As the music industry races toward a future of digital streams and smartphone apps, its latest crisis centers on a regulatory plan that has been in place since “Chattanooga Choo Choo” was a hit.

Since 1941, Ascap and BMI, the two giant licensing organizations that dominate music publishing, have been governed by consent decrees with the Justice Department. These agreements were made to guarantee fair royalty rates for songwriters and for the radio stations, television networks and even restaurants and retail shops that play their music.

But with the industry struggling to make money from digital music, this system has come under attack. The streaming service Pandora is squaring off against Ascap in a closely watched trial over royalty payments. Big music publishers like Sony/ATV and Universal are calling on the government to overhaul the system, and technology companies are accusing the publishers of trying to skirt federal rules meant to protect them.

The outcome could reshape the finances of a large part of the industry.
The charter members of the American Society of Composers, Authors and Publishers, including Victor Herbert, seated, and Irving Berlin, right. Credit ASCAP

“What’s happening with these court cases will determine the future of the music publishing and songwriting industries,” said David Israelite, the president of the National Music Publishers’ Association. “It is simply unfair to ask songwriters and publishers to be paid something less than a fair market rate for their intellectual property.”

For nearly a century, Ascap and BMI, known as performing rights organizations, have served an essential middleman function. They grant the licenses that let various outlets use songs, and then funnel royalties from these billions of “performances” back to publishers and songwriters.

Together, the groups process more than $2 billion in licensing fees each year, and represent more than 90 percent of the commercially available songs in the United States. Performance royalties have become critical for songwriters as sales of compact discs and downloads — which pay a different kind of royalty not administered by Ascap and BMI — have fallen.

Ascap, which stands for the American Society of Composers, Authors and Publishers, was founded by a group of composer luminaries including Irving Berlin and Victor Herbert. Its 100th birthday is this week. BMI, or Broadcast Music Inc., was created by broadcasters in 1939 as a competitor.

After federal antitrust investigations, both groups agreed to government supervision in 1941.

This system has hummed along for decades. But with the rise of Internet radio, publishers have complained that the rules are antiquated and unfair. They point to the disparity in the way Pandora compensates the two sides of the music business: Last year, Pandora paid 49 percent of its revenue, or about $313 million, to record companies, but only 4 percent, or about $26 million, to publishers.

“It’s a godawful system that just doesn’t work,” said Martin N. Bandier, the chairman of Sony/ATV, the world’s largest music publisher.

The wider music world has been galvanized by the issue of low royalties from fast-growing streaming companies.

In 2012, for example, when Pandora’s former chief executive testified at a congressional hearing on music licensing, songwriters protested on Capitol Hill. Five writers of hits by stars like Beyoncé and Christina Aguilera showed that 33 million plays on their songs on Pandora yielded just $587.39 in royalties for them.

Music executives argue that the problem is rooted in the Justice Department’s oversight of Ascap and BMI. Under the consent decrees, the performing rights groups are not permitted to refuse licenses to any outlet that applies for them, and rate negotiations can drag on for years. To get around this, some big publishers have tried to change their ties with Ascap and BMI, forcing digital outlets like Pandora to negotiate directly.
Pandora cried foul in its federal lawsuit, saying that the move led to higher rates and violated the Justice Department regulations. That issue is also at play in a separate pending suit filed last year by BMI against Pandora. The two suits, filed in Federal District Court in Manhattan, ask the court to set a royalty rate for Pandora. A third, much smaller performing rights group, Sesac, is not subject to a consent decree.

Pandora argued in court that it had been put in “absolute gun-to-the-head circumstances” in negotiations with publishers, and had fought to keep its rates low. In a statement, the company said that the consent decrees offered important protections for the music world, including “a mechanism to establish a reasonable royalty rate when songwriters and music users cannot agree on a rate.”

Ascap argued that Pandora should pay it more than its current rate of 1.85 percent of revenue as part of the 4 percent that it pays for all publishing rights. When Apple made direct deals with publishers last year for its new Pandora-like service, iTunes Radio, its rates were said to be about 10 percent of revenue.

Closing arguments in the case were heard on Monday, and the judge is expected to rule soon.

