a track when sold as a single. We agree. The minimum fee per track for permanent download is set at 5.9¢.

[95] The Objectors argue that the application of a per-track minimum fee to albums would hurt emerging artists whose albums they say tend to be priced lower than $9.99, and would result in an unintended and unfair increase in the rate. With the increasing number of tracks on an album, the sum of the individual minimum fees would eventually surpass the amount that the application of the full rate to the price of the album would generate. To prevent this from happening, the Objectors proposed either that there be no minimum fee on albums or to replicate the approach followed in the United Kingdom, where minimum fees decrease as the number of tracks in a bundle increases. CSI argues on the other hand that if there is no minimum fee, bundles with a very large number of tracks could be sold at a price that would result in an inappropriately low payment of royalties.

[96] The evidence the Objectors offered in this respect is rather thin. In fact, there is no evidence on which we could find that emerging artists' albums are being sold for less. Also, as we already noted, there is evidence that the average number of tracks on a downloaded album is 13, not 15.

[97] We are willing however to set minimum fees that will allow online services to test new business models in this emerging market while ensuring fair compensation for rights owners. Applying the single track minimum fee to a bundle priced at $9.99 would result in royalties that are higher than the rate we set if the bundle contains more than 15 tracks. In our opinion, as for single tracks, the minimum fee for albums should be set at two-thirds of the royalties generated when the rate is applied to the average price of an album containing an average number of tracks. Consequently, we set the minimum fee for bundles at 4.5¢ per track [9.99 × 8.8% ÷ 13 × 0.67]. In this way, the payment of the minimum fee will be triggered only when a bundle selling at $9.99 contains 20 tracks or more. The Board will no doubt expect to be provided information about the impact of this measure in future proceedings dealing with this tariff.

C. THE RATE FOR LIMITED DOWNLOADS AND ON-DEMAND STREAMING

i. Limited Downloads

[98] We adopt the position agreed upon by the parties, to the effect that the rate for limited downloads should be two-thirds of the rate for permanent downloads. We certify a rate of 5.9 per cent. We remain concerned with the possibility that this approach may lead to some level of double discounting. The lower price charged for limited downloads already reflects a lower value,

compared with permanent downloads. A lower royalty rate, intended to reflect a lower value for the right, might be an additional reduction to account for the same lower value.

[99] CSI's original proposal provided only one minimum fee for limited downloads. CSI now asks that different minimum fees apply according to whether or not a subscriber is authorized to copy the file onto a portable device. The Objectors first debated whether setting separate rates for portable limited downloads would go beyond the gazetted proposal. CSI's original proposal treated portable limited downloads as permanent downloads; moving them with limited downloads will result in lower rates. CSI's new proposal also has the merit of rationally accounting for the emergence of a business model that could not have been anticipated at the time of filing the tariff.

[100] CSI proposes that the ratio between the minimum fee payable when a subscriber can and cannot copy a file to a portable device be the same as for the amounts paid to record labels under the same circumstances. The Objectors would prefer that the ratio used be the one that exists between the average price paid for non-portable and portable limited downloads subscriptions. We agree with the Objectors' methodology, if only because it is more consistent with the approach we have used in setting the rate for permanent downloads. However, we would use the average between what Napster and MusicNet charge for such subscription as the average monthly subscription fees. These numbers are $9.50 when further reproduction on a portable device is not allowed, and $14.50 when it is. The resulting minimum fees that we certify are 37.4¢ and 57.0¢ per month respectively.

ii. On-Demand Streaming

[101] CSI requested a tariff for services that only offer on-demand streaming, even though no such service currently exists. The Objectors suggest that we should not certify a tariff for non-existent services. This suggestion misses one important point. Tariffs are in essence prospective and can well target uses of which little is known. CSI has asked for a tariff that ostensibly targets a possible, protected use of its repertoire, and should be allowed to have a tariff certified for that use.

