BEFORE THE
UNITED STATES COPYRIGHT ROYALTY JUDGES
LIBRARY OF CONGRESS
WASHINGTON, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

PROPOSED CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.

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CONCLUSIONS OF LAW

1. The purpose of this proceeding is to set rates and terms for two complementary statutory licenses created by the Digital Millennium Copyright Act ("DMCA") for eligible nonsubscription transmission services and new subscription services (*i.e.*, webcaster licenses): (a) the performance license, 17 U.S.C. § 114(d)(2), which permits eligible webcasters to perform sound recordings over the Internet; and (b) the ephemeral reproduction license, 17 U.S.C. § 112(e), which permits webcasters to make temporary copies of sound recordings to facilitate such performances.

2. The Copyright Royalty Judges ("Judges") must set the rates and terms that will apply from January 1, 2016 through December 31, 2020. 17 U.S.C. § 804(b)(3)(A).

I. THE STATUTORY STANDARD

3. Section 114(f)(2)(B) of the Copyright Act requires the Judges to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." Section 112(e)(4) of the Copyright Act requires the Judges to "establish rates that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller."

4. Section 114 further states:

> In determining such rates and terms, the Copyright Royalty Judges shall base their decision on economic, competitive and programming information presented by the parties, including –
>
> (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and

> (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.
>
> In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements . . . .

17 U.S.C. § 114(f)(2)(B).

5. Despite these additional factors that the Judges can consider, the "willing buyer/willing seller" standard is the single standard governing this proceeding. *Web III Remand*, 79 Fed. Reg. 23102, 23105 (Apr. 25, 2014) ("The Copyright Act clearly establishes the willing buyer/willing seller standard for the royalty rates at issue in this proceeding."); *Web II Remand*, 72 Fed. Reg. 24084, 24087 (May 1, 2007); *Web I CARP Report* at 21, *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2 (Feb. 20, 2002) ("the willing buyer/willing seller standard is the *only* standard to be applied"). As the Register explained in interpreting the statutory standard, these additional factors are non-exclusive and do not themselves "define[] the standard" for setting rates. *Web II Remand* at 24087; H.R. Rep. No. 105-796, at 86 (1998) ("The test applicable to establishing rates and terms is what a willing buyer and willing seller would have arrived at in marketplace negotiations"). These factors "do not constitute additional standards, nor should they be used to adjust the rates determined by the willing buyer/willing seller standard." *Web II Remand* at 24087. Instead, they "are merely to be considered, along with any other relevant factors, to determine the rates under the willing buyer/willing seller standard." *Id*.

6. Section 114 makes it clear that while copyright owners could be compelled to license their entire catalogues to eligible webcasters, Congress assured copyright owners that they would obtain a fair market value for their works. Accordingly, the purpose of this proceeding is to carry out Congress's intent "to set a rate at fair market value." *Web I Librarian's Decision* , 67 Fed. Reg. 45240, 45254 (July 8, 2002) (codified at 37 C.F.R. pt. 261). As the *Web I Librarian's Decision* made clear, the "willing buyer-willing seller" standard is not policy-driven, but "strictly fair market value." *Id*. at 45244.

7. The directive to set rates and terms at a fair market value—in other words, rates and terms that otherwise "would have been negotiated" in the marketplace between a willing buyer and a willing seller—requires the Judges to replicate rates and terms that would have been negotiated in a hypothetical marketplace. *Web II Remand* at 24087. The market is hypothetical because the actual marketplace for sound recordings sold to webcasters is preempted by the compulsory license that is the subject of this proceeding. *Id*. By definition, outcomes in a market in which one party "has no choice but to license" cannot reflect fair market value. *Id* . The Judges therefore are called upon to establish a rate that would exist in this market if the parties were not subject to a statutory license.[1]

8. It is well established that the "willing buyers" in the hypothetical marketplace are the services eligible to avail themselves of the statutory license, the willing sellers "are the record companies," and the product is the "blanket licenses for each record company's repertory of

[1] In considering the appropriateness of other marketplace agreements as benchmarks, the question whether those agreements are (or are not) free of the shadow of the statutory license is not simply one equivalent factor on a list of comparability factors, as Pandora's economic expert, Prof. Shapiro, suggested. The existence (or not) of the shadow is a paramount factor. *See, e.g.*, *Web III Remand*, 79 Fed. Reg. at 23110.

sound recordings." *Web I CARP Report* at 24; *see also Web I Librarian's Decision* at 45244 ("the willing sellers are record companies").

9. As the Judges have recognized, "[i]n the hypothetical marketplace we attempt to replicate, there would be significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors. Congress surely understood this when formulating the willing buyer/willing seller standard." *Web II Remand*, 72 Fed. Reg. at 24087.

10. Under the statute, the Judges are to establish a market rate. It is not the Judges' role to guarantee that any particular number of webcasters are profitable, are able to continue operating, or are able to enter the market in the first place:

> A single price established in any market by its very nature inevitably will restrict some purchasers who are unable or unwilling to pay the market price. (In common parlance, they may be said to have been ''priced out of the market.'') … [T]he fact that any particular number of webcasters might not profit under that rate, or that others would either shut down or never enter the market, is not evidence that the rate deviates from the market rate. The essence of a single market price is that it rations goods and services; by definition, a nondiscriminatory price system therefore excludes buyers who cannot or will not pay the market price (and excludes sellers who cannot or will not accept the market price).

Web III Remand, 79 Fed. Reg. at 23119*; accord Web II Remand*, 72 Fed. Reg. at 24088 n.8 ("It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as

more efficient market participants trivializes the property rights of copyright owners. Furthermore, it would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act.").

11. While the market is to that extent hypothetical, the statutory text, logic and precedent counsel that rates should be based as much as possible on the real-world operation of real markets that are not affected by a compulsory license in sound recordings, and thus should depart from real-world benchmarks and criteria only to the limited degree required by the fact that the actual market at issue is subject to the compulsory license.[2] That is the result most compatible with the plain language and the legislative history of the statute, as well as with applicable precedent.[3]

[2] For example, the statute's reference to the copyright owner's "other streams of revenue from its sound recordings," § 114(f)(2)(B)(i), further confirms that Congress directed the Judges to look at the market participants as they exist, rather than to adjust those participants to a different set of circumstances, such as an adjustment based on "effective" or "workable" competition. We discuss this issue in greater detail in Section II, *infra*.

[3] *See, e.g.*, Order at 5, *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2 (Oct. 18, 2002) (through "willing buyer"/"willing seller" standard Congress "require[d] licensees to pay a marketplace rate"); *Rate Adjustment for the Satellite Carrier Compulsory License*, 62 Fed. Reg. 55742, 55746, 55748-49 (Oct. 28, 1997) (statutory "fair market value" test construed to be a rate that most closely approximates rates between a willing buyer and willing seller, and that standard is best satisfied through benchmarks established through rates established in the "free market").

II. AS A MATTER OF LAW, THE WILLING BUYER/WILLING SELLER STANDARD DOES NOT INCORPORATE A REQUIREMENT OF "EFFECTIVE" OR "WORKABLE" COMPETITION

A. The Willing Buyer/Willing Seller Standard Is Satisfied As Long As Neither Party Is Coerced and Both Have Reasonable Knowledge of the Facts

12. The willing buyer/willing seller standard of § 114(f)(2)(B) of the Copyright Act is clear and unambiguous. It has a firmly-established meaning in the law. The standard is a test for determining fair market value—which is exactly what the Judges are to determine under Section 114 of the Copyright Act. *Web I Librarian's Decision* at 45244 ("[T]he standard for setting rates for nonsubscription services set forth in section 114(f)(2)(B) is strictly fair market value—willing buyer/willing seller."); *id*. at 45254 (the purpose of this proceeding is to carry out Congress's intent "to set a rate at fair market value").

13. As the Supreme Court has explained, "[t]he willing buyer-willing seller test of fair market value is nearly as old as the federal income [tax]." *United States v. Cartwright*, 411 U.S. 546, 551 (1973). Under this test, fair market value "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *Id*. (citing Treas. Reg. § 20.2031—1(b)).

14. The willing buyer/willing seller test is a universally recognized principle of law. *See, e.g., Rhodes v. Amoco Oil Co.*, 143 F.3d 1369, 1373 n.4 (10th Cir. 1998) ("Fair market value is generally defined as the price at which a sale would take place 'between a willing buyer and a willing seller, *neither being under any compulsion to buy or sell* and both having reasonable knowledge of the relevant facts.'") (citation omitted); *Amerada Hess Corp. v.*

Comm'r, 517 F.2d 75, 83 (3d Cir. 1975) ("According to the classic formulation, '[f]air market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.'") (citation omitted); *Morris v. State*, 334 P.3d 1244, 1246 (Alaska Ct. App. 2014) ("[T]he term 'market value' has a recognized meaning at common law: the price at which the property would change hands in an arm's length transaction between a willing seller and a willing buyer who are aware of the pertinent facts."); *Honeywell Info. Sys., Inc. v. Maricopa Cnty*., 575 P.2d 801, 804 (Ariz. Ct. App. 1977) ("The test of fair market value is … what the property would sell for between a willing buyer and a willing seller in an arms-length transaction."); Black's Law Dictionary 537 (5th ed. 1979) ("Fair market value" defined as "[t]he amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.").

15. Where Congress employs a legal standard that has an established meaning under the common law and does not expressly supplant that standard, courts must presume that the common-law standard applies. It is a "settled principle of statutory construction that, absent contrary indications, Congress intends to adopt the common law definition of statutory terms." *United States v. Shabani*, 513 U.S. 10, 13 (1994); *see also United States v. Wells*, 519 U.S. 482, 491 (1997) ("We do, of course, presume that Congress incorporates the common-law meaning of the terms it uses if those 'terms ... have accumulated settled meaning under ... the common law' and 'the statute [does not] otherwise dictat[e].'") (quoting *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322 (1992)).

16. This is exactly what happened here. Congress directed the Judges to apply the willing buyer/willing seller standard. Congress did not indicate—through express language, statutory structure, or legislative history—that the Judges were to modify or supplement this well-established standard. The Judges must therefore apply the willing buyer/willing seller standard as it applies under law. *Beck v. Prupis*, 529 U.S. 494, 500-01 (2000); *Shabani*, 513 U.S. at 13; *Wells*, 519 U.S. at 491.

17. While expert witnesses have no basis to opine on the meaning of a statute, it is notable that two of the Services' principal experts readily acknowledged that the willing buyer/willing seller standard has the meaning established under law. Hr'g Tr. 2657:23-2658:21 (May 8, 2015) (Shapiro) ("JUDGE STRICKLER: Is it your understanding that you could have … a market populated by a willing seller and willing buyers yet still not be a workably competitive market? A: I think I know where you're going. I wouldn't use those terms, but let me be clear. If we have a monopolist and buyers, in the antitrust context, I would still say, well, they're willing buyers. They don't have to buy. But they're subject to monopoly power, and that's a problem. Here, I think, for me, and I would—I guess I would encourage you as well to use the terms 'willing buyer' and 'willing seller' in the way that Professor Rubinfeld did, which is to say there was no statutory license imposed, and so there was a voluntary transaction in that sense, not affected by the shadow. And the term—and keep monopoly power as a separate issue. It's not what he was including here. And I think, for me, it's quite helpful to keep them distinct."); Hr'g Tr. 5301:25-5302:10 (May 21, 2015) (Fischel) ("Q: Has any of your research considered valuation from the perspective of what is known as a "willing buyer or willing seller standard"? A: Yes. The standard definition of what the value of an asset is, is what a willing

buyer would pay a willing seller when neither is under any compulsion to buy or sell. That is always, therefore the most direct evidence of how to value an asset or a service. I've said that repeatedly in my academic writing as well as in my consulting and expert testimony.").

18. The third principal expert for the Services—Prof. Katz—testified that, whereas Prof. Shapiro (as noted in the excerpt quoted above) "would have a separate test, the effective competition test," Prof. Katz believed effective competition and willing buyer/willing seller "[are] best thought of together." Hr'g Tr. 2800:19-2801:2 (May 11, 2015) (Katz). However, Prof. Katz did not cite in either his written or oral testimony any principle of law that would connect an "effective competition" standard to the willing buyer/willing seller standard established under the case law.

19. As a matter of law, the willing buyer/willing seller standard that applies here requires only that neither the buyer nor the seller is acting under compulsion and that both parties have reasonable knowledge of the relevant facts.

20. There is no suggestion by the Services—and no evidence—that any buyer-licensee under any benchmark agreement was compelled to accept the terms of any such agreement or that the buyer-licensee lacked knowledge of the relevant facts.

B. The Willing Buyer/Willing Seller Standard Has No "Effective" Or "Workable" Competition Requirement

1. The Judges Are Not Authorized To Add A Requirement That Congress Has Not Included

21. Notwithstanding the established definition of willing buyer/willing seller, the Services argue that the Judges must add to the text of § 114(f)(2)(B) that "the marketplace" that

is considered be "effectively" or "workably" competitive. Congress did not grant the Judges the authority to so rewrite the statute. To do so would be legal error.

22. As shown above, the common-law willing buyer/willing seller standard does not expressly or impliedly require there to be a particular level of competition in the marketplace—whether called "effective" or "workable." Nothing in the language of Sections 112 or 114 requires a particular level of competition. And nothing in the text or structure of the statute otherwise suggests that Congress intended the Judges to engraft such a requirement on the statute. On the contrary, Congress explicitly stated that the Judges are to set "rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). As precedent clearly demonstrates, the "hypothetical" marketplace that the Judges are to consider in establishing rates deviates from the actual, real-world marketplace only because the hypothetical marketplace would not include a compulsory licensing scheme.

23. Because Congress did not indicate any intent to modify or supplement the common-law understanding of the willing buyer/willing seller standard, this firmly-established standard applies in this proceeding. *See, e.g.*, *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739-40 (1989) (adopting common-law meaning of "employee" and "employment" because "[n]othing in the text of the work for hire provisions [of the Copyright Act] indicate[d] that Congress used the words … to describe anything other than 'the conventional relation of employer and employee'") (citations omitted).

24. When Congress has intended for a legal standard to be based on "effective competition," it has said so expressly. In 1992, Congress passed the Cable Television Consumer

Protection and Competition Act of 1992 ("Cable Act"), in part to "ensure that consumer interests are protected in receipt of cable service" "where cable television systems are not subject to *effective competition*." Cable Act, Pub. L. No. 102-385, § 2, 106 Stat. 1460 (1992) (emphasis added). Under the Cable Act, "any cable system that does not face 'effective competition,' as defined in the Act, is subject to rate regulation." *Time Warner Entm't Co., L.P. v. F.C.C.*, 56 F.3d 151, 162 (D.C. Cir. 1995) (quoting 47 U.S.C. § 543(a)(2)).

25. The fact that Congress expressly included the term "effective competition" in the Cable Act, another statute that mandated administrative rate regulation, but did not mention the term "effective competition" in the DMCA, evidences Congress's intent not to implant an "effective" or "workable" competition requirement in the willing buyer/willing seller standard under § 114(f)(2)(B). Congress knows how to impose a statutory requirement for "effective competition" when it intends to do so, and also how to provide definitional guidance for that concept. Because "Congress has shown that it knows how to [impose an "effective competition" requirement] in express terms," it would be "particularly inappropriate" for the Judges to "assume that Congress has omitted from its adopted text requirements that it nonetheless intends to apply." *Kimbrough v. United States*, 552 U.S. 85, 103 (2007) (citations and internal quotation marks omitted); *see also In re Arons*, 756 A.2d 867, 871 (Del. 2000) (finding that the federal Individuals with Disabilities Education Act did not create a right to lay representation where the statute was silent on this issue and the federal Food Stamp Act had explicitly created a similar right). There is no reason to believe that Congress intended the willing buyer/willing seller standard governing this proceeding to include an "effective competition" requirement.

26. Congress provided express guidance in the Cable Act as to the meaning of the term "effective competition." The Cable Act provides:

> (1) The term "effective competition" means that—
>
> (A) fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system;
>
> (B) the franchise area is—
>
> (i) served by at least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and
>
> (ii) the number of households subscribing to programming services offered by multichannel video programming distributors other than the largest multichannel video programming distributor exceeds 15 percent of the households in the franchise area;
>
> (C) a multichannel video programming distributor operated by the franchising authority for that franchise area offers video programming to at least 50 percent of the households in that franchise area; or
>
> (D) a local exchange carrier or its affiliate (or any multichannel video programming distributor using the facilities of such carrier or its affiliate) offers video programming services directly to subscribers by any means (other than direct-to-home satellite services) in the franchise area of an unaffiliated cable operator which is providing cable service in that franchise area, but only if the video programming services so offered in that area are comparable to the video programming services provided by the unaffiliated cable operator in that area.

47 U.S.C. § 543(l)(1).[4]

[4] It is unsurprising that Congress has provided explicit guidance as to the meaning of "effective competition" when it actually intends for this standard to apply. As discussed in Section C, *infra*, a standard based on "effective" (or "workable") competition in a given marketplace is indeterminate and unworkable without explicit definitional guidance. The expert testimony here

27. By contrast, Congress nowhere defined "effective competition" or "workable competition" in § 114. It would be inappropriate to assume that Congress intended the Judges to engraft an unwritten and undefined "effective competition" requirement onto the willing buyer/willing standard. *Kimbrough*, 552 U.S. at 103; *In re Arons*, 756 A.2d at 871.

2. Precedent Does Not Compel An "Effective" Or "Workable" Competition Requirement

28. Contrary to the Services' contention, there is no binding precedent holding that the willing buyer/willing seller standard requires there to be "effective" or "workable" competition in the hypothetical marketplace. The Services point to a footnote in the *Web III Remand* decision, which itself cites decisions from the D.C. Circuit and prior decisions of the Judges and the Librarian. *Web III Remand*, 79 Fed. Reg. at 23114 n.37. These sources do not support creating the rule that the Services propose.

