11-127

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE APPLICATION OF THP CAPSTAR ACQUISITION CORP.
(NOW KNOWN AS DMX, INC.)

UNITED STATES OF AMERICA,
Plaintiff,

AMERICAN SOCIETY OF COMPOSERS, AUTHORS AND PUBLISHERS,
Defendant-Appellant,

v.

THP CAPSTAR ACQUISITION CORP. (NOW KNOWN AS DMX, INC.),
Applicant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE

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INTEREST OF THE UNITED STATES

The decision below implements an antitrust consent decree entered between the United States and Defendant-Appellant American Society of Composers, Authors and Publishers ("ASCAP"). The United States has an interest in the correct construction of the decree.

ISSUE PRESENTED

Whether the ASCAP consent decree authorizes the district court to set a fee structure for a blanket license that incorporates a credit for directly licensed works.

STATEMENT OF FACTS

ASCAP and Broadcast Music, Inc. ("BMI") are the two largest music performing rights organizations ("PROs") in the United States. They aggregate rights from copyright holders, license them on a non-exclusive basis to music users, and distribute the royalties to their members. These and other functions provide some efficiencies, but also give the PROs significant market power. Since each has hundreds of thousands of members and millions of works, and no member may license the same composition through both PROs, no bulk user of music can operate without licenses for works from both. To cabin the exercise of their power, the government brought antitrust suits against each of them. The results were regulatory decrees which, as pertinent here, were amended to allow the district court to prescribe reasonable rates for the licenses. The version of the ASCAP decree currently applicable is the Second Amended Final Judgment. *United States v. ASCAP*, 2001-2 Trade Cas. (CCH) ¶ 73,474, 2001 WL 1589999 (S.D.N.Y. June 11, 2001) ("*AFJ2*").

The "rate court" provision of the *AFJ2* is Section IX, which provides that: "(A) ASCAP shall, upon receipt of a written request for a license for the right of public performance of any, some or all of the works in the ASCAP repertory, advise the music user in writing of the fee that it deems reasonable for the license requested . . . ." *AFJ2* at 91,962. If the parties ultimately cannot agree upon a rate, either party may ask the rate court to set one, and: "(B) In any such proceeding, the burden of proof shall be on ASCAP to establish the reasonableness of the fee it seeks . . . . (D) Should ASCAP not establish that the fee it requested is reasonable, then the Court shall determine a reasonable fee based upon all the evidence." *Id.*

The primary form of license granted by ASCAP and BMI is a "blanket license," which gives licensees the right to use as much of the PRO's music as they want at any time. In mid-2005, Appellee DMX Inc., a background music service provider that had just been purchased from bankruptcy, applied for blanket licenses from ASCAP and BMI with fees that would be discounted in proportion to its use of works that it directly licensed from members of each respective organization. *In re Application of THP Capstar Acquisition Corp. (now known as DMX Inc.)*, __ F. Supp. 2d __ (S.D.N.Y. Dec. 1, 2010), set out in Appellant's Brief Special Appendix 8, 44 ("SA"). ASCAP, unlike BMI, responded with an offer of a flat fee license with no possibility of a discount or carve-out. SA 43-44. DMX rejected ASCAP's offer, and in 2006 began a program of seeking direct licenses from ASCAP and BMI publisher members, with the result that by the time of trial in this case in 2010 it had 850 such licenses. SA 26-27, 43.

As the trial approached, ASCAP proposed two alternative fees. Its preferred approach was a flat fee of approximately $15.7 million for the period June 2005 to December 2009 (averaging $41.21 per location), and per location fee of $49 for the period 2010-2012 that took no account of DMX's direct licenses. SA 52-54. Its alternative offering for 2010-2012 was a flat fee with a static carve-out reflecting DMX's direct payments to ASCAP members in 2009. SA 59. Judge Cote found that ASCAP had not proven either to be reasonable. The pure flat fee was unreasonable because it failed to provide a carve-out. Even if the decree did not require ASCAP to offer one, Judge Cote found it "difficult to understand why ASCAP did not try to shape the contours of such a license by constructing – at least as one of its alternative proposals – a reasonable fee for one," in light of prior rulings that the court could adopt one. SA 56, citing *United States v. BMI (Applications of Muzak LLC & AEI Music Network, Inc.)*, 275 F.3d 168, 171 (2d Cir. 2001) ("*AEI*"), and *United States v. ASCAP (Applications of Muzak, LLX & DMX Music, Inc.)*, 309 F. Supp. 2d 566, 568 (S.D.N.Y. 2004) ("*Muzak I*").[1] Rejecting ASCAP's argument that a carve-out fee structure was unreasonable because no willing seller would ever offer it, she found it "appropriate and justified" on the facts of this case, particularly in implementing an antitrust consent decree where the evidence showed that it would increase competition. SA 58. Finally, DMX had the choice to apply for a blanket license or a per-segment license, and ASCAP was required to respond to the blanket license request. SA 59.