[102] CSI asked that the rate for on-demand streaming be set somewhere between the rate set for limited downloads and the rate pay audio services (Galaxie and Max Trax) have agreed to pay to CSI. Its assumption is that on-demand streams are worth less than limited downloads but more than pay audio, since on-demand streaming allows customers to select the tracks they listen to while pay audio services are non-interactive streaming. For their part, the Objectors proposed that the royalties be based on what commercial radio stations pay for the right to use CSI's repertoire, and proposed a rate of 0.5 per cent.

[103] We reject the Objectors' proposal for two reasons. First, music is worth more to on-demand streaming than to commercial radio, if only because listeners choose commercial radio for a variety of reasons, one of which is music, while those who listen to on-demand streams do so exclusively for the music. Second, a radio station has the option of operating without making reproductions of

musical works; a streaming service does not have that option. That makes the right to reproduce more valuable in a stream than over the radio.[17]

[104] Once again, we are concerned with the possibility that CSI's approach may lead to some level of double discounting, if the retail price of a service offering only on-demand streams is lower than for one that also offers limited downloads. Notwithstanding this, we adopt CSI's methodology. This results in a rate of 4.6 per cent.

[105] CSI requested that the minimum fee for on-demand streaming be set as a function of the ratio between the percentage rate for on-demand streaming and limited downloads. The Objectors did not propose a minimum rate for this category. Applying CSI's methodology to the rates yields a minimum fee of 29.2¢ [4.6 ÷ 5.9 × 37.4].

iii. Adjusting the Rates to Account for the Use of Music not in CSI's Repertoire

[106] CSI initially proposed that the rates for limited downloads and on-demand streams be adjusted to reflect the fact that not all works an online service uses are in CSI's repertoire. During the hearings, it became clear that there was no need to do so. The Services know of every instance in which a track is downloaded or streamed; indeed, the DRMs they use with limited downloads report the number of times a download was played when the consumer's device "reports" to the service. CSI is therefore able to segregate tracks that use its repertoire from those that do not and to calculate royalties accordingly.

[107] Both sides agree that royalties for services that offer only on-demand streams be calculated according to the number of individual streams. As for services that offer both on-demand streams and limited downloads, CSI asked that the royalties be calculated according to the number of plays, while the Objectors asked that they be calculated according to the number of downloads. The Objectors' main argument in this regard is that since this is a reproduction tariff, reproductions, not plays, should be used whenever possible to calculate the royalties. We disagree. When practical, reproduction royalties (and their distribution) should be a function of consumption. Recorded music is consumed by listening to it. The *CMRRA/SODRAC Inc. Commercial Radio Tariff, 2007* reflects this: a low-use station pays less than other stations not because it makes fewer copies, but because it airs the repertoire less. In this instance, however, we agree with Rogers that using plays to calculate royalties for limited downloads would create significant practical problems. Moreover, at least for the time being, there is little to gain in accuracy by using both plays and downloads to calculate royalties for services that offer both on-demand streams and limited downloads. Consequently, royalties for these services will be calculated using only downloads.

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[17] Decision of March 28, 2003 certifying the CMRRA/SODRAC Inc. Commercial Radio Tariff, 2001-2004, at page 13; Decision of August 18, 2006 certifying SOCAN Tariff 24 (Ringtones), at paragraphs 93 to 99.

D. THE RATE BASE

[108] CSI requested that royalties be calculated using all revenues received in connection with the products and services that are subject to the licence covered by the tariff, including advertising revenues. The Objectors, on the other hand, argue that royalties should be based on what consumers pay to use the online service. They purport that CSI's proposed approach is contrary to what it has agreed to with services on the one hand, and with record labels on the other.