29. In *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748 (D.C. Cir. 2009) ("*IBS*"), the D.C. Circuit considered challenges to the reasonableness of the rates and fees that the Judges had set for commercial webcasters and noncommercial broadcasters in the Web II Remand. The D.C. Circuit affirmed the Judges' determination of rates, but vacated the Judges' approval of a system that did not provide for a cap on the minimum fees paid per licensee. In doing so, the Court did not determine that the willing buyer/willing seller standard requires an "effective" or "workable" level of competition in the benchmark marketplace. On the contrary, the D.C. Circuit expressly rejected the webcasters' argument based on language from the *Web I Librarian's Decision* referring to rates agreed to by willing buyers and willing

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demonstrates this point.

sellers "in a competitive marketplace." The D.C. Circuit correctly described that language as mere "dictum." 574 F.3d at 757. We return to this point below. The D.C. Circuit then emphasized that "[t]he statute speaks only of a 'willing buyer and a willing seller.' This is the standard the Judges were to apply in evaluating whether a market benchmark was an appropriate model." *Id.* *IBS* not only fails to support the Services' argument that precedent allows the Judges to add an "effective" or "workable" competition element to the willing buyer/willing seller test; the case undercuts that argument.

30. The Judges' and the Librarian's prior decisions likewise do not support the creation of an "effective" or "workable" competition requirement. The language the Services rely upon is mere dicta, as the D.C. Circuit described the language from the *Web I Librarian's Decision*. *IBS*, 574 F.3d at 757;*see United States v. Kaley*, 579 F.3d 1246, 1253 n.10 (11th Cir. 2009) ("[D]icta is defined as those portions of an opinion that are 'not necessary to deciding the case then before [the court or administrative body].'") (citations omitted); *United States v. Crawley*, 837 F.2d 291, 292 (7th Cir.1988) ("We have defined dictum as a statement in a judicial opinion that could have been deleted without seriously impairing the analytical foundations of the holding ....") (citation and internal quotation marks omitted).

31. *Web I*, for example, referred to the hypothetical possibility of using a standard based on a market more competitive than the one that actually existed. *Web I CARP Report* at 23. This was dicta, however, because there was no evidence of oligopolistic power and hence no cause for the CARP to define or apply a competition supplement to the statute.

32. The reference to "a competitive marketplace" in the *Web I Librarian's Decision*, 67 Fed. Reg. at 45244-45, was dicta, as the D.C. Circuit expressly stated. *IBS*, 574 F.3d at 757.

To the extent that *Web I Librarian's Decision* repeated the dicta from *Web I*, that does not make the dicta law. The repetition of dicta does not convert it into precedent. *Francis v. City of New York*, 235 F.3d 763, 767-68 (2d Cir. 2000).[5] *Cf. Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 379 (1994) ("It is the holdings of our cases, rather than their dicta, that we must attend ….").

C. An "Effective" Or "Workable" Competition Requirement Would Render The Willing Buyer/Willing Seller Standard Indeterminate And Unworkable

33. The Services' proposed "workable" or "effective" competition is vague and indeterminate. To impose such a requirement in this proceeding would render the willing buyer/willing seller standard ad hoc and unworkable.

34. Profs. Shapiro and Katz agree that that their proffered concepts of "workable" or "effective" competition do not require anything near "perfect" competition as that phrase is understood in economics. They instead say that such concepts generally just require a degree of competition—but without any indication as to what degree is acceptable. *See* Hr'g Ex. PAN 5022 at 11 (Shapiro WDT) ("Workable competition does not require marginal cost pricing or anything approaching the textbook model of perfect competition."); Hr'g Ex. NAB 4000 ¶ 29 (Katz WDT) (noting that "theoretical conditions of *perfect* competition often are not satisfied in actual markets" and describing "workable" competition as markets that "are competitive, but not perfectly so").

[5] Language in other decisions repeating the dictum in *Web I* and/or the *Web I Librarian's Decision* is also dicta. None of these decisions actually turned on the employment of a competitive benchmark standard. *See Web III Remand*, 79 Fed. Reg. at 23113-14; *Web II Remand*, 72 Fed. Reg. at 24093.

35. Indeed, as Prof. Katz acknowledged, there is no "bright line that separates an effectively competitive market from a market that's not effectively competitive." Hr'g Tr. 2803:9-1 (May 11, 2015) (Katz) ("A. No, I don't believe there is."). Prof Katz also agreed that there is a broad spectrum between perfect competition and monopoly, with effective competition falling somewhere in between. *Id*. at 2949:16-20 ("Q. You agree that there's a spectrum that you've used in your textbooks that has perfect competition on one end and monopoly on the other end, correct? A. Yes."). Nor is there any sort of bright line definition of what effective competition even is. *Id*. at 2946: 12-15 ("Q. You would agree there is no bright line definition of what effective competition is, correct? A. Yes, I said that in my writings.").

36. Prof. Katz further acknowledged that he would not be able to say what the rates in the interactive service agreements would be if they did purportedly reflect effective competition. *See id*. at 2945:14-17 ("Q. You can't tell us what the rates would have been in those agreements if they did reflect effective competition, correct? A. That's correct."). Because the "concept of effective competition doesn't give you a precise number by itself," it is a "fuzzier concept," Hr'g Tr. 5660:12-21 (May 26, 2015) (Katz), and ultimately becomes indeterminate as compared to a willing buyer/willing seller test that focuses on compulsion, as Congress intended. *See id.* at 5661:6-16 ("THE WITNESS: Much broader, if it is just interpreted as saying, well, the buyer entered into the agreement without literally having a gun put to his or her head. JUDGE STRICKLER: There would be no indetermina[cy] in that situation. In a take it or leave it situation, we have determina[cy], you either pay the price the seller demands or you don't enter the market at all").

37. The indeterminacy problem is even more pronounced because, as Prof. Katz acknowledges, the licensing rate that emerges through an "effectively" or "workably" competitive market could be the same rate that emerges through conditions which would not in his view be "effectively" or "workably" competitive, such as competition in the downstream consumer market affecting upstream licensing prices. *See* Hr'g Tr. 2977:5-14 (May 11, 2015) (Katz) ("I would say that the upstream market still does not have effective competition, but that if these other factors were to push the price low enough despite the absence of effective competition, you might have a price that started looking similar. I mean, it's conceivable, if you're talking about hypotheticals, that you could have a monopoly that faced demand, that only allowed it to charge a very low price. So that's possible."); *see also id*. at 2978:19-22 ("you might get prices that nonetheless started being close to what you would see if the market had been effectively competitive").

38. That an "effective" or "workable" competition standard is indeterminate only underscores why it would be inappropriate and contrary to Congress's intent for the Judges to add such a standard to § 114(f)(2)(B).

III. THE RATES AND TERMS OF THE PANDORA-MERLIN AGREEMENT ARE INADMISSIBLE AND MAY NOT BE TAKEN INTO CONSIDERATION IN SETTING RATES AND TERMS IN THIS PROCEEDING

A. Section 114 (5)(C) Unambiguously Mandates That The Judges May Not Take Into Account Any Rate Structure, Fees, Terms Or Conditions In The Pandora-Merlin Agreement, Because Those Rates And Terms [redacted] The Pureplay Settlement Agreement

39. Pandora's rate proposal is based on a benchmark analysis of its agreement with Merlin. *See* SoundExchange's Proposed Findings of Fact Section VIII.B. The Pandora-Merlin

agreement, however, [redacted] the Pureplay Settlement Agreement, pursuant to which Pandora operates and pays royalties pursuant to the statutory license for the 2011 rate term. Hr'g Tr. 3415:23-24 (May 13, 2015) (Herring). Congress expressly barred the Judges from taking into account in this proceeding any of the rate structure, terms, conditions and the like of the Pureplay Settlement Agreement. 17 U.S.C. § 114(f)(5)(C). The Judges' consideration of the Pandora-Merlin would violate this clear Congressional command.[6]

40. Congress, of course, has the authority to determine the scope and structure of rate-setting proceedings, including establishing rules about what type of evidence is or is not admissible, and what matters the Judges may take into account in arriving at their decisions. *See Skinner v. Mid-Am. Pipeline Co.*, 490 U.S. 212, 214 (1989) (explaining that the nondelegation doctrine requires Congress to "provide[] an administrative agency with standards guiding its actions such that a court could 'ascertain whether the will of Congress has been obeyed'") (citation omitted); *Mistretta v. United States*, 488 U.S. 361, 379 (1989) (Congress provided sufficient guidance to meet the nondelegation standard where the statute at issue "outline[d] the policies which prompted establishment of the Commission, explain[ed] what the Commission should do and how it should do it, and set[] out specific directives to govern particular situations.").

[6] The fact that SoundExchange made reference to the Pureplay Settlement Agreement and used it to cross-examine Pandora's witnesses at the hearing does not affect any of the arguments in this Section III. SoundExchange preserved its objection to the Pandora-Merlin agreement and suggested the Judges could provisionally admit the evidence in order to have a full record to inform this post-hearing briefing. *See* SoundExchange's Objections to Testimony and Exhibits at 4 (filed Apr. 20, 2015); Hr'g Tr. 70:13-22 (Apr. 27, 2015) (SoundExchange Opening Statement).

41. Congress in § 114(f)(5)(C) could not have been clearer in proscribing any use in this proceeding of "any rate structure, fees, terms, conditions, or notice and recordkeeping requirements" found in the Pureplay Settlement Agreement:

> Neither subparagraph (A) *nor any provisions of any agreement entered into pursuant to subparagraph (A), including any rate structure, fees, terms, conditions, or notice and recordkeeping requirements set forth therein, shall be admissible as evidence or otherwise taken into account in any administrative, judicial, or other government proceeding involving the setting or adjustment of the royalties payable for the public performance or reproduction in ephemeral phonorecords or copies of sound recordings,* the determination of terms or conditions related thereto, or the establishment of notice or recordkeeping requirements by the Copyright Royalty Judges under paragraph (4) or section 112(e)(4). *It is the intent of Congress that any royalty rates, rate structure, definitions, terms, conditions, or notice and recordkeeping requirements, included in such agreements shall be considered as a compromise motivated by the unique business, economic and political circumstances of webcasters, copyright owners, and performers rather than as matters that would have been negotiated in the marketplace between a willing buyer and a willing seller,* or otherwise meet the objectives set forth in section 801 (b).

17 U.S.C. § 114(f)(5)(C) (emphasis added).

42. The Pureplay Settlement Agreement is an agreement entered into pursuant to § 114(f)(5)(A) and published in the Federal Register. *Notification of Agreements Under the Webcaster Settlement Act of 2009,* 74 Fed. Reg. 34796 (July 17, 2009).

43. In publishing notice of the Pureplay Settlement Agreement, the Copyright Office quoted the language of § 114(f)(5)(C) and stated that it "make[s] th[e] point clear" that:

> Unless otherwise agreed to by the parties, *the rates and terms set forth in the agreement* apply only to the time periods specified in the agreement and *have no precedential value in any proceeding*

> *concerned with the setting of rates and terms for the public performance or reproduction in ephemeral phonorecords.*

74 Fed. Reg. at 34796 (emphasis added).

44. Under the unambiguous terms of § 114(f)(5)(C), the "royalty rates, rate structure, definitions, terms [and] conditions" of the Pureplay Settlement Agreement are *not* those "that would have been negotiated in the marketplace between a willing buyer and a willing seller." In other words, they are not rates and terms that may inform the Judges' determination of rates and terms that satisfy the command of § 114(f)(2)(B). They instead are "compromise motivated by the unique business, economic and political circumstances of webcasters, copyright owners, and performers" that led Congress to enact the Webcaster Settlement Act. 17 U.S.C. § 114(f)(5)(C).

45. "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon [of statutory construction] is also the last …." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (citations omitted).

46. The terms of § 114(f)(5)(C) are unambiguous: The "rate structure, fees, terms, conditions, or notice and recordkeeping requirements" of any agreement that a party entered into under the Webcaster Settlement Act is inadmissible and the Judges may not "take[]" any such terms "into account" in setting rates and terms in this proceeding.

47. The [The evidence of this is indisputable and is catalogued in greater detail in SoundExchange's Proposed Findings of Fact Section VIII.B.

48. Under the plain language of § 114(f)(5)(C), the "rate structure," the "fees" and the core economic "terms" and "conditions" [redacted] are inadmissible, and the Judges may not "take[]" them "into account" in setting rates and terms in this proceeding.

B. Introduction Of The Pandora-Merlin Agreement Improperly Deprives SoundExchange Of The Right To Conduct Effective Cross-Examination On The Shadow The Pureplay Settlement Agreement Cast Over The Negotiation Of The Pandora-Merlin Agreement

49. The Pandora-Merlin agreement is inadmissible for another reason: because the introduction of its "rate structure, fees, terms, conditions" would deprive SoundExchange of its right to conduct effective cross-examination—if the proscription of § 114(f)(5)(C) is to be followed. Section 114(f)(5)(C) plainly renders the Pureplay Settlement Agreement inadmissible.

50. SoundExchange has the right to conduct meaningful cross-examination and to introduce its own evidence regarding the Pandora-Merlin agreement and the basis for its rate structure and terms. Such cross-examination and response necessarily would have to involve and refer to the Pureplay Settlement Agreement.[7]

51. SoundExchange has the right to show through cross-examination and introduction of its own evidence that the rates, terms, and conditions of licensees' benchmarks are affected by the shadow of statutory licenses. The most important criteria for assessing the merits of an agreement as a relevant benchmark is whether it is affected by the shadow of a statutory license,

[7] As noted above, SoundExchange's questioning at the hearing was subject to its objection and said that the Judges should provisionally allow evidence to come in so there would be a complete record with which to assess that objection. SoundExchange's cross-examination of Pandora's witnesses regarding these matters exemplifies the type of examination and evidence that SoundExchange would be precluded from pursuing if Pandora were permitted to evade the bar of § 114(f)(5)(C). *See* n.7, *supra*.

since "[t]he hypothetical marketplace is one in which no statutory license exists." *Web III Remand*, 79 Fed. Reg. at 23110.

52. SoundExchange cannot demonstrate the shadow that the Pureplay Settlement Agreement casts over the Pandora-Merlin agreement without introducing the Pureplay Settlement Agreement's rates and terms. As discussed in the preceding section, and as further demonstrated in SoundExchange's Proposed Findings of Fact, [redacted] Yet SoundExchange can only make that showing with reference to the terms of the Pureplay Settlement Agreement. Section 114(f)(5)(C), however, makes the Pureplay Settlement Agreement inadmissible.

53. Allowing Pandora to proffer the Pandora-Merlin agreement while denying SoundExchange the ability to introduce the Pureplay Settlement Agreement's terms and to use those terms to cross-examine Pandora's witnesses allows Pandora to use the Pureplay Settlement Agreement as a "sword and a shield." On the one hand, Pandora would be able to offer evidence, namely, the Pandora-Merlin agreement, [redacted] from the rates and terms of the Pureplay Settlement Agreement. On the other hand, Pandora would be using the Pureplay Settlement Agreement and the proscriptions of § 114(f)(5)(C) to block inquiry into the source of the shadow over the entire Pureplay Settlement Agreement.

54. It is well established in the law that a party may not use privileges that preclude cross-examination as both sword and shield. *See, e.g.*, *In re von Bulow*, 828 F.2d 94, 103 (2d Cir. 1987); *United States v. Workman*, 138 F.3d 1261, 1263-64 (8th Cir. 1998). The situation here is directly analogous. Congress has decreed that the rates and terms of the Pureplay

Settlement Agreement may not be admitted in this proceeding. Were it able to introduce and rely on the Pandora-Merlin agreement, Pandora could use that Congressional decree to preclude cross-examination to show the shadow cast by the very Pureplay Settlement Agreement whose rates and terms Congress precluded from use in this proceeding. The law does not countenance such a result, and the Pandora-Merlin agreement therefore is inadmissible.

IV. OTHER LEGAL ISSUES

A. The Judges Should Consider The Performance Of An Agreement As Well As The Parties' Expectations In Analyzing The Benchmark Evidence

55. The Services argue that only the parties' expectations, as set forth in pre-agreement models of potential performance, may be relevant to "the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B).[8] The Services argue that actual performance under the parties' executed agreements should not be factored into the benchmark analysis.

[8] The Services were inconsistent about what counted as an expectation. Profs. Shapiro and Fischel/Lichtman excluded from their valuation of consideration going to Merlin and Warner, respectively, multiple elements of consideration that had value to the copyright owners. *See, e.g.*, SoundExchange's Proposed Findings of Fact Section IX.C.2 (detailing evidence of Profs. Fischel/Lichtman's improper failure to consider value of consideration to Warner). An expectations-based analysis cannot ignore one party's expectations of value simply because they do not have a dollar value assigned to them or have difficulties associated with their valuation. *See In re Pawlak*, 483 B.R. 169, 184 (Bankr. W.D. Wis. 2012) (the fraudulent transfer statute requires determining whether "reasonably equivalent value" was received, even though "'value' *can* include intangible or indirect benefits" that can be "hard to quantify"); *Massachusetts Auto. Rating & Accident Prevention Bureau v. Commissioner of Ins.*, 516 N.E.2d 1132, 1143 (Mass. 1987) ("The industry argues that there was not sufficient basis for an exact quantification of the excess, so the commissioner should not have made the reduction. Apparently, the industry believes that when an area of excess is difficult to quantify, the presumption should be that the excess will be borne by the policyholders until it can be precisely measured. We cannot agree.").

56. The Services' view is wrong. Actual performance as well as pre-agreement projections are both relevant and admissible to determine "the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B).