Judge Cote described ASCAP's static carve-out license as essentially a dollar-for-dollar reduction in the basic flat fee for payments DMX made directly to the publishers for rights to ASCAP music, but with an added $25,000 per year to cover ASCAP's administrative costs. SA 59-60. She found that the net effect was that "DMX is taxed for having engaged in a direct licensing program: its license

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[1] DMX Music, Inc. acquired AEI in 2001, while the BMI appeal was pending, and continued AEI's quest for carve-out licenses.

fee is higher than it would have been if it had engaged in no such program. . . . [I]t is increasingly disadvantaged with every new license it negotiates." SA 61-62. In any event, the per location benchmark rate that ASCAP used to compute its flat fee, derived from its 2005 settlement with Muzak, was unreasonably high, SA 62-64 & 68, and the flat fee itself takes no account of the fluctuations in the number of locations DMX has served, SA 63, or the changing number of directly licensed works. SA 66. On this last point, she declined to follow Judge Conner's opinion in *United States v. ASCAP (Applications of Muzak & DMX)*, 323 F. Supp. 2d 588 (S.D.N.Y. 2004) ("*Muzak II*"), that the proper way to accommodate a developing direct license program is by a series of short term licenses and potentially recurring litigation, finding that the record in this case was sufficient to establish a reasonable adjustable fee. SA 72-73. Finally, she found that ASCAP had failed to produce adequate evidence to support its claimed administrative expenses. SA 68.

By contrast, Judge Cote found DMX's proposal reasonable. The fee structure consisted of a combination of a "floor fee" intended to compensate ASCAP for constructing and administering the blanket license, which DMX would pay even if it licensed all its music directly, and an "unbundled music fee," the value of the performance rights licensed from ASCAP, which would be adjusted by the percentage of ASCAP music licensed solely from ASCAP. SA 73-74. For the music fee, DMX used the amount it paid under its direct licensing agreements as a benchmark, and for the floor fee, it used ASCAP's own allocation of costs for the background music services licenses. Combining the music fee and the floor fee produced a total fee of $13.74 per location before deductions for direct licenses. SA 74-77. Judge Cote found that the unbundled floor fee is a reasonable means to ensure compensation to ASCAP for its services, and that, despite a conclusory protest, "ASCAP has challenged neither the methodology nor the calculations associated with the proposed floor fee." SA 77-78. With respect to the unbundled music fee, she found the direct license fees to be an appropriate benchmark, SA 79-81, and that the amount should not be increased on the basis of an advance DMX paid to Sony. SA 84-85.

ARGUMENT

THE ASCAP DECREE AUTHORIZES THE RATE COURT TO REQUIRE FEES THAT TAKE DIRECT LICENSES INTO ACCOUNT

The United States addresses here only the legal issue whether the ASCAP decree covers adjustable fee blanket licenses ("AFBLs"). ASCAP Br. 51-59.

In *AEI*, this Court's interpretation of the BMI consent decree endorsed a blanket license fee structure that makes competition between a PRO and its members plausible. 275 F.3d at 171. ASCAP here seeks to be shielded from such competition based not on any difference between its operations and BMI's, and based not on any operative term of its consent decree, but rather based on a definition of a term that does not actually appear in the relevant sections of its decree. And even ASCAP's reading of "blanket license" would require the Court to ignore the definition of "ASCAP music," on which the definition of "blanket license" turns for these purposes. This Court should decline ASCAP's invitation to adopt a strained interpretation of the ASCAP consent decree in order to undermine its competitive effects.