[109] We agree with the Objectors' proposed approach, but for different reasons. First, online music services do not earn much more than what consumers pay. Second, we need to know whether, and to what extent, these other revenue streams are attributable to the use of CSI's repertoire. There was some evidence that advertising-based services may start offering music for free on the Internet. We think that these new services will remain relatively marginal, at least for the life of the current tariff. In the meantime, the minimum fees that we have set should generate sufficient royalties from those services. For these reasons, the tariff will use what consumers pay to the services as the rate base.

E. THE ROLE OF RECORD LABELS

[110] CRIA's Class A members were allowed to object to the proposed tariff because they operate or intend to operate their own online services. Their interest goes beyond this, however. They wish to be able to act as intermediaries between CSI and the online services, presumably only with respect to the musical works that are embedded onto sound recordings that each of them owns. In order to achieve this, they ask that the tariff not specify who can apply for a licence.

[111] CRIA's members argue that the systems currently in place to clear rights for prerecorded CDs can easily be put to use in the online market, allowing them to provide fully cleared products here as in the physical world. They point to certain difficulties which online services have encountered in obtaining licences from CSI, all of which they argue can be overcome if record labels are allowed to sub-licence CSI's repertoire to the services.

[112] CSI opposes this request. It notes that the request does not come from the online music services themselves, who all have agreements with CSI. It submits that there are no valid legal or practical reasons to allow the record labels to step into the shoes of the actual users of the repertoire and that there is no precedent for such action. CSI acknowledges that there have been difficulties in processing the applications of online services. It points out that given the sheer numbers involved, it was to be expected that setting up the required systems would take some time. CSI has hired additional staff to address the problem. It mentions the labels' allegedly less than stellar record of compliance with the MLA as an indication that they should not be allowed to interpose themselves in the relationship between user and collective. Finally, CSI insists that it must be able to maintain a direct relationship with the users in order to properly monitor the actual use of its repertoire.

[113] We are convinced that the tariff should not allow the record labels to interpose themselves between CSI and the online music service, for the following reasons.

[114] First, allowing the record labels to licence the use of CSI's repertoire pursuant to this tariff would add an unnecessary layer of communication between the collective and the actual user of its repertoire. As Mrs. Fortier explained, this has not been common practice in the past; it should not become common practice in this case.[18]

[115] Second, to allow the record labels to interpose themselves would overly complicate the way in which CSI would obtain the information to which it is entitled. If all four major labels were to avail themselves of the tariff, CSI would receive, in each reporting period, at least five reports with respect to each service: one from the service and one from each label. Allowing independent labels to enter the fray would further complicate these relationships.

[116] Third, CSI has already established direct relationships with all the services that operate in Canada. There seems to be no need to disrupt those relationships.

[117] Fourth, the person who is ultimately liable for the royalties pursuant to the tariff remains the actual user of the repertoire. Providing unreliable information can result in increased liability. Thus, it is probable that the person who bears the ultimate burden for an error is least likely to commit that error.

[118] Fifth, the efficiencies that the record labels contend can be achieved by dealing through them are far from certain. No one knows whether it would be more efficient for labels to report on part of the sales of several online services or for each service to report on its total sales from a number of overlapping catalogues of sound recordings. Nothing prevents the labels from convincing CSI and the services that they can help to make reporting under the tariff more efficient. Nothing prevents CSI from rearranging its reporting channels; we will not force it to do so.

[119] In the past, the Board has stated that generally speaking, a tariff should target uses, not users.[19] The *Act*, not the Board, determines who is liable to pay for a protected use. A tariff can neither impose liability where the *Act* does not nor remove liability where it exists.

[120] The Board has also stated that generally speaking, a tariff should target both the right to do and the right to authorize. When administered collectively, the right to authorize an act is subject to

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[18]There are, of course, exceptions to this. Royalties for public performances in concert venues and reception rooms are mostly collected from the venues, not the performers. There are practical reasons for doing so, which are simply not present here, as we explain in the following paragraph.