57. The willing buyer/willing seller standard is related to, among other sources, the standard for determining the hypothetical royalty to which a patentee and an infringer would have agreed before the infringement began. In determining a reasonable royalty, patent courts examine the "hypothetical negotiation or the 'willing licensor-willing licensee' approach," which "attempts to ascertain the royalty upon which the parties would have agreed had they successfully negotiated an agreement just before infringement began." *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009); *see also Rite–Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1554 n. 13 (Fed. Cir. 1995) (en banc); *Radio Steel & Mfg. Co. v. MTD Prods., Inc.*, 788 F.2d 1554, 1557 (Fed. Cir. 1986) ("The determination of a reasonable royalty, however, is based not on the infringer's profit, but on the royalty to which a willing licensor and a willing licensee would have agreed at the time the infringement began."); *Georgia–Pacific Corp. v. U.S. Plywood Corp*., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970). "The hypothetical negotiation tries, as best as possible, to recreate the ex ante licensing negotiation scenario and to describe the resulting agreement. In other words, if infringement had not occurred, willing parties would have executed a license agreement specifying a certain royalty payment scheme." *Lucent*, 580 F.3d at 1325.

58. In applying the hypothetical negotiation/willing licensor-willing licensee standard, courts have rejected the argument the Services make here, i.e., that courts must confine

their consideration to the parties' ex ante projections. Courts have looked instead to actual performance data. In doing so, courts have relied on the Supreme Court's seminal "book of wisdom" doctrine:

> [A] different situation is presented if years have gone by before the evidence is offered. Experience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within.

Sinclair Ref. Co. v. Jenkins Petroleum Process Co., 289 U.S. 689, 698 (1933).

59. As the Federal Circuit has noted, "the hypothetical negotiation analysis permits and often requires a court to look to events and facts that occurred thereafter and that could not have been known to or predicted by the hypothesized negotiators." *Lucent*, 580 F.3d at 1333 (quoting *Fromson v. Western Litho Plate & Supply Co*., 853 F.2d 1568, 1575 (Fed. Cir. 1988), overruled on other grounds by *Knorr–Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp*., 383 F.3d 1337 (Fed. Cir. 2004) (en banc)).

60. In applying this approach, including to areas beyond patent law, including trade secret law, courts have expressed the difficulty of coming up with a rate based solely on ex ante projections. In *Honeywell Int'l. Inc. v. Hamilton Sundstrand Corp*., 378 F. Supp. 2d 459, 465 (D. Del. 2005), for example, the court noted the artificiality of the hypothetical negotiation and its subjective nature:

> Over fifty-five years after *Sinclair Refining*, the Federal Circuit in *Fromson* adopted the Supreme Court's rationale for flexibility—the "book of wisdom"—and applied it to the hypothetical negotiation method of calculating damages under § 284: The [hypothetical negotiation] methodology encompasses fantasy and flexibility; fantasy because it requires a court to imagine what warring parties would have agreed to as willing negotiators;

> flexibility because it speaks of negotiations as of the time infringement began, yet permits and often requires a court to look to events and facts that occurred thereafter and that could not have been known to or predicted by the hypothesized negotiators.

Id. at 465 (citing Fromson, 853 F.2d at 1575); *see also Info–Hold, Inc. v. Muzak LLC*, 2013 WL 6008619, at *2 (S.D. Ohio Nov. 13, 2013) ("[n]either a jury nor this Court can be expected to invent a reasonable royalty out of thin air, particularly given that the Federal Circuit requires 'sound economic proof of the nature of the market and likely outcomes' in order 'to prevent the hypothetical from lapsing into pure speculation'"); *MSC.Software Corp. v. Altair Eng'g, Inc.*, 2014 WL 6485492, at *6 (E.D. Mich. Nov. 13, 2014).

61. During cross-examination of Prof. Rubinfeld, iHeart's counsel tried to impeach Prof. Rubinfeld's reliance on the "book of wisdom" doctrine by suggesting he had eschewed looking at actual performance when testifying as an expert in an earlier case. Hr'g Tr. 6381:5-6386:13 (May 28, 2015) (Rubinfeld).

62. In fact, this is what the district court in that case said, in a published opinion, about Prof. Rubinfeld's expert testimony in the matter that iHeart's counsel cited:

> A hypothetical negotiation should take into account the actual facts as they occurred in the matter both before and after the hypothetical negotiations would occur. . . . *I was persuaded by Dr. Rubinfeld's testimony that it would be appropriate to assume that in the "but for" world of an unpatented Materna, the generic substitution rate for Materna would be substantially similar to the actual substitution rate for Stuartnatal 1+1*.

Univ. of Colo. Found., Inc. v. Am. Cyanamid Co., 216 F.Supp.2d 1188, 1197, 1202 (D. Colo. 2002) (emphasis added). In other words, Prof. Rubinfeld's damages analysis did rely on actual performance.

63. As applied to the benchmark analysis in these proceedings, the "book of wisdom" approach makes tremendous practical sense. The benchmark agreements submitted in proceedings such as these generally are between parties with continuing business and contractual relationships, not between rights owners and infringers. The agreements often have short terms, precisely so the parties can assess actual performance under the agreements and the development of the market. It is entirely logical that the parties would look to actual performance in assessing the rates and terms they would agree to on a going-forward basis.

64. For the foregoing reasons, it is appropriate as a matter of law to consider both ex ante projections and actual performance in determining "the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B).

B. Terrestrial Radio Is An Improper Benchmark In These Proceedings Because Performances Of Sound Recordings On Terrestrial Radio Are Not Subject To A Public Performance Right

65. NAB's economic expert, Prof. Michael Katz, proposed a "zone of reasonableness" for a royalty rate to apply only to licensees that simulcast terrestrial radio performances. Hr'g Ex. NAB 4000 ¶ 80 (Katz WDT).

66. Prof. Katz opined that the "lower bound of the zone of reasonableness is zero percent of simulcasting revenues." *Id*. at 53, Heading "A." Prof. Katz arrived at this "lower bound" by reference to the fact that terrestrial radio broadcasters pay no royalties for performing copyright owners' sound recordings. *Id*. ¶¶ 81-84.

67. As a matter of law, terrestrial radio is an improper benchmark in establishing rates in these proceedings. Terrestrial broadcasters pay a royalty of zero because the Copyright Act

does not provide copyright owners with a right of public performance. *See* 17 U.S.C. § 114(a). The fact that copyright owners by law are not compensated for broadcasters' terrestrial performances of sound recordings does not mean that the owners would charge a royalty of zero if the Copyright Act conferred an exclusive right over those performances. It is implausible, to say the least, that copyright owners would charge a royalty of zero in such circumstances.

68. As a matter of law, therefore, the fact that terrestrial broadcasters pay no royalty for performing copyrighted sound recordings has no probative value as a benchmark whatsoever for determining the rates that willing buyers and willing sellers would agree to absent the statutory license.

C. The Rates Established By SDARS Are An Improper Benchmark In These Proceedings: Those Rates Are Not Market Data, And They Were Set Based On A Legal Standard That Does Not Apply Under § 114(f)(2)(B)

69. Prof. Katz, as well as Profs. Fischel/Lichtman, have attempted to justify the reasonableness of their proposals with reference to the rates the Judges established in the *SDARS II* proceeding. Hr'g Ex. NAB 4000 ¶¶ 85-93 (Katz WDT); Hr'g Ex. IHM 3034 ¶¶ 105-110 (Fischel-Lichtman Amended WDT).

70. The *SDARS II* rates were established pursuant to a different statutory standard than applies in this proceeding. Under 17 U.S.C. § 801(b)(1), the rates the Judges establish for preexisting satellite digital audio radio services "shall be calculated to achieve" several enumerated "objectives," including "(D) [t]o minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices."

71. The § 801(b)(1) standard has no application to the benchmark analysis in this proceeding. As stated in *Web I*, the § 801(b)(1) standard is "policy-driven, whereas the standard

for setting rates for nonsubscription services set forth in section 114(f)(2)(B) is strictly fair market value—willing buyer/willing seller." *Web I Librarian's Decision*, 67 Fed. Reg. at 45244.

72. The Copyright Office recently reaffirmed this fundamental distinction between the standards that apply under § 801(b)(1) and § 114(f)(2)(B):

> Satellite radio and "pre-existing" subscription services (such as those provided through cable television) are able to benefit from the four-factor section 801(b)(1) test, which allows the CRB to ponder broader concerns than what negotiating parties might consider in the marketplace—for example, whether a contemplated rate will result in "disruptive impact on the structure of the industries involved and on generally prevailing industry practices." Many interpret the section 801(b)(1) language as enabling the rate-setting body to protect the vested interests of licensees by establishing rates lower than what would (at least theoretically) prevail in the free market. . . . For example, in 2008, in establishing rates for satellite radio services, the CRB found it "appropriate to adopt a rate . . . that is lower than the upper boundary most strongly indicated by marketplace data," stating that they did so "in order to satisfy 801(b) policy considerations related to the minimization of disruption that are not adequately addressed by the benchmark market data alone." In any event, there appears to be a shared perception among many industry participants — both those that chafe at the section 801(b)(1) standard and those that like it — that the standard yields lower rates.

U.S. Copyright Office, *Copyright and the Music Marketplace: A Report of the Register of Copyrights*, at 142-43 (Feb. 2015).

73. For these reasons, the rates established in *SDARS II* have no relevance to the benchmark analysis in this proceeding.

D. iHeart's Proposal to Amend the Sound Recording Performance Complement Is Impermissible

74. iHeart's Proposed Rates and Terms ask the Judges to modify the sound recording performance complement, 17 U.S.C. § 114(j)(13), in several respects. *See* Proposed Rates and Terms of iHeartMedia, Inc., at 2-3, 3-5 (proposed "Other Terms," ¶¶ 1, 3(a), and 3(b).

75. The sound recording performance complement is defined by statute. iHeart does not cite, and we are not aware, of any authority that permits the Judge's to make the requested modifications. Nor does iHeart explain why the changes would be warranted, even if the Judges have authority to modify the definition established by Congress.

Dated: June 19, 2015

Respectfully submitted,

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PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

PROPOSED FINDINGS OF FACT OF SOUNDEXCHANGE, INC.

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I. INTRODUCTION

1. The purpose of this proceeding is to set the rates and terms for compulsory licenses according to Congress's commands. The standard that governs is clear and unambiguous: "the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). After more than five weeks of hearings—which included the live testimony of almost four dozen witnesses and the admission of more than 700 hundred exhibits—the evidentiary record decisively supports SoundExchange's reasonable proposal for rates in the 2016-2020 term that are modestly above the current statutory rates. SoundExchange supported its proposal with more than 80 real-world agreements between pairs of licensors and licensees—exactly the type of "thick market" showing the Judges said they wanted to see presented in this proceeding. The parties to those agreements—a wide range of willing seller-copyright owners and willing buyer-licensees, including some of the largest and most powerful companies in the world—reached those deals through the true give-and-take of self-interested negotiations. They did so in a real marketplace—one unencumbered by the statutory license. No party in a webcasting proceeding has ever supported its rate proposal with such a robust showing.

2. In contrast, those Service participants that relied on agreements at all pointed to an exceedingly narrow group of unrepresentative agreements, one of which is inadmissible. Those agreements were heavily influenced by the shadow of the statutory license and applicable rates. The timing and terms of these isolated agreements also raise questions about whether they are legitimate benchmarks or were instead—in the words of one of iHeart's experts—simply "written to influence the conversation we're having today." Hr'g Tr. 4017:16-21 (Lichtman).

3. Pandora based its rate proposal on its singular agreement with Merlin, a consortium of copyright owners whose repertoire accounts for less than 5% of performances on Pandora. That agreement derives directly from the Pureplay Settlement Agreement, the rates and terms of which cannot be taken into account in this proceeding[1] and which plainly drove the core economic terms of the deal. Pandora failed to show that it could replicate the key steering terms of its agreement with Merlin across the range of copyright owners whose content is required for Pandora to offer its users the highly customized playlists that Pandora touts and that its users want to hear. Pandora also failed to show that the "threat of steering" is alone sufficient to lower rates; indeed, there is not a single example of any webcaster reaching an agreement for lower rates because of a "threat of steering."

4. iHeart relied principally on its agreement with a major recorded music company, Warner Music Group, to support an "incremental" rate theory that not only was thoroughly debunked by SoundExchange at the hearing, but was even rejected by Pandora's expert (Prof. Shapiro), who chose to use the same "average effective rate" approach used by SoundExchange. The iHeart-Warner agreement provided consideration to Warner—much of which iHeart's experts simply refused to value and account for in their analysis—that is significantly in excess of what Warner would have received had iHeart simply opted to proceed under the statutory license. Moreover, iHeart's witnesses admitted the company could not replicate the deal's terms across the entire record industry.

5. NAB, for its part, put forward no benchmark analysis at all, but instead proposed a "zone of reasonableness" with the manifestly unreasonable poles of (a) zero, based on

[1] SoundExchange's contemporaneously filed Proposed Conclusions of Law set forth in more detail SoundExchange's arguments on the application of § 114(f)(C)(5) and other legal issues that emerged as relevant through the course of the hearing.

terrestrial radio broadcasts, for which there is no performance right and therefore no royalties at all, and (b) a maximum of 13% of revenues, based on the *SDARS II* rates, which the Judges, not the marketplace, decided under an entirely different statutory standard and an entirely different set of market factors (including a single licensee and very different cost considerations) that do not apply in this proceeding.

6. The agreements, arguments, and range of incredibly low rates the Services proffered do no justice to the statutory inquiry and disregard the realities of the marketplace in which the Services compete today. The evidence demonstrated that webcasting is a vibrant and growing market, attracting corporate behemoths, such as Apple and Google, and a tremendous diversity of other webcasters. All of these participants recognize what is clear to artists, record companies, and anyone who follows developments in this space, which continues to evolve daily (see, e.g., Apple's launch of its new music service just days after the hearing concluded): streaming music is not just the future, but the here and now of how people consume recorded music. Consumer adoption of music streaming is on a meteoric rise and is quickly replacing consumer ownership of copies (be they digital or physical).

7. Today's streaming market can no longer be divided into tidy categories. The Services repeatedly described Spotify, for example, as "interactive" or "on-demand" or "lean-forward"—as if applying those labels automatically made Spotify different than the "non-interactive" or "lean-back" offerings of Pandora and iHeart. But the real market evidence tells a very different story. Today, "lean-back" radio services are being offered by many so-called "interactive" services, including Spotify, Rdio, Google, Rhapsody and Apple. These services have created platforms with a variety of offerings to suit whatever interests a consumer may have at a particular time. If you want a free service that allows you to lean back and let the service

select the music, Pandora and iHeart are hardly your only choices. Numerous other services that Pandora tried to pigeonhole as "lean forward" also provide that free, lean-back offering. Those services are competing for the same listeners—including but by no means limited to the coveted base of users in the younger-age demographics—that Pandora and other statutory webcasters want to reach. The offerings from Pandora, iHeart, and other statutory licensees are converging and competing with the offerings of direct licensees for the finite number of hours in a day that consumers can listen to music streamed over the internet.

8. These marketplace developments are crucial in assessing what would happen if a record company today were to negotiate a license with Pandora or any other webcaster without the presence of a statutory license. A record company would not agree to a significantly lower rate for Pandora than the so-called "interactive" services that are offering similar radio offerings, as well as other offerings that may be "upsold" to the listeners who use the free offerings.

9. Five years is an eternity in this rapidly developing market. It is imperative that the Judges establish rates that reflect the fair market value of the content that is indispensable to the success of music streaming offerings; that provide copyright owners with fair market returns on that content, for which those owners make enormous and recurring investments every year; and that require Services proceeding under the statutory license to pay fair market rates rather than provide such Services unfair and unwarranted advantages vis-à-vis their competitors in the form of below-market compulsory rates. It is no exaggeration to say that the rates the Judges set will have an enormous impact on the webcasting market, on recording artists' lives and livelihoods, and the future of recorded music more generally. SoundExchange's proposal is reasonable, well supported, and wholly consistent with the willing buyer/willing seller standard

the statute directs the Judges to apply. We respectfully submit the Judges should adopt that proposal.

10. SoundExchange organizes and presents its Proposed Findings in the following Sections:

11. Section II provides a general overview of the proceedings and participants.

12. Section III provides the general factual background relevant to the willing buyer/willing seller standard. The legal issues involved in that standard, what it entails (consideration of actual market participants in a market without a statutory license), and what it does not (an a-textual addition of an "effective" or "workable" competition requirement that Congress did not enact and did not authorize the Judges to engraft onto the statute) are discussed in SoundExchange's Proposed Conclusions of Law.

13. Section IV describes the factual record concerning the unique product that artists and record companies contribute to the music webcasting enterprise. That product derives from the innate talents and hard work of the extraordinary men and women whose music the public wants to consume. And that product is underwritten, developed, and produced through the massive and recurring investments that record companies large and small must make year-after-year to continue the supply of that content.

14. Section V describes the evidence of the transformational shift in music consumption that underlies the entire streaming music market at the heart of these proceedings. The evidence made it clear beyond cavil that streaming is how people are rapidly coming to consume music and that it will be the critical mode of consumption over the next five years. That reality has completely changed the way that copyright owners view the phenomenon of consumption-by-listening. It is not a means to encourage people to buy a product. Streamed

music *is* the product. And the product offerings of Pandora, iHeart, other statutory licensees are converging and competing head-to-head with the offerings of copyright owners' directly licensed partners. That irrefutable fact directly informs how a willing seller would approach a licensing discussion with a buyer like Pandora in the hypothetical marketplace: the seller would require Pandora to take measures to incentive its customers to transition to service offerings that return higher value to those copyright owners, would require Pandora to pay a higher royalty for an ad-supported tier that inhibited the growth of subscription offerings, or would simply refuse to license Pandora's ad-supported service.