In frustration, leading music figures have begun to ask the government to update the consent decrees to allow more flexible licensing. In an opinion article in The Wall Street Journal last month, the songwriter Burt Bacharach said these agreements “are supposed to guarantee us ‘reasonable fees,’ but these aren’t remotely reasonable.”

Ascap and BMI have met with the Justice Department, although they would not say specifically what they had requested. A Justice Department spokeswoman declined to comment.

What will happen if publishers do not get the relief they want from the government is unclear. Some have suggested that they might abandon the performing rights organizations.

“Everything is geared now to what happens with the Department of Justice,” said Zach Horowitz, the chairman of the Universal Music Publishing Group. “If we can’t secure adjustments to the consent decrees, which were last modified before the introduction of the iPod, we’ll have no choice but to consider some radical steps in order to ensure our writers are fairly compensated in the rapidly changing marketplace.”

Two court rulings late last year threw the industry into confusion over how the performing rights organizations would continue to represent publishers. Universal and Sony/ATV have since made short-term arrangements with BMI to stabilize the market, but their involvement in the long run is still an open question.

“If we were forced into the corner and had to do that,” Mr. Bandier said when asked whether his company would withdraw from Ascap and BMI, “it would be catastrophic for those two societies. And we don’t want that to happen.”
A future without Ascap and BMI, or one in which they no longer represent a majority of songs, has the music industry worried. Major publishers could handle responsibilities like issuing licenses to radio networks, but even the biggest of them say that Ascap and BMI have an irreplaceable infrastructure.

“No other organization, and certainly no single publisher, can negotiate, track, collect, distribute and advocate for music creators on the scale that we do, with the same level of accuracy, efficiency and transparency across so many different media platforms,” Paul Williams, the songwriter and president and chairman of Ascap, said in a statement.

On Thursday — the 100th anniversary of its founding meeting — Ascap reported that it had $944 million in revenue in 2013. It also paid $851 million in royalties to its members, up 3 percent from 2012.

For songwriters, Ascap and BMI have also been among the most reliable institutions in the music industry, and few want to see them go. But Rick Carnes, a Nashville songwriter and president of the Songwriters Guild of America, said that while these organizations had served him and his colleagues well, the Justice Department agreements that govern them were outdated and must be changed.

“This is a horse-and-buggy consent decree in a digital environment,” Mr. Carnes said. “There’s no way that works now.”
In the increasingly bitter dispute over royalties for online music, Pandora Media won an important battle in court. But the state of the larger war is far from clear.

Last week, Judge Denise L. Cote of the United States District Court for the Southern District of New York ruled in a closely watched lawsuit between Pandora, the leading Internet radio service, and the American Society of Composers, Authors and Publishers, the 100-year-old music licensing group better known as Ascap. The ruling was sealed, but on Friday Ascap revealed that the judge had left unchanged the royalty rate that Pandora must pay Ascap to use its music, at 1.85 percent of Pandora’s revenue.

Based on the royalty rate alone, the decision appeared to have split the issue down the middle. Pandora had wanted the slightly lower rate that radio broadcasters pay (1.7 percent of revenue); Ascap, envious of the (much) higher royalties that record companies make from Pandora, had wanted the rate to gradually increase to 3 percent. So neither side got what it wanted.

But taken in its entirety, Judge Cote’s ruling, unsealed Wednesday, was to a large degree a win for Pandora. Not only did the company succeed in many of its core arguments, but the judge also harshly criticized several top music executives over their testimony.

The scorecard can also be read in the reactions to the decision. In a statement, Will Valentine, a Pandora spokesman, said, “We appreciate the important role the court serves in determining the fair market value of an Ascap license.”

On the other hand, David Israelite, the president of the National Music Publishers’ Association, reflected the anger throughout the music world by calling the ruling “a slap in the face to anyone who creates music or represents those creators.”

Pandora argued in court that its service, which customizes a stream of music for each user, is a form of radio. Ascap’s lawyers disputed this, noting that Pandora plays far more music each hour than most radio stations and lacks telltale radio features like disc jockeys and news. But in her 136-page ruling Judge Cote sided with Pandora.