[19] Decision of March 15, 2002 certifying the SOCAN-NRCC Pay Audio Services Tariff, 1997-2002, at pages 27-28; Decision of March 19, 2004 certifying SOCAN Tariffs 2.A (Commercial Television) and 17 (Pay and Specialty Television), at pages 38-39.

the same regime as the act itself. Furthermore, the authorization right, though separate, co-exists with the right to do.[20]

[121] We agree with both propositions. We do not consider that proscribing record labels from availing themselves of this tariff contradicts either proposition.

[122] Thus, many of the tariffs that do not mention whom it can be collected from involve persons who are jointly liable for a single act. This is the case, for example, of the non-broadcast television service and the cable operator for the single communication that occurs when a program is transmitted from the service, to the operator and then on to the operator's subscriber. Simply put, it is not possible to split a single act. Here, as we pointed out, the record labels cannot claim to be the actual users, though they may carry some liability for that use if they purport to authorize it. It is possible to segregate what the labels do from what the online music services do. The Board has already underlined that it is legally possible to assign the right to do to a collective and the right to authorize to another.[21]

[123] Also, almost all tariffs that deal with both the right to act and the right to authorize are SOCAN tariffs. If SOCAN did not file tariffs for both acts, subsection 67.1(4) of the *Act* would prevent it from seeking payment from those who authorize. Here, this is not the case; record labels will not be able to avail themselves of the tariff, but CSI will retain the option to license them if it wishes, and to sue them if they purport to authorize the unlicensed use of its repertoire.

[124] Other tariffs specifically provide that they do not apply to certain types of use. This is what we propose to do. The relevant provision prevents the record labels from interposing themselves only to the extent that a CSI licence is required. Labels will remain free to licence the use of musical works where they are already authorized to do so.

[125] Had we not been convinced that we are able to expressly prevent record labels to avail themselves of the tariff, we would have designed the administrative provisions so as to ensure that CSI would not be obliged to deal with multiple reporting channels. For example, we would have provided that unless CSI consented, one, and only one, report per service could be filed in a reporting period.

F. ABILITY TO PAY

[126] The online music industry is in its infancy. It is small by any standard, with relatively low profit margins and long payouts. Still, we believe that online services can absorb the royalties we set without raising prices while at the same time remaining able to meet their mid-and long-term business objectives.

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[20] See generally, decision of March 26, 2004 dealing with an issue of jurisdiction concerning SOCAN Tariff 4 (Concerts), at pages 8-9.
[21] *Idem*, at page 11.

[127] We think that it is appropriate to phase in this new tariff by applying a discount of 10 per cent to the rates we would set otherwise. This discount is the same that the Board granted when it first certified the Pay Audio Services Tariff. This discount is intended to apply only for the life of this tariff.

G. VALIDATION MEASURES

[128] There is evidence before us which permits us to compare the rates we certify with those in three major foreign markets.

[129] In the United States, for the reproduction of the musical work, permanent downloads currently are subject to the compulsory licence rate of 9.1¢ per track, which corresponds to 9.1 per cent of the retail price of a download from the *iTunes Music Store*.[22] That rate will be subject to review by the Copyright Royalty Board for the period starting January 1, 2008.

[130] In Germany, the *Gesellschaft für musikalische Aufführungs-und mechanische Vervielfältigungsrechte* (GEMA) intends to collect an effective rate of 12 per cent of gross revenues for the right to communicate and reproduce the musical work (not the sound recording) with respect to permanent and limited downloads. The German association representing producers of musical recordings has proposed a royalty of 6 per cent generally and 4.8 per cent for the downloading of music onto cell phones.

[131] In the United Kingdom, the Mechanical Copyright Protection Society, the Performing Rights Society and the British Phonographic Industry settled on a rate of 8 per cent for the reproduction and communication of musical works in all downloads and on-demand streams. The rate base, however, continues to be the object of a dispute which will be settled by the Copyright Tribunal.