15. Section VI sets forth SoundExchange's proposal, and Section VII details the evidentiary record supporting it. The evidence showed, among other things, that the marketplace has spoken in favor of a "greater-of" structure, which provides economic benefits to both parties and facilitates beneficial price discrimination among services depending on whether they face relatively low or high price elasticities. SoundExchange's proposal is based on numerous agreements with services that provide a wide range of functionality, running the gamut of "lean back" to "lean forward" features. These marketplace agreements are more important and relevant in this proceeding than in any prior webcasting proceeding. We discuss in detail the factual evidence showing that SoundExchange's principal economic expert, Prof. Rubinfeld, carefully utilized an appropriate and reliable methodology to arrive at a proposed rate that was inherently conservative. Section VII further demonstrates that the Services' scattershot attacks on Prof. Rubinfeld's analysis fail to undermine the soundness of his findings and SoundExchange's proposal.

16. Sections VIII through X respond to the Services' economic proposals. Section VIII responds to Pandora's rate proposal and demonstrates why it is unrepresentative,

inadmissible, and unsupportable. Pandora ignores aspects of consideration that were valuable to Merlin labels and that, when properly valued, show that the effective rate is not lower than the Pureplay settlement rates under which Pandora operates. Moreover, "steering" is not the silver bullet Pandora imagines. Steering commitments cannot be replicated across the industry. The evidence showed that the "threat of steering" would not lead copyright owners across the industry to cut their prices. The record contains *not even one* instance in which this purported threat had the claimed effect of discounting. And Prof. Shapiro failed to show that even a service like Pandora could make steering a credible threat that would induce copyright owners to discount their rates.

17. Section IX discusses the evidence concerning iHeart's proposal in support of reducing the statutory rate it and other simulcasters pay by a jaw-dropping 80%. That proposal was based on Profs. Fischel/Lichtman's so-called "incremental" analysis, which imagined that parties bargaining directly in the shadow of the statutory license would only negotiate over a per-performance rate for performances allegedly in excess of those that would occur absent a direct license. The evidence did not show that any party to any agreement that iHeart cited—almost exclusively iHeart's own agreements, though later supplemented to include the Pandora-Merlin deal—actually negotiated this way. Of course, no party in the real world would negotiate this way. Parties instead would consider the value of the entire agreement. Profs. Fischel/Lichtman, however, failed to value numerous pieces of consideration that were critical to Warner entering into the agreement.

18. Section X discusses the evidence that undermines the NAB's so-called "zone of reasonableness" approach. As noted above, that approach cites as boundaries elements and values (terrestrial broadcasts: 0.0000, and SDARS II: 13% of revenues) that have no place in

this proceeding as a matter of law. This Section further demonstrates why the evidence wholly fails to support any segmentation of rates for simulcasters. NAB offered no evidence that demand elasticities are different among distinct segments of services, or that different types of users would listen to a simulcast over a different webcasting service. Statutory-rate segmentation would be highly impracticable; would be based on unsupported assumptions regarding simulcast and terrestrial radio; would discourage marketplace deals; would stifle innovation; and would encourage gamesmanship. If there is to be segmentation among different groups of webcasters, that is something the market can and should be permitted to sort out.

19. Section XI shows that multiple other marketplace agreements—including with Apple's iTunes Radio, Beats for "The Sentence", and others—are fully consistent with and support SoundExchange's rate proposal.

20. Section XII shows that NAB's and Sirius XM's attacks on the Webcaster Settlement Act rates they voluntarily agreed to are completely unfounded, and that their attempt to use these voluntarily negotiated settlements to undermine the rates set by the Judges in *Web III* entirely misses the mark.

21. Section XIII details the evidence related to the consideration "whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings." 17 U.S.C. § 114(f)(2)(B)(i). The evidence showed that consumer use of statutory services interferes directly with the "other stream of revenue" that is and will continue to be critical to copyright owners over the coming rate term: higher-revenue-generating subscription offerings. The evidence failed to support the Services' contentions that the widespread use of statutory streaming services—*e.g.*, 80+ million (and growing) active Pandora

users, the overwhelming majority of them on the low-revenue, ad-supported tier, streaming more than 20 hours per month (and growing)—was net promotional of recorded music industry overall; or that non-interactive streaming had some net promotional advantage relative to streaming on interactive services. iHeart's second attempt in these proceedings to make the latter showing failed, just as iHeart's first attempt (Prof. Danaher's withdrawn report) failed before it. The evidence showed that Dr. Kendall's study was based on wildly unrepresentative data—including data purporting to show that users of interactive services (mainly Spotify) spend 18 times more time listening to music than Pandora users do, something that is contrary to all market evidence and that even Pandora's CFO, Mike Herring, dismissed as unrealistic. Dr. Kendall's unreliable data and analysis produced completely unreliable results.

22. Section XIV discusses the evidence regarding webcaster profitability. The evidence showed that webcasters are focused on future profits—which is unsurprising given the relative nascence of the market and its exploding growth. For this reason, the Services' focus on their lack of short-term profitability is both misleading and irrelevant to the statutory inquiry. The evidence is undeniable that Pandora has made a deliberate decision to defer short-term profitability in order to grow its market share (as well as its stock market valuation). Pandora has the right to make its own decisions about whether and if so when to try to achieve profitability. Nothing in Section 114 or any other provision of law, however, compels copyright owners to subsidize the business strategies of Pandora or any other webcaster.

23. Sections XV through XIX discuss, respectively, evidence concerning the minimum fee, rates for noncommercial webcasters, SoundExchange's specific proposed terms and regulations, the designation of SoundExchange as the sole collective under the statute, and the § 112 royalty for ephemeral copies.

II. BACKGROUND

A. The Parties

1. SoundExchange

24. SoundExchange is a 501(c) (6) nonprofit performance rights organization established to ensure the prompt, fair, and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for the use of sound recordings over, among other things, the Internet, wireless networks, cable and satellite television networks, and satellite radio services via digital audio transmissions. Hr'g Ex. SX-2 at 3 (Bender WDT).[2]

25. In the previous *Webcasting III* proceeding, the Judges designated SoundExchange "as the Collective to receive statements of account and royalty payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g)." Hr'g Ex. SX-2 at 3 (Bender WDT); 37 C.F.R. § 380.4(b).

26. The Judges have also designated SoundExchange as the Collective to collect and distribute for other types of services, including preexisting subscription services and preexisting satellite digital audio radio services. 37 C.F.R. § 382.2; 37 C.F.R. § 383.13(b).

[2] In these Findings, "WDT" refers to a witness's written direct testimony, as submitted in the direct phase of the proceeding and admitted by the Judges during the unified hearing (e.g., "Bender WDT"). "WRT" refers to a witness's written rebuttal testimony, as submitted in the rebuttal phase of the proceeding and admitted by the Judges during the unified hearing (e.g., "Bender WRT"). Citations to the "WDT" and "WRT" will be preceded by the exhibit number, paragraph number or page number, and relevant witness's last name (e.g., Hr'g Ex. SX-2 at 3 (Bender WDT)). For citation to exhibits other than a witness's written testimony, the citation will be to the hearing exhibit number, and, where applicable, will be followed by the page number being cited (e.g., Hr'g Ex. SX-209 at 2). "Tr." is the abbreviation for the transcript of oral testimony that took place before the Judges. "Tr." abbreviations will precede the pin cite to the location in the transcript as well as the relevant date of the testimony and the last name of the witness on the stand (e.g., Hr'g Tr. 6041:21-24 (May 27, 2015) (Talley)).

27. SoundExchange is governed by an 18-member Board of Directors that is made up of equal numbers of artist representatives and sound recording copyright owner representatives. Copyright owners are represented by board members associated with the major record companies (four), independent record companies (two), the Recording Industry Association of America (two), and the American Association of Independent Music (one). Artists are represented by one representative each from the American Federation of Musicians ("AFM") and the Screen Actors Guild – American Federation of Television and Radio Artists ("SAG-AFTRA"). There are also seven at-large artist seats, which are held by artists' representatives and recording artists. Hr'g Ex. SX-2 at 3-4 (Bender WDT).

28. As of October 2014, SX has approximately 18,000 rights-owner members (including both record labels and artists who own the copyrights in their own recordings) and more than 40,000 artist members. SoundExchange also pays statutory royalties to non-members – copyright owners and artists alike – as if they were also members. In total, and because some artists and rights holders maintain multiple accounts, SoundExchange maintains more than 100,000 accounts for recording artists and rights holders. Hr'g Ex. SX-2 at 4-5 (Bender WDT).

29. SoundExchange has distributed royalties based on trillions of digital sound recording performances, and processes royalties related to tens of billions of webcasting performances each month. As of October 2014, SoundExchange has conducted a total of 61 royalty distributions and has made more than 510,000 individual payments totaling more than $2 billion. SoundExchange paid out statutory royalties of approximately $293 million in 2011, $462 million in 2012, $590 million in 2013, and, in just the first six months of 2014, SoundExchange paid out $323.6 million. Hr'g Ex. SX-2 at 5 (Bender WDT).

30. Since its founding, SoundExchange has, on behalf of artists and record labels, sought the establishment of royalties and regulations that enable the prompt, fair, and efficient distribution of royalties to all artists and copyright owners entitled to such royalties. In addition to participating in rate-setting proceedings, SoundExchange has represented artists and record labels with respect to other issues, such as notice and recordkeeping. SoundExchange also undertakes a number of measures to protect the interests of artists and copyright owners under the statutory licenses, including by conducting audits of licensees, seeking and obtaining compliance by noncompliant licensees, and engaging in other enforcement and compliance measures. Hr'g Ex. SX-2 at 4 (Bender WDT).

31. SoundExchange's core mission is to collect and distribute statutory royalties as efficiently and accurately as possible. SoundExchange has developed sophisticated systems, business processes, and extensive databases uniquely suited to the challenging task of distributing statutory royalties. For managing royalty collection and distribution, SoundExchange employs operational procedures concerning receipt of payment, loading and processing of reports of use, matching of recordings listed in reports of use with SoundExchange's database, research of sound recording ownership, account assignment, royalty allocation, account adjustment, and distribution. Hr'g Ex. SX-2 at 5-11 (Bender WDT). Those operations are described in greater detail in Section XVIII, *infra*.

32. SoundExchange strives to minimize the administrative costs associated with all of these efforts, including with royalty collection and distribution. In 2013, SoundExchange's administrative cost rate was 4.5%. Hr'g Ex. SX-2 at 5 (Bender WDT).

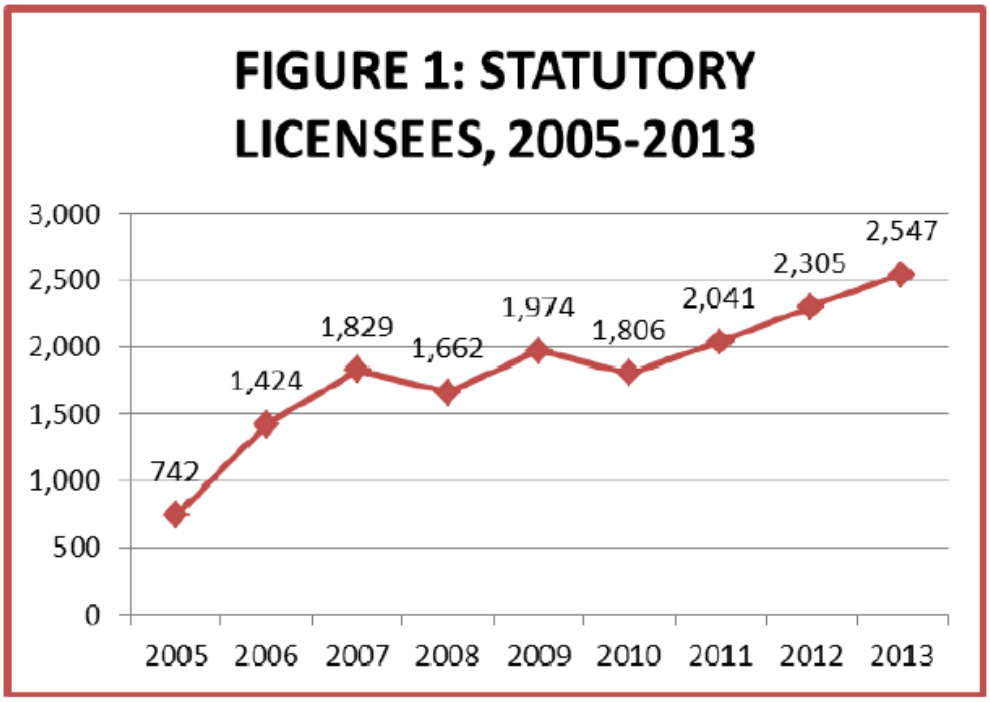
2. Webcasting Licensees

33. There has been an increasing and robust number of webcasters paying royalties to SoundExchange in the last rate period. In 2013 alone, 2,516 webcasting services paid

SoundExchange statutory royalties. That number likely undercounts the total number of webcasters that paid royalties in that year because some corporate enterprises (e.g., radio station groups like iHeartMedia or the Corporation for Public Broadcasting) pay and report in a consolidated manner on behalf of all of their affiliates, while affiliates of other enterprises pay and report separately for each station or for distinct subsets of stations (for example, on a regional basis). Taking these differences into account, SoundExchange actually receives reporting and payments on behalf of several thousands of channels and stations. Hr'g Ex. SX-2 at 11-12 (Bender WDT).

34. There is a historical trend of an increasing number of licensees paying statutory royalties for rates set pursuant to Section 112(e) and Section 114 or settlements adopted thereto, from 2,016 webcasting licensees in 2011, to 2,273 webcasting licensees in 2012, to 2,516 webcasting licensees in 2013. In fact, the total number of statutory licensee numbers since 2005 to 2013 has generally increased year to year, as follows (Hr'g Ex. SX-2 at 12 (Bender WDT):

RESTRICTED GRAPHIC



SOURCE: SoundExchange Data, Resiliency Analysis

35. In the prior rate period, in part as a consequence of settlements adopted pursuant to the Webcaster Settlement Acts, there were several license categories available to webcasting services operating under Sections 112(e) and 114). There were 13 license categories available to webcasters, including 8 for commercial webcasters (Commercial Webcaster-CRB; Commercial Webcaster—WSA; Broadcaster; Microcaster; Pureplay, Small Broadcaster; Small Pureplay; Small Webcaster) and 5 for noncommercial webcasters (Corporation for Public Broadcasting; Noncommercial Educational Webcaster; Noncommercial Microcaster; Noncommercial Webcaster—CRB; Noncommercial Webcaster—WSA). The majority of commercial webcasters operated pursuant to the Broadcaster rates and terms or the Commercial Webcaster—CRB rates and terms, which were set by the Judges in *Webcasting III*, or the Commercial Webcaster—WSA rates and terms. The noncommercial webcasters were more evenly dispersed among the various

license categories. Hr'g Ex. SX-2 at 12-13 (Bender WDT). The Figure below shows the number and distribution of licensees by license type in the years 2011 through 2013.

RESTRICTED GRAPHIC

FIGURE 2: LICENSEES BY TYPE, 2011-2013

YEAR	2011	2012	2013
TOTAL COMMERCIAL LICENSEES	**1188**	**1339**	**1517**
Broadcaster	678	851	949
Commercial Webcaster-CRB	129	103	121
Commercial Webcaster-WSA	31	12	9
Microcasters	22	41	35
Pureplay	2	5	5
Small Broadcaster	252	248	319
Small Pureplay	9	15	13
Small Webcaster	65	64	66
YEAR	**2011**	**2012**	**2013**
TOTAL NONCOMMERCIAL LICENSEES	**828**	**934**	**999**
Noncommercial Educational Webcaster	423	481	516
Noncommercial Microcasters	65	84	108
Noncommercial CRB	148	165	169
Noncommercial WSA	191	203	205
Corporation for Public Broadcasting/NPR	1	1	1

SOURCE: SoundExchange Data, Licensee Counts

36. Since 2011, of those webcasters who were subject to the $500 statutory minimum fee set by the Judges for the current license period, approximately 97% of noncommercial webcasters paid only that minimum fee. Even among commercial webcasting licensees, a little less than half paid only the minimum fee. When combined, approximately two-thirds of all webcasting licensees subject to the minimum fee set by the Judges paid *only* that minimum fee and no additional royalties. Hr'g Ex. SX-2 at 14 (Bender WDT).

B. History Of Prior Webcasting Proceedings

1. The Webcasting I Decision

37. The Copyright Arbitration Royalty Panel ("CARP") convened the first rate-setting proceeding for statutory webcasting. In 2002, it issued its report setting rates and terms for the time period 1998 – 2002. *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2 (Feb. 20, 2002). The CARP set a rate for the performance right under Section 114 of $0.0014 per stream for Internet-only webcasters, and $0.0007 per stream for broadcast simulcasters. For noncommercial services, the CARP accepted the Recording Industry Association of America's offer to license performances at one-third of the rate for commercial webcasters. With respect to Section 112, the CARP set the ephemerals rate at 8.8% of the rate paid for performances.

38. The Librarian of Congress rejected some of the CARP's recommendations, found no rational basis for setting different rates for Internet-only webcasters and broadcast simulcasters, and set the rate for both at $0.0007 per stream. *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, Final Rule and Order*, 67 Fed. Reg. 45240, 45272 (July 8, 2002) ("*Webcasting I*"). Several of the parties appealed to the D.C. Circuit, which upheld the Librarian's decision. *Beethoven.com LLC v. Librarian of Congress*, 394 F.3d 939 (D.C. Cir. 2005).