“Unlike traditional broadcast AM/FM radio, in which one program is played for many listeners, Pandora’s digital radio service provides the opportunity to have a unique program created for the enjoyment of each listener,” she wrote. “This distinction between programmed and customized radio has been referred to as the one to many, versus the one to one distinction. But, despite that differentiation, made possible by digital technology, Pandora is radio.”
Yet Judge Cote rejected Pandora’s argument that this means it is entitled to the same royalty rate as radio stations. She also disagreed with Ascap that the much higher rate paid by Apple for its Pandora-like iTunes Radio service could be used as a benchmark. So while Pandora might enjoy some satisfaction from having the judge’s agreement about what radio means, it is not clear how this part of the decision will benefit Pandora.

The background to the case is complex and has to do with the federal regulation that has governed Ascap and another performing rights group, Broadcast Music Inc., or BMI, since 1941. With the growth of streaming music, music publishers have come to believe that this regulation has resulted in unfairly low rates.

So a few years ago some of the biggest publishers began changing their relationships with Ascap and BMI in a way that forced online services like Pandora to deal with the publishers directly. (This change was later rejected as violating the terms of Ascap and BMI’s regulatory agreements with the Department of Justice, known as consent decrees.)

As recounted in Judge Cote’s ruling, the resulting negotiations were not pretty. Executives from Sony/ATV and Universal, which together control a huge portion of the market, made what Pandora and the judge both interpreted as “not too veiled” threats that could shut Pandora down by withholding licenses.

At the same time, the judge recounted, publishers — and Ascap — refused to provide lists of their repertory in ways that would let Pandora remove those songs if an agreement could not be reached, exposing Pandora to “crippling copyright infringement liability.” In a few stinging passages, the judge also singled out executives at Sony/ATV and Universal for giving testimony on these points that was “not credible.”

Martin N. Bandier, the chairman of Sony/ATV, said in a statement: “While we respect the court and the judicial process, we know what occurred in the SATV/Pandora negotiation and we strongly disagree with the court’s expressed views on credibility and its conclusions.”

The music industry has become increasingly frustrated about the rates from streaming music, which have begun to amount to significant revenue yet can still be very low when they filter down to individual artists, particularly when it comes to songwriting royalties. Last year, for example, the musician and activist David Lowery posted a royalty statement showing that more than one million plays of one of his songs on Pandora yielded him only $16.89 in songwriting royalties.

The decision in Pandora’s case against Ascap leaves many questions about music royalties unanswered. The company is still facing a similar suit against BMI. And music companies have begun openly calling for new legislation and changes to regulation that would let them raise rates. If they are successful, that could result in more money for musicians, but also higher prices for consumers.

Pandora raised the price this week of its premium subscription plan, blaming the rising royalties it pays to record companies. (In a sign of the complexity of the music licensing process, yet
another panel of federal judges sets the royalties that Pandora pays record companies, which currently amount to about half of Pandora’s revenue.)

Pandora remains by far the most popular online radio service, with about 75 million people listening to 1.5 billion hours of music each month.

A federal judge on Friday left unchanged the royalty rate that the streaming service Pandora pays songwriters, a move that may fuel efforts by music groups to change the decades-old government regulation over licensing.

Judge Denise L. Cote of Federal District Court in Manhattan ruled on Friday that for each year from 2011 to 2015, Pandora must pay 1.85 percent of its revenue to the American Society of Composers, Authors and Publishers for the use of its members’ music, according to a statement by the society, better known as Ascap, which was sued by Pandora in late 2012.

While Ascap revealed Judge Cote’s rate determination, her full decision remains under seal for the parties to review for potential redaction of confidential information.

Ascap, which represents millions of songs, had asked the court to raise Pandora’s royalty gradually from 1.85 percent, its current rate. Pandora sought a rate of 1.7 percent, which is what most commercial radio stations pay Ascap. The difference represents a potential shift of millions of dollars for the whole industry, and the case came to symbolize the economic conflict between technology companies and the traditional music industry.

Pandora’s suit shined a light on the regulatory system behind Ascap and Broadcast Music Inc., or BMI, the other major performing rights group for music publishers.

Both have had legal agreements known as consent decrees with the Justice Department since 1941, and lately music groups have complained that this system results in unfairly low rates to songwriters.

“Today’s decision further demonstrates the need to review the entire regulatory structure,” John A. LoFrumento, Ascap’s chief executive, said in a statement.

A spokesman for Pandora said the company could not comment until the decision was released. Pandora faces a similar trial against BMI, scheduled to begin later this year.