[132] The rates we are certifying would be 8.8, 5.9 and 4.6 per cent before discount. After discount, they are 7.9, 5.3 and 4.1 per cent. The simple average of these rates are 6.4 and 5.8 per cent. The weighted average rates, reflecting the relative importance of each type of download, would be much closer to the higher, permanent download rate.

[133] The Board has often stated that caution must be exercised when comparing the rates it certifies to those that apply in other jurisdictions. We nevertheless find that looking at the U.S., U.K. and German situations brings us some measure of comfort that the rates we set in this decision are fair to both copyright owners and copyright users.

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[22] A "digital phonorecord delivery" does not trigger the equivalent of the Canadian communication right in the United States.

VI. TARIFF WORDING

[134] Arriving at the wording of the tariff we certify proved to be a complicated task. Consultations started almost as soon as the hearings ended, when we addressed a series of questions on the structure of the tariff and what it ought to address. Over more than four months, parties, helped by Board counsel, exchanged several sets of correspondence. They met with our counsel for one full-day meeting. They received two drafts, the second being significantly different than the first. Consultations ended barely two weeks ago.

[135] The wording of the tariff we certify is very different from what was published in the *Canada Gazette* or what CSI proposed in the end. This explains why this section of our reasons is somewhat longer than usual.

A. DEFINITIONS

[136] We removed a number of unnecessary definitions. Of those that remain or were removed, some deserve comment.

[137] Section 3 lists what an online music service "and its authorized distributors" are allowed to do pursuant to the tariff. The parties proposed a definition of authorized distributor which we did not include in the tariff. The notion simply does not need to be defined.

[138] CSI asked that the tariff apply to on-demand streams and limited downloads only when they are offered for a fee. CSI and the Objectors agreed that to achieve this, a definition of subscriber was required. We believe that simply using the term without defining it is sufficient. The notion of subscription implies that a payment is made for what is the object of the subscription. Furthermore, in the longer term, we believe that it would probably be appropriate to include such services in the tariff even when they are financed through other means, such as advertising.

[139] The definition of portable limited download was the subject of lengthy discussions. We agree with Rogers that portable limited downloads should be defined as copies that are made by the subscriber. When a service allows the file to be delivered by it to more than one device, as we described in paragraph 87, this should not be considered a portable download.

B. APPLICATION

[140] The tariff allows an online music service and its authorized distributors to make all reproductions required in connection with the operation of a service. It also allows the service to provide 30-second promotional and other previews without incurring any liability or reporting obligations.

[141] The tariff does not apply to medleys. In the physical market, these uses apparently are not licensed through the MLA; they are the subject of separate deals. It is no imposition on those who negotiate those deals to require them to also address uses in the online market.

C. REPORTING REQUIREMENTS

[142] The information that an online music service is required to provide CSI is considerably less than what CSI was asking for. The following principles guided us in deciding what should and should not be provided.

[143] First, CSI should get enough information to allow it to identify which files use its repertoire and which do not. For this reason, services must report descriptive information concerning files for which, according to the service, no licence is required.

[144] Some objectors fear that CSI may seek to use the information it gets on works that are not in its repertoire to recruit new members. We do not think it necessary to account for this possibility for two reasons. First, the reporting timelines are simply too tight for CSI to be able to gain any significant advantage in this respect. Second, there is no reason to believe that CSI has done this in the past or may be thinking of doing it in the future. Needless to say, any indication to the contrary would result in the Board changing the reporting requirements and imposing restrictions on what CSI may use the information for.

[145] Second, given the way in which business has been conducted to date in related markets, CSI should obtain a certain amount of information that is otherwise redundant. CSI has convinced us that there is enough uncertainty in the information it gets pursuant to the MLA, for example, to justify providing a certain amount of alternative, additional information. That being said, redundancy should be limited to what is clearly informative and helpful. Asking for more information than necessary penalizes those who provide CSI with all the information it needs in the first place. Generally speaking, the best way to get correct information is to ask for it and to sanction those who do not comply.