1. The interpretation of a consent decree is an issue of law that the court of appeals determines *de novo*. *Waldman v. Riedinger*, 423 F.3d 145, 148-49 (2d Cir. 2005). The basic rules of contract interpretation apply. The meaning of a decree is to be discerned from its text in the first instance. *Firefighters Local Union No. 1784 v. Stotts*, 467 U.S. 561, 574 (1984). If ambiguities appear, the court may rely upon appropriate aids to construction, including the circumstances surrounding its adoption. *United States v. ITT Cont'l Baking Co.*, 420 U.S. 223, 238 (1975). In this case, the antitrust context is one such circumstance. *AEI*, 275 F.3d at 175; *ASCAP v. Showtime/The Movie Channel, Inc.* ("*Showtime*"), 912 F.2d 563, 570 (2d Cir. 1990). In addition, deference is especially appropriate to the

interpretation of the district judge who enters and oversees a consent decree. *Doe v. Pataki*, 481 F.3d 69, 75-76 (2d Cir. 2007).

2. ASCAP appears to argue (ASCAP Br. 50) that the decree does not require it to offer music users a blanket license carve-out rate as sought here. That argument confuses negotiating procedure with licensing substance. When ASCAP is asked for a license, Section IX(A) requires that it quote "the fee which it deems reasonable," "giv[ing] ASCAP the initiative in proposing the entire formula." *United States v. ASCAP (Application of Metromedia, Inc.)*, 341 F.2d 1003, 1005 n.1, 1009 (2d Cir. 1965) ("*Metromedia*"). The applicant, however, has no obligation to accept ASCAP's proposal. It is simply a starting point for negotiation, and if the parties resort to the rate court, Sections IX(B) and (D) explicitly place the burden of proving that its rate quote is reasonable on ASCAP. *AFJ2* at 91,962.

The real question, then, is whether the court has the discretion to require a carve-out rate structure in appropriate circumstances.[2] A comparison of the language in Section IX of the ASCAP decree to the language of Section XIV of

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[2] ASCAP presents this issue as whether the district court may establish a fee structure that would "allow licensees to circumvent" the *AFJ2*. ASCAP Br. 5. The function of the *AFJ2* is to mitigate ASCAP's market power by imposing certain obligations and prohibitions on it. The decree imposes no obligations or prohibitions on licensees for them to "circumvent."

the BMI decree that this Court construed in *AEI*, 275 F.3d at 176-77, shows that the rate court plainly has that power.

Invoking *United States v. ASCAP (Application of Shenandoah Valley Broadcasting, Inc.)*, 331 F.2d 117 (2d Cir.), *cert. denied*, 377 U.S. 997 (1964) ("*Shenandoah*"), ASCAP contends that *AEI* is inapplicable because the decrees, read as a whole, are different. In ASCAP's view, *Shenandoah* allows the court to set rates only for licenses required by other parts of the ASCAP decree, the decree requires ASCAP to give "background/foreground music services" (as the decree refers to commercial music services like DMX) only "blanket licenses" and "per-segment license[s]" as defined in Sections II(E) and (J), and the license sought here is neither. ASCAP Br. 51-54.

The short answer is that Section VI, the provision of the decree requiring ASCAP to provide "any music user" a "license to perform all of the works in the ASCAP repertory," which is the type of license DMX seeks here, does not use the defined term "blanket license," so there is no reason to impose any limitations on the fee structure that might derive from the definition.

The longer answer is that ASCAP raised these same arguments in *Muzak I* before Judge Conner, the judge who entered the decree, and he correctly rejected them. He held that the principles of *AEI* apply, 309 F. Supp. 2d at 577-78, and that the *AFJ2* does not preclude a carve-out license. *Id.* at 578-81. ASCAP relies on the definition of a blanket license as one that "does not vary depending on the extent to which the music user in fact performs ASCAP music." ASCAP Br. 53 (quoting § II(E)). As Judge Conner pointed out, under a carve-out license "any fee variance for the blanket license would not be based on the frequency or degree of ASCAP music performance, but rather on the existence of applicants' direct licensing relationship with ASCAP members." *Muzak I*, 309 F. Supp. 2d at 579. ASCAP reaches its contrary result by distinguishing between music licensed directly from its members and music licensed only through it, but that distinction is foreclosed by the decree. The *AFJ2* defines "ASCAP music" as "any work in the ASCAP repertory" or which "ASCAP has . . . the right to license" (Sections II(B)-(C)) without regard to whether ASCAP actually licenses it. *AFJ2* at 91,958. Under the formula at issue here, if DMX uses no works from the ASCAP repertory, it will owe the full blanket rate; it must pay for the right to use the music whether or not it exercises that right. If it uses ASCAP works, whether 100 or 1,000 works, the fee will remain the same if none are directly licensed. Thus, the fee will vary with the percentage directly licensed, *e.g.*, 40% or 60%, but will not depend on the extent to which DMX uses ASCAP music.