2. The Webcasting II Decision

39. In 2005, the Judges initiated a proceeding to set the statutory webcasting rates and terms for the rate period running from 2006 to 2010. After the submission of written cases, discovery, and extensive hearings, the Judges issued their Final Determination of Rates and Terms in 2007. *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule and Order*, 72 Fed. Reg. 24084 (May 1, 2007) ("*Webcasting II Original"*).

40. The Judges are required to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f) (2) (B); 17 U.S.C. § 112(e) (4). With respect to the willing buyer/willing seller standard, the Judges wrote, "In the hypothetical marketplace we attempt to replicate, there would be significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors. Congress surely understood this when formulating the willing buyer / willing seller standard." *Webcasting II Original*, 72 Fed. Reg. at 24087 (May 1, 2007).

41. The parties submitted competing benchmarks as the basis for setting rates. The Judges concluded that based on the available evidence, "the most appropriate benchmark agreements are those reviewed by Dr. Pelcovits in the market for interactive webcasting covering the digital performance of sound recordings." *Id.* at 24092.

42. For commercial webcasters, the Judges established per-performance rates of $.0008 for 2006, $0.0011 for 2007, $0.0014 for 2008, $0.0018 for 2009, and $0.0019 for 2010. For noncommercial webcasters , the Judges set a per station or channel rate of $500 for transmissions not exceeding 159,140 ATH per month, with usage in excess of the ATH cap at the commercial per-performance rates. For all webcasters, the Judges set the non-refundable but recoupable minimum fee at $500 per station or channel. *Id.* at 24096.

43. With respect to the Section 112 license for ephemeral copies, the Judges declined to ascribe any percentage of the royalty as the value for the ephemeral rights. *Id.* at 24101-02.

44. The Judges also established terms for the Section 112 and 114 licenses, including the designation of SoundExchange as the sole Collective to collect and distribute webcasting royalties. *Id.* at 24102-10.

(a) Appeals to the D.C. Circuit

45. Several webcasters unsuccessfully appealed various aspects of the Judge's decision. Among the arguments they raised were that the Judges erred in not basing rates on a perfectly competitive market and that the rates in SoundExchange's interactive benchmark analysis were erroneous because the interactive market is insufficiently competitive. The D.C. Circuit rejected all of these claims. *See Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 757-758 (D.C. Cir. 2009).

46. Another issue appealed was a challenge to the Judges' determination with respect to the minimum fee. The argument, as it was made, is that it is arbitrary for the Judges not to impose a cap on the number of a service's channels or stations subject to the minimum fee. The D.C. Circuit agreed with the challenge, vacated, and remanded the minimum fee determination for commercial webcasters. *See id.* at 761-62.

47. Noncommercial webcasters also raised a number of unsuccessful challenges, but on one issue – the minimum fee – the D.C. Circuit agreed. On that issue, the D.C. Circuit held that "[b]ecause there is no record evidence that $500 represented SoundExchange's administrative cost per channel or station, the Judges' determination in this regard cannot be sustained." *Id.* at 767. The D.C. Circuit vacated and remanded for a minimum fee determination for noncommercial webcasters.

48. Finally, Royalty Logic challenged the constitutionality of the Judges under the Appointments Clause. The D.C. Circuit ruled against Royalty Logic on waiver grounds and also rejected Royalty Logic's challenge to the designation of SoundExchange as the sole Collective. *Id.* at 755-56, 770-771.

(b) Remand of the Minimum Fee Decisions

49. On remand, SoundExchange and the Digital Media Association reached a settlement for commercial webcasters of $500 per station or channel but capped at $50,000 a year. The settlement was adopted by the Judges.

50. For noncommercial webcasters, the Judges convened an evidentiary hearing to address the minimum fee issue and concluded that a $500 annual fee per station or channel was appropriate for noncommercial services for the 2006 to 2010 rate period. *Amendment to Determination Pursuant to Remand Order*, Docket No. 2005-1 DTRA (June 30, 2010).

(c) Second Appeal to the D.C. Circuit

51. During IBS's appeal of the Judge's further determination, IBS had also appealed the *Webcasting III* determination. The *Webcasting II* appeal was stayed during the pendency of the *Webcasting III* appeal. In the latter appeal, the D.C. Circuit held the appointment of the Judges was unconstitutional. The *Webcasting II* appeal was remanded to the Judges for a determination concerning the noncommercial minimum fee. The Judges ultimately accepted, based on a *de novo* review of the record, the $500 minimum fee for the years 2006 to 2010. *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Determination after Second Remand*, 79 Fed. Reg. 64669, 64673 (Oct. 31, 2014) ("*Webcasting II Second Remand*").

3. The Webcasting III Decision

52. On January 5, 2009, the Judges announced the commencement of a rate proceeding to determine the royalty rates and terms applicable under the webcasting license for 2011 through 2015. The Judges published their Final Determination in the matter in March 2011.

53. In the original *Webcasting III* decision, the Judges found "the interactive webcasting benchmark to be of the comparable type that the Copyright Act invites [judges] to

consider." *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule and Order*, 76 Fed. Reg. 13026, 13031 (Mar. 9, 2011) ("*Webcasting III Original"*). Specifically, the Judges noted there were "three criteria for an appropriate rate based on the marketplace evidence" they were presented: (1) a rate structure that reflects their finding that the most likely prevailing rate in the target market is closer to the lower boundary than to the upper boundary; (2) a rate structure that accommodates some modest growth in rates over the term of the license period; and (3) a rate structure that provides for longer periods of stable rates during the term of the license period. *Id.* at 13036. Under those criteria, the Judges adopted the following commercial per-play rates: "$0.0019 for 2011, $0.0021 for 2012, $0.0021 for 2013, $0.0023 for 2014, and $0.0023 for 2015." *Id.* With respect to noncommercial webcasters and "[h]aving rejected *in toto* the contentions and claims of IBS" the Judges adopted the same flat fee and minimum fee as was adopted in *Webcasting II*. *Id.* at 13042.

(a) **Appeal to the D.C. Circuit**

54. IBS appealed the original *Webcasting III* determination to the D.C. Circuit, contending that the noncommercial minimum fee was excessive and challenging the constitutionality of the Judges under the Appointments Clause. The D.C. Circuit ruled that the Judges were acting as principal officers of the government and therefore in violation of the Appointments Clause. *See Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1342 (D.C. Cir. 2012). This violation was cured by eliminating the limit on the Librarian's removal power of the Judges but also, the D.C. Circuit vacated and remanded the original *Webcasting III* determination. *Id.* at 1334, 1342.

(b) **Remand Decision**

55. On remand, the Judges interpreted the D.C. Circuit's order as directing the Judges to review the entire record and issue a new determination, not just to review the issues IBS had

raised on appeal. *In re Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule and Order*, 79 Fed. Reg. 23102, 23103 (Apr. 25, 2014) ("*Webcasting III Remand*"). The Judges noted they "are not limited with regard to the evidence they may consider (other than the limitations in the [Webcasters Settlement Acts] on the use of agreements reached under those statutes)." *Id.* at 23104. Importantly, "[e]xcept as directed by the WSAs, the Judges may consider rates and terms negotiated in voluntary licensing agreements for comparable transmission services." *Id.*

56. With respect to rate structure, "[g]iven the limitations of the record developed by the parties," the Judges deferred to the parties' "decision to eschew advocacy" for a percentage of revenue based fee." *Id.* at 23105. The Judges emphasized, however, that they "do not *per se* reject future consideration of rate structures predicated upon other measurements, such as a percentage of revenue realized by webcasters." *Id.*

57. With respect to commercial webcaster rates, after a searching and detailed analysis, the Judges concluded "[t]he present *de novo* determination is substantively distinct in a number of respects from the prior determination, but the analysis leads to an approximate 'zone of reasonableness' within which an appropriate rate for commercial webcasters can be established that includes the rates established in the March 9, 2011 determination." *Id.* at 23120.

58. Finally, with respect to noncommercial webcasters, the Judges concluded "that it is appropriate to continue this commercial/noncommercial distinction because there is a good economic foundation for maintaining this dichotomy. More specifically, a 'noncommercial' webcaster by definition is not participating fully in the private market." The Judges further noted that "[i]f a participant in a rate proceeding were to present evidence that, in a hypothetical marketplace, a willing buyer and a willing seller would negotiate a different rate for

noncommercial webcasters at a given ATH level than they would for all other noncommercial webcasters, that would argue in favor of recognizing noncommercial webcasters at that ATH level as a distinct type of service." *Id.* at 23122. On a related subject, as in prior proceedings, the Judges acknowledged that "it is reasonable and appropriate for the minimum fee to at least cover SoundExchange's administrative cost" which, in turn supported SoundExchange's minimum fee proposal which was adopted by the Judges. *Id.* at 23124.

C. History Of This Proceeding

59. On January 3, 2014, the Judges published in the Federal Register a notice announcing the commencement of the proceeding to determine reasonable rates and terms for two statutory licenses permitting certain digital performances of sound recordings and the making of ephemeral recordings for the period beginning January 1, 2016, and ending on December 31, 2020. 79 Fed. Reg. 412 (Jan. 3, 2014).

1. Submission of Petitions to Participate

60. Petitions to participate were due no later than February 3, 2014. 79 Fed. Reg. 412 (Jan. 3, 2014).

61. Twenty-nine parties filed timely petitions to participate. On the Licensor side, this included SoundExchange and George Johnson, an independent musician doing business as GEO Music Group. On the Licensee side, petitions to participate were filed by the following entities: 8tracks; AccuRadio; Amazon; Apple; Beats Music; College Broadcasters, Inc.; iHeartMedia (formerly Clear Channel Communications); CMN, Inc.; CustomChannels.Net; Digitally Imported; Digital Media Association; Educational Media Foundation; Feed Media; Harvard Radio (WHRB); Intercollegiate Broadcasting System; idobi Network; Music Reports; National Association of Broadcasters (NAB); National Music Publishers Association ("NMPA"); National Public Radio ("NPR"); National Religious Broadcasters Noncommercial

Music Licensing Committee ("NRBNMLC"); Pandora; Rhapsody; Sirius XM; SomaFM.com; Spotify, USA; and Triton Digital.

62. The Judges subsequently struck the petitions to participate filed by Music Reports, Inc.; NMPA; and Triton Digital.

2. Period of Voluntary Negotiations

63. A voluntary negotiation period commenced on February 21, 2014 and ended on May 22, 2014. No party reported a settlement at that time.

3. Written Direct Statements and Unified Hearing

64. On July 29, 2014, all of the parties remaining in the proceeding except CBI filed a Joint Motion for Issuance of Discovery Schedule and Alteration of Case Schedule. While the proposed case schedule maintained the division of past proceedings between the submission of written direct statements and written rebuttal statements, the proposed schedule called for one unified hearing. On August 29, 2014, the Judges issued an order modifying the particular dates of the proposed schedule but retaining the unified hearing.

65. By October 10, 2014, 8Tracks, CMN, Feed Media, Spotify, CustomChannels.Net, Digitally Imported, Amazon, Rhapsody, SomaFM.com, and idobi Network all filed notices of withdrawal from the proceeding.

66. Of the remaining parties, AccuRadio, George Johnson, CBI, IBS, iHeartMedia, NAB, NPR, NRBNMLC, Pandora, Sirius XM, SoundExchange, and WHRB all filed written direct statements with written testimony from at least one witness. Educational Media Foundation filed a letter stating that as a member of NRBNMLC, Educational Media Foundation would be supporting and joining the direct case exhibits and rate proposal of NRBNMLC. Apple, Beats Music, and the Digital Media Association did not file either a notice of withdrawal or a written direct statement.

67. In February 2015, iHeartMedia, George Johnson, NAB, Pandora, and Soundexchange all filed written rebuttal cases as well.

68. On March 17, 2015, the Judges granted SoundExchange's motion to strike the testimony of Kurt Hanson, AccuRadio's only witness, in its entirety.

69. The unified hearing commenced on April 27, 2015 with a day of opening statements followed by twenty-six hearing days. The hearing involved more than 7,500 pages of live testimony from approximately 47 witnesses, hundreds of additional pages of written testimony, and the introduction of more than 700 documentary exhibits.

70. Both SoundExchange and Mr. Johnson actively participated on behalf of Licensors. Pandora, NAB, NRBNMLC, iHeartMedia, IBS, and Sirius XM all actively participated on behalf of Licensees. Counsel for NPR and CBI, both parties that have submitted settlements with SoundExchange, appeared on the opening day of the hearing.

71. While some witnesses were taken out of turn and others were submitted without live testimony, the general order of the hearing presentation was:

- Licensor Direct Case
- Licensee Rebuttal to Licensor Direct Case
- Licensee Direct Case
- Licensor Rebuttal to Licensee Direct Case

D. Witnesses

1. SoundExchange Witnesses

72. SoundExchange presented testimony from the following 23 witnesses:

73. Dennis Kooker, President of Global Digital Business and U.S. Sales for Sony Music Entertainment, testified before the Judges on Tuesday, April 28, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 2 (April 28, 2015). Mr. Kooker returned on Friday,

May 29, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 24 (May 29, 2015).

74. Darius Van Arman, Co-Founder and Co-Owner of Secretly Group, testified before the Judges on Tuesday, April 28, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 2 (April 28, 2015). Mr. Van Arman returned on Tuesday, June 2, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 26 (June 2, 2015).

75. Michael Huppe, President & CEO of SoundExchange, testified before the Judges on Wednesday, April 29, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 3 (April 29, 2015) . Mr. Huppe returned on Wednesday, June 3, 2015, to testify before the Judges regarding his Written Rebuttal Testimony . Hr'g Tr. Day 27 (June 3, 2015).

76. Raymond Hair, President of the American Federation of Musicians of the United States and Canada, testified before the Judges on Wednesday, April 29, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 3 (April 29, 2015).

77. Prof. Daniel McFadden, Emeritus Professor of Economics at the University of California, Berkeley and winner of the 2000 Nobel Memorial Prize in the Economic Sciences, testified before the Judges on Wednesday, April 29, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 3 (April 29, 2015). Prof. McFadden was qualified as an expert in "[conjoint] methodology and discrete choice." Hr'g Tr. 826:23 – 827:4 (April 29, 2015).

78. Aaron Harrison, Senior Vice President of Business & Legal Affairs, Global Digital Business, at UMG Recordings Inc., testified before the Judges on Thursday, April 30, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 4 (April 30, 2015). Mr. Harrison returned on Tuesday, June 2, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 26 (June 2, 2015).

79. Simon Wheeler, Director of Digital at Beggars Group, testified before the Judges on Thursday, April 30, 2015, and Friday, May 1, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 4 (April 30, 2015); Hr'g Tr. Day 5 (May 1, 2015) . Mr. Wheeler returned on Monday, June 1, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 25 (June 1, 2015).

80. Jeffrey Harleston, General Counsel & Executive Vice-President for Business and Legal Affairs for North America at Universal Music Group, testified before the Judges on Friday, May 1, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 5 (May 1, 2015).

81. Prof. Thomas Lys, Professor of Accounting and Information Management at the Kellogg School of Management, Northwestern University, testified before the Judges on Monday, May 4, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 6 (May 4, 2015) (Lys). Prof. Lys returned on Friday, May 29, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 24 (May 29, 2015). Prof. Lys was qualified as an "expert in economics, accounting, and finance." Hr'g Tr. 1442:23 – 1443:2 (May 4, 2015).

82. Dr. David Blackburn, Vice President at NERA Economic Consulting, testified before the Judges on Monday, May 4, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 6) (May 4, 2015) (Blackburn). Dr. Blackburn returned on Tuesday, May 26, 2015, and Wednesday, May 27, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 21 (May 26, 2015); Hr'g Tr. Day 22 (May 27, 2015). Dr. Blackburn was qualified as "an expert in the field of applied microeconomics." Hr'g Tr. 1548:7-11 (May 4, 2015).

83. Prof. Daniel Rubinfeld, Professor of Law and Professor of Economics Emeritus at the University of California, Berkeley, testified before the Judges on Tuesday, May 5, 2015,

Wednesday, May 6, 2015, and Thursday, May 7, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 7 (May 5, 2015); Hr'g Day 8 (May 6, 2015), Hr'g Day 9 (May, 7, 2015). Prof. Rubinfeld returned on Thursday, May 28, 2015, to testify before the Judges regarding his Written Rebuttal Testimony (Hr'g Tr. Day 23) (May 28, 2015). Prof. Rubinfeld was qualified as "an expert in microeconomics, econometrics, and antitrust economics." Hr'g Tr. 1746:22 – 1746:2 (May 5, 2015).

84. Ron Wilcox, Executive Counsel of Business Affairs, Strategic and Digital Initiatives, at Warner Music Group, testified before the Judges on Thursday, May 7, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 9 (May 7, 2015). Mr. Wilcox returned on Wednesday, June 3, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 27 (June 3, 2015).

85. Jonathan Bender, Chief Operating Officer of SoundExchange, testified before the Judges on Friday, May 8, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 10 (May 8, 2015). He returned on Tuesday, June 2, 2015, to testify before the Judges regarding his Written Rebuttal Testimony. Hr'g Tr. Day 26 (June 2, 2015).

86. Prof. Eric Talley, Professor of Law and Director of the Berkeley Center for Law, Business, and the Economy at the University of California, Berkeley, testified before the Judges on Wednesday, May 27, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 22 (May 27, 2015). Prof. Talley was qualified as "an expert in microeconomics, bargaining and game theory, and economic analysis of the law." Hr'g Tr. 6011:23 – 6012:4 (May 27, 2015).

87. Glen Barros, President and Chief Executive Officer of Concord Music Group, testified before the Judges on Thursday, May 28, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 23 (May 28, 2015).