[146] Third, CSI should get not only the information it requires to calculate and distribute royalties, but also other information that will allow it to develop a sense of overall compliance without having to resort to systematic audits.This is why we would have required services to provide information about their overall sales, had CSI not agreed in the end to abandon this request. On the other hand, financial information concerning files for which no licence is required ought to be kept to a minimum.

[147] Financial information concerning files using works whose status is uncertain is another matter. Thus, when CSI realized that we would probably not require services to provide it with detailed sales reports for all files, it asked to be provided with at least a list of all files that had been streamed or downloaded in a month. We would not have done so for files for which no licence is required. We thought of requiring some sales information regarding files using works whose status is uncertain but did not do so in the end. For this tariff, at least, it seems to us that CSI will be sufficiently busy dealing with files it knows to be in its repertoire. Moreover, some services already provide complete sales data to CSI simply because it is more convenient to do so. The matter should be reexamined when the time comes to certify the next tariff.

[148] Fourth, if information is essential, a service ought to provide it even if this means getting it from someone else. Music labels do not always provide online music services the name of the author of a musical work, the International Standard Recording Code assigned to a sound recording or a variety of information about the album on which a sound recording may have been released in physical format. This is not reason enough to relieve the service from providing the information. Services require a licence. They need CSI's help to determine what is in its repertoire and what is not. Basic copyright information should therefore be provided. In other cases, where the information is helpful but not essential, the information ought to be provided only if available.

[149] In this tariff, however, we are willing to make an exception. This is a first tariff with significant retroactive effects. CSI's licences with the services do not oblige them to provide the information. Requiring the labels and the services to adjust their systems rapidly could prove unnecessarily costly. However, it appears that the worldwide reporting format currently being discussed contemplates including most if not all of that information. In any event, the services should expect to be required to supply this information in all cases in the near future.

D. INFORMATION FLOW

[150] Upon starting operations, a service will report and update monthly basic information about itself and the files it posts on its server. CSI will then tell the service which files use CSI's repertoire. We are conscious that in so doing, we are certifying a tariff that entrenches the systematic violation of the rights of those whom CSI does not represent. For practical reasons, it would be difficult to act otherwise, at least for the time being. This may be due in large part to what could be seen as a variety of applications of the so-called long tail effect to this market. First, the market was originally structured around the compulsory licence that existed in Canada until 1989 and that still exists in the United States. Second, this market requires players to rapidly digitize and offer back catalogues whose owners may not always be easy to identify. Third, the quest to offer everything that is available means that a lot of what is offered may be consumed little, if at all; understandably, no one wishes to expend resources to determine who owns the rights in something that generates no royalties. This is a matter that will have to be re-examined in subsequent proceedings.

[151] Each month, a service will report to CSI the information required to calculate the royalties owing and CSI will do so, based on the reports each service files, and then invoice the service. The Objectors' request to have the option of calculating royalties themselves or asking CSI to do so would create unnecessary uncertainty and delays.

[152] Reporting and payment dates have been set to allow CMRRA to continue to distribute royalties within 75 days of each quarter. This can be made easier by spreading the reporting burden over time. For this reason, information is to be exchanged every month even though payments are made only once per quarter.

[153] Involving CSI in the information chain has certain consequences. Since the system is not fully self-reporting, for example, it is possible that a service may pay an incorrect amount of royalties through no fault of its own. A service should not then be held liable for the consequences of CSI's errors. We have reworded the usual provisions dealing with payment adjustments, liability for audit costs and interests accordingly. We did not grant CSI's request that liability be shifted only where incorrect payments are the result "solely" of an error or omission on the part of CSI. We do not wish to put all the burden of a joint error on only one party.

[154] On the other hand, we have not allowed the Objectors to audit CSI's books. CSI will provide detailed royalty calculations; these should be sufficient for a service to verify if the amount being asked of it is correct.