ASCAP further argues that allowing an adjustable rate blanket license is inconsistent with the *AFJ2*'s provision for per segment licenses and the related "genuine choice" requirement, which would be "eviscerate[d]" or made superfluous by carve-out licensing. ASCAP Br. 52-53, citing *AFJ2* sections VII(A)(2) and VIII(B). ASCAP's contention, however, cannot be reconciled with this Court's fundamental rationale in *AEI* that AFBLs are blanket licenses, to which all applicants are entitled, despite their modified fee structure. 275 F.3d at 176-77. Indeed, ASCAP's reasoning would imply that *AEI* was wrongly reasoned and wrongly decided.

To begin with, ASCAP's reasoning has been rejected by all three rate court judges who have faced it. As Judge Conner explained, the "genuine choice" provision was intended simply to "level the financial playing field between the different types of licenses, and to preclude ASCAP from compelling music users into accepting license *A* by overpricing license *B*," not to preclude some other type of reasonable fee structure. *Muzak I* at 580. Similarly, in the recent decision in *WPIX, Inc. v. BMI*, Opinion and Order, 09 Civ. 10366 (LLS) (S.D.N.Y. Apr. 27, 2011), Judge Stanton held that the availability of per program licenses for broadcasters under the BMI decree did not preclude them from seeking blanket licenses with a carve-out fee structure. As he explained, the provisions for other types of licenses do not affect an applicant's entitlement to a blanket license, because under *AEI* a carve-out is "a mere readjustment to the fundamental blanket license and thus was required to be made available without regard to the per-piece or per-program options." *WPIX* at 7. In other words, as Judge Cote concluded, "ASCAP's preference that DMX apply for a per-segment license" does not override the applicants' right to a blanket license, and their right to a reasonable fee for such a license – even if that fee includes a carve-out for directly licensed works. SA 59.

Even setting aside those bedrock principles about pricing a blanket license, ASCAP's argument still proves too much, because it would imply that *AEI*'s reasoning was faulty and its conclusion was wrong. In brief, ASCAP reasons that because an AFBL might serve the needs of a licensee desiring a per-segment licensing arrangement, the AFBL must actually not be available to anyone, lest the consent decree's per-segment licensing provision be surplusage. But the BMI decree also offers licenses different from a traditional blanket license – per-program and per-programming-period licenses that allow some broadcasters to benefit from direct licensing – that might be simulated by an AFBL. On ASCAP's reasoning, under the BMI decree no broadcaster (or perhaps no one at all) would have the right to an AFBL because of the existence of such alternatives. Of course, *AEI* held just the opposite. Indeed, BMI recently made exactly ASCAP's argument, and the district court in *WPIX* flatly rejected it as inconsistent with *AEI*. There, Judge Stanton correctly recognized that the *AEI* Court was well aware of the alternative licenses under the BMI decree, yet did not decide the permissible terms of the blanket license based on what alternative licenses might have been available. *WPIX*, *supra*, at 7. Moreover, ASCAP's argument would, strictly speaking, only imply the unavailability of AFBLs to licensees who could otherwise take advantage of per-segment licensing. But drawing such distinctions among potential AFBL licensees is at odds with the implication of *AEI*: because AFBLs are merely blanket licenses with a different fee mechanism, they are available as a matter of right to all users, regardless of whether any particular user may also be entitled to other, narrower licenses. *See WPIX*, *supra*, at 7.

Finally, ASCAP renews its argument that *AEI* does not apply because of the overall difference in the context of the two decrees (ASCAP Br. 54-55), but again, Judge Conner rejected that argument, pointing out that having disposed of the specific provisions on which ASCAP relied, the remaining provisions are "sufficiently comparable in their entireties to warrant following the analytic trail blazed" in *AEI*. *Muzak I* at 580-81. ASCAP offers no rebuttal to Judge Conner's reasoning on any of these points.

On the other hand, ASCAP relies on Judge Conner's decision in *Muzak II* to argue that the decree limits the rate court to allowing credits only for direct licenses in existence at the time of the trial. ASCAP Br. 56-57 (citing 323 F. Supp. 2d at 590).[3] In *Muzak II*, however, Judge Conner did not address the construction of the decree itself, but rather his Order in *Muzak I* and its references to "arrangements previously entered into" and "prior direct licensing arrangements." *Muzak II* at 591 (citing *Muzak I* at 577-78). His only direct reference to the decree is that "the Court's determination of a reasonable fee in a rate court proceeding cannot be subject to unpredictable future events." *Muzak II* at 591 n.3. Judge Conner also endorsed ASCAP's view that short term licenses would be preferable to a flexible fee structure, which would be "likely to spawn expensive and time-consuming litigation every time that applicants enter into a new direct licensing arrangement during the license term." *Id.* at 592.