88. Sarah Butler, Vice President at NERA Economic Consulting, testified before the Judges on Friday, May 29, 2015, regarding her Written Rebuttal Testimony. Hr'g Tr. Day 24 (May 29, 2015). Ms. Butler was qualified as "an expert in survey design." Hr'g Tr. 6760:21-25 (May 29, 2015).

89. Charlie Lexton, Head of Business Affairs and General Counsel at Merlin, testified before the Judges on Monday, June 1, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 25 (June 1, 2015).

90. Jennifer Fowler, Senior Vice President, U.S. Marketing & Revenue Generation at Sony Music Entertainment, testified before the Judges on Monday, June 1, 2015, regarding her Written Rebuttal Testimony. Hr'g Tr. Day 25 (June 1, 2015).

91. Jim Burruss, Senior Vice President, Promotions Operations at Columbia Records, Sony Music Entertainment, testified before the Judges on Monday, June 1, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 25 (June 1, 2015).

92. The Judges accepted the Written Rebuttal Testimony of Prof. Marc Rysman, Professor of Economics at Boston University, as a written submission. *See* Hr'g Tr. 7186:14-7187:6 (June 2, 2015)

93. The Judges accepted the Written Direct Testimony of Fletcher Foster, President and CEO of Iconic Entertainment Group, as a written submission. *See* Hr'g Tr. 7186:14-7187:11 (June 2, 2015).

94. The Judges accepted the Written Rebuttal Testimony of Doria Roberts, an independent recording artist, as a written submission. *See* Hr'g Tr. 7186:14-7187:11 (June 2, 2015).

95. The Judges admitted the Designated Testimony of Dr. George Ford. Hr'g Tr. 2588:13-21 (May 8, 2015).

2. Geo Music Witnesses

Geo Music presented testimony from George Johnson. Mr. Johnson testified before the Judges on Friday, May 8, 2015. Hr'g Tr. Day 10 (May 8, 2015).

3. IBS

96. IBS presented testimony from Captain Frederick Kass. Captain Kass testified before the Judges on Tuesday, May 28, 2015, regarding his Written Direct Testimony. (Hr'g Tr. Day 23) (May 28, 2015).

4. WHRB

97. WHRB presented testimony from Mr. Michael Papish. Mr. Papish testified before the Judges on Tuesday, May 19, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 17 (May 19, 2015).

5. iHeartMedia Witnesses

98. iHeart Media presented testimony from the following 11 witnesses:

99. Todd Kendall testified before the Judges on Tuesday, May 12, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 12 (May 12, 2015).

100. Marissa Morris testified before the Judges on Wednesday, May 13, 2015, regarding her Written Rebuttal Testimony. Hr'g Tr. Day 13 (May 13, 2015).

101. Jeffrey Littlejohn testified before the Judges on Wednesday, May 13, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 13 (May 13, 2015).

102. Jon Pedersen testified before the Judges on Thursday, May 14, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 14 (May 14, 2015).

103. Prof. Douglas G. Lichtman testified before the Judges on Friday, May 15, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 15 (May 15, 2015).

104. Robert Pittman testified before the Judges on Wednesday, May 20, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 18 (May 20, 2015).

105. Tom Poleman testified before the Judges on Thursday, May 21, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 19 (May 21, 2015) (Poleman).

106. Prof. Daniel R. Fischel testified before the Judges on Thursday, May 21, 2015, and Friday, May 22, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 19 (May 21, 2015); Hr'g Tr. Day 20 (May 22, 2015).

107. Prof. John Hauser testified before the Judges on Friday, May 22, 2015 regarding his Written Rebuttal Testimony. Hr'g Tr. Day 20 (May 22, 2015).

108. David Pakman testified before the Judges on Wednesday, May 27, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 22 (May 27, 2015). Mr. Pakman was a witness for both iHeartMedia and for the NAB.

109. Steven Cutler testified before the Judges on Tuesday, June 2, 2015 regarding his Written Direct Testimony. Hr'g Tr. Day 26 (June 2, 2015).

6. NAB Witnesses

110. NAB presented testimony from the following 11 witnesses:

111. Prof. Michael Katz testified before the Judges on Monday, May 11, 2015, and Tuesday, May 12, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 11 (May 11, 2015); Hr'g Tr. Day 12 (May 12, 2015). Prof. Katz returned on Tuesday, May 26, 2015, to

testify before the Judges regarding his Written Direct Testimony. Hr'g Tr. Day 21 (May 26, 2015).

112. Prof. Dominique Hanssens testified before the Judges on Thursday, May 14, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 14 (May 14, 2015).

113. Dr. Steven R. Peterson testified before the Judges on Thursday, May 14, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 14 (May 14, 2015). Dr. Peterson was a witness for both the NAB and Pandora.

114. Prof. Roman L. Weil testified before the Judges on Thursday, May 14, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 14 (May 14, 2015).

115. Steven Newberry testified before the Judges on Wednesday, May 20, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 18 (May 20, 2015).

116. Ben Downs testified before the Judges on Thursday, May 21, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 19 (May 21, 2015).

117. John Dimick testified before the Judges on Tuesday, May 26, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 21 (May 26, 2015).

118. The Judges accepted the Written Direct Testimony of Johnny Chiang as a written submission. *See* Hr'g Tr. 7148:6-7150:1 (June 2, 2015).

119. The Judges accepted the Written Direct Testimony of Julie Koehn as a written submission. *See* Hr'g Tr. 7148:6-7150:1 (June 2, 2015).

120. The Judges accepted the Written Direct Testimony of Jean-Francis Gadhoury as a written submission. *See* Hr'g Tr. 7148:6-7150:1 (June 2, 2015).

121. The Judges accepted the Written Direct Testimony of Francis "Buzz Knight" Kocak as a written submission. *See* Hr'g Tr. 5396:1-5397:2 (May 22, 2015).

7. NRBMLC Witnesses

122. NRBMLC presented testimony from the following two witnesses:

123. Gene Henes testified before the Judges on Thursday, May 21, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 19 (May 21, 2015).

124. The Judges accepted the Written Direct Testimony of Joseph Emert as a written submission. *See* Hr'g Tr. 7148:6-7150:1 (June 2, 2015).

8. Pandora Witnesses

125. Pandora presented testimony from the following 6 witnesses:

126. Prof. Carl Shapiro testified before the Judges on Friday, May 8, 2015, Monday, May 18, 2015, Tuesday, May 19, 2015, and Wednesday, May 20, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 10 (May 8, 2105); Hr'g Tr. Day 16 (May 18, 2105); Hr'g Day 17 (May 19, 2105); Hr'g Day 18 (May 20, 2105).

127. Michael Herring testified before the Judges on Tuesday, May 12, 2015 and Wednesday May 13, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 12 (May 12, 2015); Hr'g Day 13 (May 13, 2015). Mr. Herring returned on Monday, May 18, 2015, to testify before the Judges regarding his Written Direct Testimony. Hr'g Tr. Day 16 (May 18, 2015).

128. Larry Rosin testified before the Judges on Thursday, May 14, 2015, regarding his Written Rebuttal Testimony. Hr'g Tr. Day 14 (May 14, 2015).

129. Stephan McBride testified before the Judges on Monday, May 18, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 16 (May 18, 2015).

130. Simon Fleming-Wood testified before the Judges on Wednesday, May 27, 2015, regarding his Written Direct Testimony and his Written Rebuttal Testimony. Hr'g Tr. Day 22 (May 27, 2015).

131. The Judges accepted the Written Direct Testimony of Tim Westergren as a written submission. *See* Hr'g Tr. 7374:21-7375:25 (June 3, 2015).

9. Sirius XM

132. Sirius XM presented testimony from the following one witness:

133. David Frear testified before the Judges on Friday, May 22, 2015, regarding his Written Direct Testimony. Hr'g Tr. Day 20 (May 22, 2015).

E. Submission Of Settlements

1. CBI Settlement

134. On October 7, 2014, SoundExchange and CBI filed a joint motion to adopt a partial settlement covering certain internet transmissions by noncommercial educational webcasters.

135. The Judges published the settlement in the Federal Register on November 5, 2014, and invited any comments or objections by November 26, 2014. 79 Fed. Reg. 65609 (Nov. 5, 2014).

136. Fifty six entities filed comments on the settlement.

137. To date, the Judges have neither adopted nor declined to adopt the settlement.

2. NPR and CPB Settlement

138. On February 24, 2015, SoundExchange, NPR, and Corporation for Public Broadcasting filed a joint motion to adopt a partial settlement covering certain internet transmissions of "Covered Entities" including NPR, American Public Media, Public Radio International, Public Radio Exchange, and certain public radio stations.

139. The Judges published the settlement in the Federal Register on March 26, 2015, and invited any comments or objections by April 16, 2015. 80 Fed. Reg. 15958 (Mar. 26, 2015).

140. The only comment received on the settlement was from IBS. IBS would not be covered by the settlement and IBS's objection was one of timing and procedure not substance. Hr'g Tr. 234:24-235:6 (Apr. 27, 2015) (Steinthal); *Id.* at 227:25-228:7 (Apr. 27, 2015) (Malone).

141. To date, the Judges have neither adopted nor declined to adopt the settlement. The Judges have acknowledged that the deadline has passed for comments, there is no reason not to recommend acceptance, and "at this point, it's a matter of logistics." Hr'g Tr. 236:2-19 (Apr. 27, 2015) (Barnett, C.J.).

III. THE WILLING BUYER WILLING SELLER STANDARD AND THE HYPOTHETICAL MARKET

A. The Willing Buyer – Willing Seller Standard Has No "Effective" Or "Workable" Competition Requirement; The Judges Are To Consider the Record Companies And Services As They Presently Exist in the Market

142. Section 114(f)(2)(B) of the Copyright Act requires the Judges to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B).

143. Section I of SoundExchange's contemporaneously filed Proposed Conclusions of Law sets forth the statutory standards for applying the willing buyer/willing seller test under section 114(f)(2)(B), including the requirements that the Judges ascertain the rates that would have been negotiated in a market without the statutory license, and that the "willing sellers" are the record companies as they exist in the market.

144. Section II of SoundExchange's Proposed Conclusions of Law explains why, as a matter of law, (a) section 114(f)(2)(B) does not include an "effective" or "workable" competition requirement, (b) the Judges may not add such a requirement to the statutory test.

145. To the extent necessary to these Proposed Findings of Fact, SoundExchange incorporates by reference on the foregoing legal points and on any other legal points relevant to the matters discussed herein.

B. The Hypothetical Market Is One In Which There Is No Statutory License

146. The statute requires the Judges to consider a hypothetical market in the absence of the statutory license. Given that mandate, the effect of the statutory shadow is a critical, indeed, threshold, factor for the Judges to consider in reviewing potential benchmark evidence. It is undisputed that the interactive service agreements are the least affected by the statutory shadow of all the proposed benchmarks, rendering them a more appropriate benchmark in this proceeding.

1. Agreements Negotiated Directly in the Shadow of the Statutory License Are Improper Benchmarks

147. A threshold requirement for the willing buyer / willing seller test is a hypothetical market in *the absence of a statutory license*. As the Judges have noted, the "Act instructs the Judges to use the willing buyer/willing seller construct, assuming no statutory license." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23107 (Apr. 25, 2014); *see also id.* at 23110 ("The hypothetical marketplace is one in which no statutory license exists"). Because the hypothetical marketplace between willing buyers and willing sellers depends upon the absence of a statutory license, *a priori* agreements that are least affected by the statutory shadow would most readily reflect the hypothetical marketplace. *See id*.

148. As Prof. Shapiro testified at the hearing, when you take a license that is a "statutory service" and that "is directly influenced by the presence of the statutory license," and "you're going to use that as a benchmark, you need to think through carefully how did the

statutory license affect that rate," which "means you've got some work to do." Hr'g Tr. 2668:18-2669:7 (May 8, 2015) (Shapiro).

149. The effect of the statutory license is particularly problematic because it creates a downward bias in the observable agreements that are negotiated in its direct shadow. As Prof. Talley explained and demonstrated through his use of structural modeling techniques, regardless of allocation of bargaining power, the range of negotiated prices in agreements negotiated under the shadow of a statutory license will generally be below those that would otherwise exist in the absence of a statutory rate. The reason for this is that the statutory license option crowds out a significant fraction of deals that would otherwise be negotiated transactions above or near the statutory rate, leaving behind only a subset of transactions with relatively low prices below the statutory rate. Hr'g Ex. SX-19 at 48-60 (Talley WRT); Hr'g Tr. 6021:25-6030:4, 6034:4-6037:19 (May 27, 2015) (Talley).

150. Agreements also may be reached in the shadow of the statutory license where the parties value the consideration provided in the agreement differently (as is the case, for example, with the Pandora-Merlin agreement, *see* Section VIII.D.1 *infra*), and where the parties have different projections of performance under the agreement (as is the case with respect to the Apple iTunes Radio agreements, *see* Section XI.A, *infra*).

2. The Interactive Agreements Are Least Affected By The Statutory Shadow And Are Therefore More Appropriate As a Benchmark

151. As the Judges have acknowledged, "[i]n the interactive market, the rates for sound recordings are not subject to the statutory license." *Webcasting III Remand*, at 23115. This fact renders interactive service agreements less affected by the statutory license than agreements for non-interactive services negotiated directly in the shadow of the statutory license, and accordingly, more appropriate as a benchmark.

152. The statutory license casts a shadow across the entire streaming industry, and all agreements, including the interactive agreements, are affected to varying degrees by this shadow. Hr'g Ex. SX-17 ¶ 91 (Rubinfeld Corr. WDT). The extent to which the existing statutory or Pureplay rates directly affect the rates of directly-negotiated services falls on a spectrum, depending upon the degree and extent of differences in service functionality at issue, *i.e.*, the less difference in functionality between the directly negotiated service and statutory service, the more affected the negotiated rates will be by the statutory license (and/or the Pureplay rates). *Id.* Because the interactive agreements offer certain functionality that prevents the services from immediately falling back to the statutory license if an agreement is not reached, they are not directly influenced by the existing statutory rates. *Id.* ¶ 18.

153. The Services agree on this point. As Prof. Shapiro has stated: "I agree with Prof. Rubinfeld that the interactive services do not have the option of electing the statutory license, so the interactive licenses are less influenced by the statutory license than are the licenses signed with statutory webcasters." Hr'g Ex. PAN 5023 at 4; *see also id.* at 6 ("I agree with Prof. Rubinfeld that agreements signed by statutory webcasters are influenced more by the availability of the statutory license than are agreements signed by interactive services."); Hr'g Tr. 2669:8-10 (May 8, 2015) (Shapiro) (problem with shadow is "less true for the interactive benchmark because it's not as, at least, directly influenced by the statutory license").

3. The Pandora-Merlin Agreement Was Negotiated Directly in the Shadow of the Pureplay Rates And Expressly Reflects Such Rates

154. The problem of the statutory shadow is particularly acute for the Pandora-Merlin agreement, which, as Pandora and Prof. Shapiro acknowledge, not only exists in the direct shadow of the existing Pureplay rates, but in fact [ ]. *See* Section VIII.B.1, *infra*; Hr'g Tr. 4571:9-14 (May 19, 2015) (Shapiro)

[redacted]

[redacted]]); Hr'g Tr. 4583:22-24 (May 19, 2015) (Shapiro) (Pandora - Merlin Agreement is "definitely negotiated in the shadow of the pureplay rates. No question. It's obvious."); Hr'g Tr. 4262:14-21 (May 18, 2015) (Herring) [redacted]

[redacted]]); *see also* Hr'g Ex. SX-13 ¶ 5 (Lexton WRT) ("In my view, this license was therefore directly affected and inextricably bound by the existing statutory rates, not evidence of what the next statutory rates should be."); Hr'g Ex. SX-29 ¶ 64 (Rubinfeld Corr. WRT) ("Most fundamentally, the Pandora-Merlin agreement is an improper benchmark because it was directly influenced by the existing pureplay rates"). Furthermore, Pandora previously licensed Merlin's sound recordings through SoundExchange and continues to license all other record companies' repertoires under the statutory license.

155. As noted, the imposition of a statutory license can crowd out a significant number of consensually negotiated transactions that would otherwise exist above or near the statutory rate. Hr'g Ex. SX-19 at 48-60 (Talley WRT); Hr'g Tr. 6021:25-6030:4, 6034:4-6037:19 (May 27, 2015) (Talley). The Pandora-Merlin agreement exists at the far left-hand tail of the distribution curve of potential rates that would exist in the absence of a statutory rate, and therefore reveals a rate that both suffers from selection bias and a downward bias created by the Pureplay rates. Hr'g Ex. SX-19 at 54-6 (Talley WRT); Hr'g Tr. 6034:4-6037:19 (May 27, 2015) (Talley). By contrast, the interactive service agreements avoid this problem because they do not exist in the direct shadow of the statutory license. *See* Hr'g Tr. 6036:15-6037:15 (May 27, 2015) (Talley).

156. Prof. Talley's structural modeling approach revealed that, due to the effect of the satututory shadow, the Pandora – Merlin rates could skew significantly further from the true

willing buyer willing seller rate than the interactive benchmark. This is true even where Prof. Talley stacked the deck against the interactive benchmark by assuming (i) that sellers in the interactive space have undue bargaining power, (ii) sellers in the non-interactive space have less bargaining power, and (iii) bargaining power was equally distributed in the Pandora-Merlin deal. *See* Hr'g Ex. SX-19 at 57-58 (Talley WRT).