E. TERMINATION OF THE LICENCE

[155] CSI asks that the tariff provide for the termination of the licence if a service does not pay royalties, does not comply with the tariff or becomes bankrupt or insolvent. The only other tariffs to do so are the Canadian Broadcasters Rights Agency (CBRA) Media Monitoring Tariffs. The Objectors disagree. They point out, among other things, that certain provisions of the *Bankruptcy and Insolvency Act* (*BIA*) and of the *Companies' Creditors Arrangements Act* prevent the termination of agreements.

[156] Our understanding is that the *BIA* addresses copyright issues differently. It seems to us that if, as section 83 of the *BIA* provides, an assignment of copyright is terminated by operation of the law (that is, without the scenario having been provided for in the assignment contract), then *a fortiori*, a licence can provide that a bankrupt licensee shall not be entitled to avail itself of the licence. We see no reason why copyright owners should subsidize an insolvent operation. Furthermore, we would rather let the ordinary courts of law determine whether or not a provision such as section 13 of the tariff is or not effective.

[157] Subsections 65.1(1) and (2) of the *BIA* may prevent CSI from ending the licence for the sole reason that royalties are owing "in respect of" a period before the filing of a notice of intention or proposal. Apparently, this allows a trustee to use the licence as long as it is complied with from the date of the notice of intention or proposal. Subsection 65.1(4) also provides that a person is entitled to require immediate payment for the use of "licensed property" after the filing of the notice or proposal, or to require the further advance of money or credit. In the longer term, a solution may be to provide that an insolvent service must pay royalties in advance. Again, analyzing this matter is better left to another time.

F. SECURITY, TPMS AND OTHER REQUIREMENTS

[158] The tariff does not deal with minimum security requirements, the use of technological protection measures (TPMs), the nature and extent of the information regarding copyright that a service should provide to its customers or customer content usage rules. From the outset, it was

agreed that at most, the tariff would require that the service comply with the same rules as those agreed upon with the music labels. As time went on, it became clear that such a provision would be redundant at best. Then recently, PureTracks announced that it had started offering some files without any attached DRM software. It is better to address this matter later, to the extent it is relevant.

G. TRANSITIONAL PROVISIONS

[159] We have allowed for extended delays to file reports that relate to periods before the tariff was certified. The agreements between CSI and the online services require the services to make interim payments until the Board certified the tariff. The discrepancies between these payments and what the final tariff sets, though not insignificant, are relatively modest. Furthermore, CSI has not yet provided many of the reports it must supply in order for the services to know what they ought to pay. Under the circumstances, we see no need to provide for the payment of interests on the difference.

VII. FINAL RATES

[160] The following Table 2 shows the rates we obtain before the application of the 10 per cent discount, and the ones we certify, after its application.

TABLE 2

Category	Rates before discount	Rates certified, after discount
Permanent Download	8.8% of the amount paid by a consumer Minimum fee: 4.5¢ per file in a bundle; 5.9¢ per file in all other cases	7.9% of the amount paid by a consumer Minimum fee: 4.1¢ per file in a bundle; 5.3¢ per file in all other cases
Limited Download	5.9% of the amounts paid by subscribers Minimum fee: 57.0¢ per month, per subscriber if portable limited downloads are allowed; 37.4¢ if not	5.3% of the amounts paid by subscribers Minimum fee: 51.3¢ per month, per subscriber if portable limited downloads are allowed; 33.7¢ if not
On-demand Stream	4.6% of the amounts paid by subscribers Minimum fee: 29.2¢ per month, per subscriber	4.1% of the amounts paid by subscribers Minimum fee: 26.3¢ per month, per subscriber

[161] It is not possible to estimate with any reliability the total amount of royalties that this tariff will generate for CSI. However, based on numbers recently publicly released by Nielsen SoundScan Canada, it is possible to estimate that the tariff on permanent downloads would generate royalties close to $2 million in 2006, and slightly under $1 million in 2005.

Claude Majeau
Secretary General