ASCAP's reliance on *Muzak II* is ill-advised. The objection to unpredictability, if taken to its logical conclusion, suggests that only a fixed fee is allowed, and not one that incorporates a formula for adjustment over time, even a

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[3] Judge Conner denied a motion by Applicants Muzak and DMX Music, Inc., to allow an interlocutory appeal. *United States v. ASCAP (Application of Muzak)*, 333 F. Supp. 2d 215 (S.D.N.Y. 2004). A few months later, Muzak settled with ASCAP, and DMX Music, Inc. (Appellee's predecessor) filed for bankruptcy, SA 15, so his decision was never appealed. Muzak filed for bankruptcy in 2009. SA 18-19.

per location rate. *See* SA 63-64. Yet Judge Conner did not go to such extremes. To the contrary, in *Muzak I* he ruled in favor of AFBLs, and in *Muzak II* suggested short-term licenses so as not to impede the use of AFBLs. In this proceeding, Judge Cote found no ASCAP support for short-term licenses (SA 72-73), and ASCAP has not objected to the per location aspect of the rate prescribed here. As to increasing litigation, neither ASCAP nor BMI in its parallel appeal has argued that the formulas imposed here would have that effect.[4]

Moreover, as Judge Cote found, Judge Conner was working on an abstract proposal where the applicants did not yet have direct licenses. SA 72. In effect, he was making a first, or preliminary, try at dealing with the new world of AFBLs. By contrast, Judge Cote had before her a fully formed record showing a "robust" program encompassing hundreds of direct licenses that would clearly warrant recognition under *Muzak I*, and no one advocated Judge Conner's *Muzak II* solution of short-term licenses, which she saw as unpredictable and inefficient. *Ibid*. These factual differences fully justified her in distinguishing *Muzak II* and

[4] Judge Cote expressed a parallel concern about the possibility of frequent litigation arising from the use of short term licenses. SA 72-73. This is probably not a major consideration in either direction. As the courts decide the basic legal principles for either short term licenses or a formula in cases like this, the open legal and factual issues worth litigating would quickly shrink to the point that negotiated settlements would become the norm.

deciding not to follow it "to the extent that the record permits a reasonable fee to be set for an adjustable fee license," a condition she found to be met by DMX's proposal. SA 73. ASCAP does not deny the factual differences, but mistakenly argues only that *Muzak II* established an immutable principle of law. ASCAP Br. 56-57.

Finally, ASCAP argues that a carve-out license is "economically unreasonable" and not one that a seller would willingly grant. ASCAP Br. 58-59. Historically, however, the courts adopted the hypothetical willing buyer/willing seller test only to measure the reasonableness of benchmarks for blanket license rate levels. It is a tool for trying to assign value to the collective performance rights of ASCAP's members' compositions in the absence of a competitive market. There is no *a priori* reason it should also govern rate structure. Moreover, ASCAP is essentially a pass-through administrator for its thousands of members for whom it negotiates fees. To the extent its members choose to negotiate direct licenses with DMX, it no longer has to pass those royalties on to them. The result is enhanced competition, with some members agreeing to lower per play fees in the hope of a higher number of plays and putting pressure on others to do the same, and DMX reaping the benefit. Absent the carve-out, any DMX direct licensing effort would face double payments for the same works, and

ASCAP has produced no evidence that an entity like DMX has been able to operate successfully solely on direct licenses. So long as these circumstances have prevailed, ASCAP has been able to negotiate or litigate for collective prices on behalf of its members much higher than the ones so far produced by competition. In that context, a carve-out rate structure that allows competition is entirely reasonable and within the scope of the language of the *AFJ2*. SA 58-59.

CONCLUSION

For these reasons, the Court should affirm the district court's holding that it can impose a carve-out rate structure.

Respectfully submitted,

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May 6, 2011

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Dated: May 6, 2011

CERTIFICATE OF SERVICE

I, Robert J. Wiggers, hereby certify that on May 6, 2011, I electronically filed the foregoing Brief for the United States as Amicus Curiae with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the CM/ECF system. Attorneys for each party in the case who are registered CM/ECF users will be served by the CM/ECF system.

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