4. The iHeart-Warner and iHeart-Indie Agreements Were Negotiated Directly in the Shadow of the NAB Settlement and Pureplay Rates

157. The iHeart-Warner agreement also was negotiated directly in the shadow of the statutory license, specifically, the NAB Settlement and the rates that Settlement established for the statutory license that a webcaster such as iHeart utilizes. For this reason, the value of the iHeart-Warner agreement as a standalone willing-buyer/willing-seller benchmark is diminished. Profs. Fischel/Lichtman agree that at least the largest portion of the iHeart-Warner agreement "is directly affected by the existing statutory rates." Hr'g Ex. IHM 3034 ¶ 48 (Fischel/Lichtman AWDT). This stands in contrast to the interactive services benchmarks, in which, as iHeart's experts admit, the shadow "probably weighs less." Hr'g Tr. 4141:17-18 (May 15, 2015) (Lichtman).

158. The shadow of the Pureplay statutory rates that Pandora pays also directly influenced the rates established in the iHeart-Warner agreement. [ ]. Hr'g Ex. SX-32 at 7 (Wilcox WRT); *see also* Hr'g Ex. SX-17 ¶ 184 (Rubinfeld Corr. WDT). Notably, the 27 direct licenses between iHeart and independent record labels also [ ]

[redacted]. *See, e.g.* Hr'g Ex. IHM 3365 at 6, 11 (iHeart-Concord Agreement).

159. Furthermore, iHeart previously licensed Warner's sound recordings through SoundExchange and continues to license other recorded music companies' repertoire—including the repertoire of Sony and Universal, the two other major recorded music companies—under the statutory license. Hr'g Ex. SX-17 ¶ 181 (Rubinfeld Corr. WDT).

160. Finally, iHeart intended to use this agreement as a benchmark in this proceeding, further demonstrating the taint of the statutory shadow on the agreement. As Mr. Cutler testified, iHeart [redacted] *See* Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler) [redacted])

5. The Sony and Warner iTunes Radio Agreements with Apple Are Affected By The Statutory Shadow

161. Apple's agreements with Sony and Warner, [redacted] was plainly negotiated in the shadow of the existing statutory and Pureplay rates. *See* Hr'g Ex. SX-128 ¶ 8 (Rubinfeld Corr. WRT, App. 2).

162. However, as discussed further below (Section XI.A.3, *infra*), that agreement, unlike the iHeart-Warner and Pandora-Merlin agreements, [redacted]. Hr'g Ex. SX-128 ¶ 8 (Rubinfeld Corr. WRT, App. 2). Indeed, Apple resisted the submission of the agreement in this case, chose not to participate in the proceedings, and also opposed third-party discovery from the Services. *Id*. In sum, Apple's licenses with Warner and Sony may well be

less in the shadow of the statutory proceeding then the ones created and proposed by the Services. *Id.*

163. Additionally, the tight integration of the iTunes ecosystem with iTunes Radio is unique and reflects additional value for the label – downloads –[ ] and which would not ordinarily be available as compensation under the statutory license. *See* Section XI.A.1, *infra*. This further removes the iTunes Radio agreements from the shadow of the statutory license.

164. Moreover, the parties' decision [ ].

IV. SOUND RECORDINGS ARE A UNIQUE PRODUCT, CREATED FROM THE CONTRIBUTIONS OF RECORDING ARTISTS AND RECORD COMPANIES, THAT INCREASINGLY DEPEND ON WEBCASTING REVENUES

165. This Section provides an overview of the extensive evidence of the contributions from the content creation side of the market. These contributions are the lifeblood of the statutory licensees' consumer offerings. The contributions start with individual artists, whose creativity, hard work, and perseverance are essential to the creative process. The contributions continue with the extensive investments that record companies make to find, develop, record, market, and disseminate the artists' work. The risks that record companies undertake are substantial. The rates that record companies receive from streaming services has been—and over

the next five years will continue to be—critical to those companies' ability to make such recurring investments.

A. Sound Recordings Start With A Recording Artist, Without Whom Music Services Would Have No Music to Play

166. Recording artists invest significant amounts of money, time, labor, and creativity in order to create the music at the heart of this proceeding. Hr'g Ex. SX-6 ¶9-21 (Foster WDT); Hr'g Ex. SX-8- at 5-6 (Hair WDT); Hr'g Ex. SX-16 at 4-9 (Roberts WRT).

167. Making sound recordings is a creative process that must be supported and nurtured. Creation sometimes happens in a flash of inspiration, but more often requires long hours of work. As artists' manager Fletcher Foster testified, "The process of creating a sound recording can be slow, painful, and difficult. On occasion, inspiration strikes, a song is created, and quickly comes together in a recording with ease. But that is the rare exception. Most often, making records is an arduous process that requires the creative commitment of many people over a long period of time." Hr'g Ex. SX-6 ¶ 9 (Foster WDT).

168. The creative process cannot be standardized like the process of making widgets on an assembly line. Each artist's work (and the process to create that work) reflects that individual artist's lifetime of training, experience, sacrifice and passion. And each artist seeks to create music for his or her own reasons. As independent recording artist Doria Roberts explained, "[Music] is not just something I play. It is a language I speak." Hr'g Ex. SX-16 at 4 (Roberts WRT).

169. The President of the American Federation of Musicians, Raymond Hair, Jr., also testified about the work his members undertake to create music. "It is our talent, our training, our hard work and our passion that results in great recordings that the public around the world wants to hear." Hr'g Ex. SX-8 at 5 (Hair WDT).

170. These creative efforts cost money and require sacrifice. Roberts testified that she lived sparingly to support her craft, and would put all of the money she earned from touring into the process of releasing her next record. She would invest everything she made into the raw materials for her next release: musicians, a photographer, a graphic designer, printing costs, pressing costs, etc. All of these costs have to be covered for a record to get made. Hr'g Ex. SX-16 at 4-13, (Roberts WRT).

171. Foster also described the costs underlying the creation of sound recordings. "Musical instruments, recording equipment, home studios, renting time at a recording studio, session musicians, back-up vocalists – all of these things cost money. Beyond the costs of the recording itself, substantial costs in developing artists' image, publicizing their music, the huge expense of going on tour (with the cost gas, vehicle, hotel rooms, etc.) and other activity aimed at promoting artists' music can all add up quickly." Hr'g Ex. SX-6 ¶ 14.

172. These efforts also take a considerable amount of time and labor. As Mr. Foster testified, "[t]he recording process can consume an artist for months or even years." As but one example, Mr. Foster described the artist Levi Hummon, who signed to Big Machine/Valory Records in June of 2014. Mr. Foster testified that he did not expect Mr. Hummon's debut album to come out until mid to late 2015. Hr'g Ex. SX-6 ¶ 18.

173. Independent recording artist George Johnson underscored these points, offering the Judges his own description of the costs of making music, including receipts for the costs he represented that he has incurred in getting his recordings to market. *See,* e.g. Hr'g Ex. GEO-2769, 2771, 2896-2898(a)-(c); 2902-2953.

174. Without the substantial investment in time, money and creativity that recording artists make, the services that seek to play music in these proceedings would not have any

product to distribute. As Ms. Roberts explained, we do not know what artists today are being discouraged from following their creative passions to creating great music. When touring ceased to provide the requisite revenues for her next record, Ms. Roberts stopped touring and today makes less music than she once did. We do not know what music we will miss if artists are not fairly compensated for the music they create. Hr'g Ex. SX-16 at 9-13 (Roberts WRT).

B. Record Companies Play An Important Role In Bringing Recorded Music To Market.

175. While some recording artists like Mr. Johnson and Ms. Roberts make their own records supported by their own self-run labels, other recording artists work with record companies that are in the business of bringing sound recordings to the public. SoundExchange presented witnesses who described the process record labels typically follow in working with recording artists to get sound recordings to the public. *See, e.g.*, Hr'g Ex. SX-9 (Harleston WDT); Hr'g Ex. SX-12 (Kooker WDT).

176. These witnesses described the substantial investments made, costs incurred, and risks taken by record labels in getting sound recordings to the right audience. These significant contributions are made through each phase of the process — artist development, business affairs, production and recording, marketing and promotion, and distribution. *See, e.g.*, Hr'g Ex. SX-9 (Harleston WDT); Hr'g Ex. SX-12 (Kooker WDT).

1. Artists & Repertoire (A&R)

177. The A&R Department at a record label is where its "research and development" is conducted. A&R staff are responsible for discovering, nurturing and delivering new talent. Kooker WDT, Hr'g Ex. SX-12 at 4; Harleston WDT Hr'g Ex. SX-9 at 4, 5.

178. As Jeff Harleston, General Counsel and Executive Vice President of Business Affairs, North America, of Universal Music Group explained, a record labels' A&R department

consists of "talent scouts . . . tasked with finding new artists or coaxing existing artists who are maybe coming out of a record deal to come to us." Hr'g Tr. 1318:2-5 (Harleston).

179. Mr. Harleston testified that A&R executives are "always looking for a new sound and a new fresh persona to go with it. The trick is in finding an artist that is new and fresh and unique but not so new that the world is not yet ready to embrace them." Harleston WDT, Hr'g Ex. SX-9 at 4.

180. A&R representatives typically are "looking for an artist that they believe has a combination of artistic appeal and commercial appeal." Hr'g Tr. 1318:14-22 (Harleston).

181. A&R representatives invest considerable effort in their search for the "next big thing." They listen to thousands of demonstration recordings ("demos"), scour the Internet, conduct market research, attend live shows, meet with artists and their managers, and go to nightclubs and music festivals throughout the country. Harleston WDT, Hr'g Ex. SX-9 at 4; Hr'g Tr. 1317:21-1318:22 (Harleston); Kooker WDT, Hr'g Ex. SX-12 at 4.

182. Once a label finds an artist it wants to sign, it has to decide whether to make the considerable investment in that artist that signing will require. Different artists require different degree of effort, but it is rare that an artist presents herself as fully realized such that the label sees her as likely to achieve commercial and critical success without tremendous work. Labels must then make investments in discovered artists to get both the artist and their music to a place where labels expect the public to accept them. Those efforts can include all kinds of financial investment in creating the complete package: dance and vocal lessons, personal stylists, makeup artists, trainers, media training, etc. can all be a part of the process. , Hr'g Ex. SX-9 ¶ 10 (Harleston WDT); Hr'g Ex. SX-12 at 4 (Kooker WDT); Hr'g Tr. 1318:23-1324:2 (May 1, 2015) (Harleston)

183. The costs incurred in finding new talent are substantial, and recurring as record companies must continually search for new talent to grow their businesses. [redacted].] Hr'g Tr. 357:12-21 (Kooker).

184. In fiscal year 2013, Universal [redacted] Hr'g Ex. SX-9 ¶ 11 (Harleston WDT).

2. Business and Legal Affairs

185. Once an artist has been identified as a potential signing candidate, Business & Legal Affairs departments assume responsibility for negotiating and entering into an artist recording agreement. Often, numerous labels are in competition for the same artist, which leads to more complex deal negotiations and more expenses for the record label. Hr'g Ex. SX-9 ¶ 12 (Harleston WDT); Hr'g Tr. 356:21-357:11 (April 28, 2015) (Kooker); *id.* at 1334:18-1335:20 (May 1, 2015) (Harleston).

186. While recording agreements may be structured differently, a typical recording agreement consists of a label agreeing to front the costs of recording, mixing and mastering a record. Artists typically receive a share in the proceeds from the labels' exploitation of the artists' recordings, in the form of royalties. Typically, record labels offer an advance against future royalties at signing. If the artist succeeds, then the record label and the artist reap the benefits. If the artist does not succeed – as is often the case – then the record company absorbs the loss. Hr'g Ex. SX-9 ¶ 13 (Harleston WDT); Hr'g Ex. SX-12 at 6-7 (Kooker WDT).

187. These costs of signing talent are also recurring and substantial. In its fiscal year 2013, [redacted].] Hr'g Ex. SX-9 ¶ 13 (Harleston WDT).

188. Sony [redacted]. (This figure does not include salaries and

overhead required to identify and sign talent and oversee the recording process.) Hr'g Ex. SX-12 at 5 (Kooker WDT); Hr'g Tr. 0356:1-0363:18 (Apr. 28, 2015) (Kooker).

3. Production and Recording Process

189. After an artist has been signed, the process of making the album begins. This process is typically overseen by the A&R representative who signed the artist. Hr'g Ex. SX-9 ¶ 14 (Harleston WDT).

190. In pre-production, A&R representatives work closely with artists to develop material to be recorded. They match artists with the right combination of producer and recording studio to best suit that artist. For some hip hop and pop artists, A&R representatives may sift through thousands of rhythm tracks to match an artist with a producer and a studio. The right combination can be invaluable in helping to propel an artist's success. Hr'g Ex. SX-9 ¶ 15 (Harleston WDT).

191. A&R representatives will also work to put artists together to collaborate with other artists as a means of introducing artists to another artist's fan base. A recent example of this phenomenon was the track "Bang Bang," a huge hit that combined the efforts of Ariana Grande, Jessie J, and Nicki Minaj. The track appears on both Ariana Grande's second album, "My Everything," and as the first single off of Jessie J's second album "Alive" released in September 2014. Through this collaboration, Ariana Grande and Jessie J's immense fan base of pop listeners became exposed to the more hip hop leaning rap style of Nicki Minaj and vice versa. Another example that has succeeded on more than one occasion is the combination of Rihanna and Eminem, who recorded together the hit "Love the Way You Lie," giving Rihanna's pop audience favorable exposure to Eminem and Eminem's rap audience an introduction to Rihanna. Hr'g Ex. SX-9 ¶ 16 (Harleston WDT).

192. The A&R representative typically also remains involved throughout the recording process to ensure that sessions run smoothly and to be a sounding board for the artist. Hr'g Ex. SX-9 ¶ 18 (Harleston WDT).

193. Often, many more tracks are recorded than eventually appear on the album. A&R representatives and others at the label work with an artist to determine which tracks should actually be on the album. Other tracks may be used as "exclusive" content to offer to retailers or streaming partners, to help distinguish the recordings available from one versus from another. Hr'g Ex. SX-9 ¶ 19 (Harleston WDT). Today, streaming services compete with one another to obtain the right to these exclusives. Hr'g Tr. 7001:10-18 (June 1, 2015) (Fowler) ("All of the big partners that we have obviously are competing to get access to the big established artists that we have, the big emerging artists that we have.").

194. The costs underlying these efforts recur with every record and every new artist. Mr. Harleston testified that Universal [redacted] in recording costs and advances on a brand new artist before an album is ever released. Hr'g Ex. SX-9 ¶ 20 (Harleston WDT).

195. In the case of an established artist, [redacted] Hr'g Ex. SX-9 ¶ 21 (Harleston WDT).

4. Marketing & Promotion

196. Marketing and promoting recording artists is a creative endeavor involving a record label's music industry expertise. A record labels' marketing and promotion departments use their expertise to drive discovery of artists across all platforms. The goal is to create awareness among consumers about the artist's music in order to build interest and excitement surrounding the artist and incentive consumers to purchase the music. Through a unique

marketing plan for every album, record label staff creates opportunities for the artist to reach her potential fans. Hr'g Ex. SX-9 ¶¶ 23, 28 (Harleston WDT)..

197. The marketing plan for any project will generally include a variety of components, like promotion, publicity, social media, live tour support, video promotion, and brand sponsorship as well as traditional media like print and TV advertising. Hr'g Ex. SX-27 at 5-6 (Kooker WDT).

198. As Mr. Harleston explained, the key marketing and promotion platforms for a particular artist vary. Social media platforms and artist websites are important for some artists. Some marketing efforts are designed to build a viral "street" buzz. For every artist, the label works to get them in front of the public, get them noticed, and make consumers want to acquire the music. Hr'g Ex. SX-9 ¶ 23 (Harleston WDT).

199. Music videos are a key part of artist marketing plans. Music video departments work with artists and video directors to deliver an audio-visual interpretation of the recording. The challenge is to ensure that an artist's music videos are creative and exciting, and developed consistently with the artist's genre and image. Music video production costs are some of the most significant marketing costs a label incurs. Hr'g Ex. SX-9 ¶ 24 (Harleston WDT).

200. Artist development departments work with artists and their management to identify touring opportunities and coordinate all of the various marketing efforts on behalf of that artist while the artist it out on the road. In-house publicity staff works with media outlets and supervises artists' outside publicists. Sales departments at labels and distribution companies ensure that artists' music is available to the consumer and positioned in the best way possible to succeed. Hr'g Ex. SX-9 ¶25-26 (Harleston WDT).

201. Digital marketing or new media departments work to market artists on the Internet through social media and other tools. Digital marketing staff work to ensure that music is featured prominently on digital music services like Spotify, Amazon, the iTunes Store, and Beats. Digital marketing departments develop playlists to feature the label's music on these services and brand them with a particular artist, to increase the profile of an artist's music on these digital services. Hr'g Ex. SX-9 ¶27 (Harleston WDT); Hr'g Tr. 359:10-361:2 (Kooker); Hr'g Ex. SX-7 ¶¶ 12-16 (Fowler WRT).

202. These marketing and promotion costs are substantial and recurring as record companies sign artists and grow their business. In fiscal year 2013, UMG [redacted] focused on this important work.

203. For its most recent fiscal year, Sony invested [redacted] .] Sony's Dennis Kooker testified that [redacted]]." Hr'g Ex. SX-12-006; Hr'g Tr. 360:21-361:2 (Kooker).

5. Distribution

204. The final process of bringing recordings to market involves the actual manufacturing and distribution of music to retailers and digital partners for delivery to consumers. Both physical and digital product require substantial investment and involve significant recurring costs.

205. Digital distribution does not happen at the push of a button. Universal has an entire division, Universal Mastering Studios, that converts artists' master sound recordings into digital audio files. It maintains systems that maintain content assets, including the artwork and

digital audio files that comprise digital releases. A separate database controls the scheduling of digital releases. A global repertoire system tracks all of the key data associated with each recording, a global pricing system is used to determine pricing, and a global rights system defines how Universal can use a recording. Two other systems work together to finalize and prepare the product for delivery to digital partners. One system maintains partner profiles and determines which content goes to which partner. Yet another system serves as the encoding engine, ensuring that each partner receives the artwork and digital audio files that meet their individual specifications. Hr'g Ex. SX-9 ¶ 33 (Harleston WDT).

206. Since commercially viable digital services first emerged, Universal has invested [redacted] in IT infrastructure and operating costs and in professionals that distribute the thousands of digital files provided to hundreds of service partners every year. Hr'g Ex. SX-9 ¶ 32 (Harleston WDT).

207. Manufacturing costs for physical records are significant, [redacted] for only a subset of Universal labels (excluding EMI). Hr'g Ex. SX-9 ¶ 31 (Harleston WDT).

208. Mr. Kooker testified that Sony invested [redacted] to digitally distribute content, including the costs of employees dedicated to the digital business. Physical distribution of products [redacted] over the same period. Hr'g Ex. SX-12 at 5 (Kooker WDT).

C. Recording Artists And Record Companies Undertake Tremendous Risk In Bringing Sound Recordings To Market

209. The risk of failure facing a recording artist is tremendous. No set formula assures success. To illustrate that point, Mr. Foster described two new artists his company was working with in October 2014, Taps and Levi Hummon. Each of those artists enjoy considerable support

from his artist management company and other sources. But even with that support, Mr. Foster testified that he could not predict which of the two artists would succeed or even if either of them would. Artists struggle to build careers over several years, and sometimes never find success. As Mr. Foster described, it is not for lack of talent, citing the example of America's Got Talent singer Emily West. Ms. West had been signed for years to a record label, never "broke," then obtained significant attention through affiliation with America's Got Talent. Even once successful, artists struggle to maintain their success, as Mr. Foster illustrated with the example of LeAnn Rimes. Hr'g Ex. SX -6 ¶9-21 (Foster WDT).

210. Ms. Roberts explained that she had success for years as a touring musician, with her earnings from tours getting invested in the next CD. But today, despite a passionate fanbase and years of work, she cannot afford to do another tour. The risk of failure is too great. Hr'g Ex. SX-16 at 9 (Roberts WDT).

211. When an artist signs with a record company, the record company assumes a great deal of the risk in deciding which artists to sign and invest in. Record labels' significant investments in artists take place long before a label knows whether an artist will be a commercial success. Most of the time, for new artists, that risk does not pay off. Although record labels always hope that an artist they sign will be successful, they operate on the principle that out of every ten artists signed only one is likely to succeed. The success stories go to pay the costs of those other efforts that do not end as well. Hr'g Ex. SX-9 ¶ 20 (Harleston WDT).

212. As Mr. Kooker testified:

> As with other R&D driven industries, the risks that we undertake are significant. Notwithstanding Sony Music's best efforts to control costs – particularly in this era of shrinking revenues – we still must spend considerable money to support new releases. The majority of those releases, however, do not return a profit. Most advances are eventually written off. In order for us to continue

> finding and developing the musical talent that the public desires, we must earn a fair return on the exploitation of our content.

Hr'g Ex. SX-12 at 6-7 (Kooker WDT).

213. In a market with declining sales, making the right calls and the right investments in the right artists is more important than ever. Signing an artist today involves even more of a commitment to invest significant money and time, and an even greater risk without any guarantee of a return. The diminished return on investment under the current "access" model makes it more important to make the right call in terms of investment in artists. Hr'g Ex. SX-9 ¶¶ 35-38 (Harleston WDT); Hr'g Tr. 1329:3-1330:15 (May 1, 2015) (Harleston)..

214. Dennis Kooker testified about the risks Sony faces in investing in both new and established artists:

> Well, I think when you -- when you look at it, probably best to split the business between established artists and new artists. And so for established artists where we have a track record of performance, it is easier to estimate and forecast what the results of future releases and sales and revenues of future releases would be. That being said, there certainly are no guarantees that -- that future performance will be indicative of the past. For new artists, it's much more speculative. And the new artist part of our business is really -- it's really the research and development of our business. This A and R process is a research and development. Our job, ultimately, is to -- is to make investments, you know, much like other R and D businesses industries do around the world. We're making investments to ultimately look and hope that we have a couple of major hits that break out of it.

Hr'g Tr 362:11-363:10 (Kooker).

215. When music is not commercially successful, labels and artists bear the financial risk – and that risk has consequences. Mr. Kooker testified that, if a record company is not able to make a return on its investment, "[u]ltimately, we would have to invest less and that would be less, obviously, in the talent side of the business and in the marketing and promotion, and we would also haveto reduce our overhead." Hr'g Tr. 363:11-18 (Apr. 28, 2015) (Kooker).

216. By contract, digital streaming partners get the benefit of record labels' and artists' efforts as the creative input of their business, but do not have to live, as labels and artists do, with the risk of failure. Digital streaming services can play the hits, without fretting over the losses incurred because of the misses. Hr'g Ex. 9 ¶ 38 (Harleston WDT).

D. Streaming Revenues Are Critical To The Continued Creation of Music, For Both Recording Artists And Record Companies

217. In this age of increased consumption through streaming services, the revenues received from non-interactive webcasting are increasingly important to both artists and record companies. Hr'g Ex. SX-16 at 10-14 (Roberts WRT); Ex. SX-12 at 8-16 (Kooker WDT).

> As AFM President Ray Hair explained about the livelihood of musicians, "most of us make a living by patching together revenue from many different sources. Session fees, live performing fees, royalties, teaching, you name it — they all are necessary to earn a decent living that allows you to continue to make music. Every income stream is important to a working musician, but digital performance royalties are becoming especially important as music fans change the way they consume recorded music, from purchasing CDs and downloads to listening to music on digital music services."

Hr'g Ex. SX-8 at 5 (Hair WDT).

218. The statutory license is particularly important because it compensates featured artists directly, and compensates session musicians and vocalists through the AFM & SAG-AFTRA Fund. The statutory license requires a payment of 50% of the performance royalties to performers: 45% to featured artists, and 5% to non-featured artists. Because artists are paid directly, these royalties are not subject to recoupment, which makes them even more valuable to performers. Hr'g Ex. SX-8 at 5-6 (Hair WDT).

219. Under the current rates artists like Ms. Roberts find it difficult to keep creating. As Ms. Roberts testified, her weekly payments of $200-$750 from the physical CDs and digital downloads she used to sell have diminished to an average of $11.36 a month from all streaming

services combined. For nearly 600,000 performances on webcasting services, Ms. Roberts testified that SoundExchange's data shows she is entitled to $470.00 – in her words "an obscenely paltry amount." The diminishing returns have led to her playing fewer shows, and making less music. Hr'g Ex. SX-16 10-13(Roberts WRT).

220. Mr. Kooker testified that the continued vitality of record companies under the "access" model depends on shifting listeners to higher ARPU services. At current rates, webcasters are not paying market rate returns to artist and content owners:

> We have found that streaming services cannot generate revenues sufficient to compensate us for the value of our music unless those services increase the revenues—specifically, the ARPU—they generate from the consumption of our music. Streaming services are generally unable to significantly increase their ARPU through advertising alone. While there has been some growth in recent years in advertising on streaming services, neither the amounts that advertisers pay nor the average time that services run advertisements are on par with the corresponding dollar amounts and number of ads per hour on terrestrial radio. For example, Pandora's free service runs an average of only five advertisements per hour, lasting a total of between 2.5 and 3 minutes. On its iheart.com site, iHeartMedia (formerly Clear Channel) promotes ad-free, uninterrupted listening on its custom stations. Terrestrial radio, by comparison, runs an average of 17.5 minutes of advertisements per hour.
>
> The limited revenue from advertising on streaming services' free-listening tiers translates into ARPU that is significantly lower than ARPU from directly licensed services' subscription tiers. For example, Pandora reported advertising revenues of $489.3 million for 2013. Spread across Pandora's 76.2 million users at year-end 2013, this yields ARPU from advertising of just $6.42 annually. In contrast, many directly licensed paid subscription services generate annual ARPU of $119.88—many multiples greater than Pandora's ARPU. (Pandora reported subscription revenues for 2013 of $110.9 million. Pandora's subscription revenues do not yield market rate returns to artists and content owners. Even combining Pandora's advertising and subscription revenues yields total annual ARPU of just $7.88—which still is many multiples below the ARPU of many directly licensed paid subscription services.)

Hr'g Ex. SX-12 at 14 (Kooker WDT).

V. OVERVIEW OF EXISTING DIRECT LICENSING MARKET

A. Thick Market Analysis Requires Consideration Of The Entire Digital Music Marketplace

221. Section 114 requires that the Judges "shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. 114(f)(2)(B). Near the outset of this proceeding, the Judges recognized that the statutory mandate requires analysis of a "thick market." *Order Denying Without Prejudice Motions of Issuance of Subpoenas* at 5, Docket No. 14-CRB-0001-WR (2016-2020) (Apr. 3, 2014). In order to have an accurate picture of the rates and terms to which willing buyers and willing sellers would agree in a market unencumbered by the statutory license, a "thick market" analysis requires a comprehensive consideration of the entire digital music marketplace as it currently exists—and how it will exist over the next five years.

222. In the five years since *Web III*, the digital music marketplace has evolved—and continues to evolve—at a breakneck pace. This rapid evolution is seen in terms of the technology, product offerings, market participants, consumer behavior and preferences, and means for copyright owners to generate and measure revenue. Hr'g Ex. SX-17 ¶¶ 42-43, 45-46 (Rubinfeld Corr. WDT); Hr'g Ex. SX-3 ¶ 7 (Blackburn WDT); Hr'g Ex. SX-12 at 7-22 (Kooker WDT); Hr'g Tr. 2735:5-7 (May 8, 2015) (Shapiro). All of these interrelated dynamics affect and inform how licensing would take place in the hypothetical marketplace.

223. This section discusses the facts that are critical to understanding the complete thick market of agreements that by statute must guide the setting of rates and terms in this proceeding.

224. Section B details the extensive evidence concerning the fundamental shift underway in the recorded music business from a distribution model based on ownership of

copies to one based on access to music through streaming services. That shift has accelerated dramatically since *Web III*; revenue from streaming services will become even more important to copyright owners, and through them recording artists and others involved in the constantly recurring process of creation of recorded music content, over the coming rate term. In particular, the shift to access models makes it imperative that copyright owners and services convince consumers to open their wallets and pay for the music they are consuming, since listening through streaming is the end product in a system of music access. In order to incentivize consumers to pay for that product, it is critical that subscription offerings provide consumers with a service that is not otherwise free to the listener.

225. Section C discusses the overwhelming evidence showing that distinctions between "non-interactive" and "interactive" services are rapidly disappearing. While it remains the case that "interactive" services provide consumers the ability to receive on-demand transmissions of particular sound recordings, the evidence showed that, across an entire range of attributes, the consumer offerings and marketplace behavior of both types of services are converging and will continue to converge over the coming rate term. Pandora and its economic expert, Prof. Shapiro, argued that, whatever the convergence at the consumer level, there exist at the "upstream" level two discrete markets for licensing from copyright owners, and that Pandora, iHeart, and other statutory licensees purportedly exist in a market separate from Spotify, Google, and other direct licensees. The evidence showed that the only dividing line at the "upstream" level is the statutory license. Without the statutory license, Pandora, iHeart, and the various licensee services would have to compete with all other streaming services for the rates and terms on which they would be able to stream copyright owners' sound recordings. The evidence showed that, in a market without the statutory license, copyright owners would seek to obtain

contractual commitments from services like Pandora to try to upsell consumers to revenue-generating offerings and/or to receive financial remuneration if such a service tried to delay revenue in order to grow market share. In short, the willing buyer-willing seller transactions in such a market would look very similar to copyright owners' current agreements in the thick market of direct licenses. At bottom, therefore, the rapid convergence in the market means that in a hypothetical market rational record companies would not let statutory services pay significantly less than their competitors who use the very same products to generate more value.

B. The Recorded Music Industry Is Undergoing A Transformational Shift From Consumer Ownership To Consumer Access As The Dominant Means Of Consuming Music

1. The Traditional Sales Model, and the Shift from Physical to Digital Sales

226. Historically, owners of copyrighted sound recordings relied on the sale of copies of their works to generate returns on their investments in creating and distributing recorded music. Hr'g Ex. SX-12 at 8 (Kooker WDT).

227. For much of that time, copyright owners distributed their sound recording products in physical form, such as vinyl records, cassettes, or CDs and DVDs. Hr'g Ex. SX-12 at 8 (Kooker WDT).

228. Starting in the early 2000s, copyright owners started distributing their sound recording products by selling permanent digital downloads through online retailer stores like Apple iTunes Store, Amazon.com, and others. Hr'g Ex. SX-12 at 8, 11 (Kooker WDT); Hr'g Tr. 363:19-365:9 (Apr. 28, 2015) (Kooker).

229. The revenues that copyright owners have earned on their investments have decreased dramatically over the last decade and a half. In 1999, $14.5 billion in recorded music

was distributed in the United States. In 2013, the amount had dropped to just under $7 billion—a decline of 52% from 14 years earlier. Hr'g Ex. SX-12 at 8-9 (Kooker WDT).

230. Physical sales have declined dramatically since 1999. In 1999, U.S. manufacturers distributed CDs with a total retail value of $12.8 billion. By 2008, the retail value of CD shipments was $5.5 billion—a 57% drop from 1999. By 2013, the retail value of CD shipments was $2.1 billion, a 60% decrease from 2008. Hr'g Ex. SX-12 at 9 (Kooker WDT).

231. Revenue from the sale of permanent downloads and other forms of digital exploitation have increased over the last decade, but the amount of revenue has been significantly lower than the decline in physical sales. In 2013, total digital revenues for the U.S. recorded music industry were $4.4 billion. In comparison, the total revenues from physical sales had declined more than $10 billion from 1999 to 2013. Hr'g Ex. SX-12 at 9 (Kooker WDT).

232. More recently, the popularity of digital permanent downloads has flattened and started to decrease. For example, revenues from the sales of permanent downloads decreased 12% from midyear 2013 to midyear 2014 (from $1.486 billion to $1.305 billion). Hr'g Ex. SX-12 at 14 (Kooker WDT).

233. "Major" and "independent" record companies alike project that the digital download business, like the physical sales business, will continue to decline over the 2016-2020 rate term. Hr'g Tr. 368:4-16 (Apr. 28, 2015) (Kooker) ("at this point, in the public projections that we have put out through our investor relations group, our forecast is that the download business is going to continue to decline into the foreseeable future"); Hr'g Ex. SX-21 ¶ 28 (Wheeler WDT) ("At Beggars Group, already [ ]."); Hr'g Ex. SX-10 ¶ 11 (Harrison Corrected WDT) ("The most visible example of . . . the market's

transition away from an ownership model to an access model is the rapid decline in permanent download sales. January is typically [Universal's] biggest month for download sales because iTunes gift cards are a common holiday gift. In January 2014, however, we saw a 20% decline in download sales from the prior January. Since January, the rate of decline has decreased somewhat from the prior year, but it is still 18% year-to-date.").

234. Multiple factors have driven the decline in record industry revenues across the board. These include online piracy (through services like Napster and others), changes in technology, and changes in consumer preferences. Hr'g Ex. SX-12 at 8 (Kooker WDT); Hr'g Tr. 364:20-365:14 (Apr. 28, 2015) (Kooker).

235. The substantial reduction in music industry revenues has led to the loss of thousands of jobs across the music industry. For example, the number of Sony Music employees in the U.S. at the end of 2013 was approximately [ ] of the number employed at Sony Music at the end of 2005. Hr'g Ex. SX-12 at 11 (Kooker WDT).

236. Notwithstanding the decline in revenues, record companies must make substantial investments in digital infrastructure and personnel in order to create and maintain a digital business. Among other things, record companies must pay for hardware and software, and must upgrade both, in order to digitize and store content; to transmit content to digital partners; and to ingest partners' reporting activity, so that record companies may account to artists and other parties. Hr'g Ex. SX-12 at 10 (Kooker WDT). To take just one example, Sony Music, for its fiscal year ending March 2014, expensed more than] in equipment, software and personnel directly related to digital distribution. Hr'g Ex. SX-12 at 10 (Kooker WDT).

2. The Shift from Ownership to Access Models

237. The recorded music industry is undergoing a transformational shift in the way its content is consumed and how copyright owners monetize that consumption. Specifically,

content dissemination and consumption are shifting from a model based on consumer ownership of copies of sound recordings (physical and digital) to a model based on consumer access to music through digital streaming services.

238. The consumer shift to access models has been rapid and dramatic. Nearly two-thirds of people in the United States have listened to music streamed online. Hr'g Ex. SX-12 at 12 (Kooker WDT).

239. Pandora, the market leader in streaming, has more than 81 million active users, and streamed more than 20 billion hours of content in 2014. Hr'g Ex. SX-158 at 6 (Pandora 2014 10-K). By comparison, Pandora reported 65.6 million active users and 12.56 billion hours of content streamed just two years earlier. Hr'g Ex. SX-12 at 12 (Kooker WDT).

240. Numerous services have entered and continue to expand their presence in the online streaming space. These include some of the largest companies operating in the online space and, indeed, in the economy at large, including Apple, Google, and Amazon. The space also includes services like Spotify, Rhapsody, iHeart Radio, and others that for several years have offered online streaming services. Hr'g Ex. SX-12 at 12-13, 16 (Kooker WDT).

[.] Hr'g Ex. SX-269 at 64 Hr'g Tr. 4307:22-4309:7 (May 18, 2015) (Herring).

241. As compared to other forms of revenue, including most notably from selling copies of sound recordings, revenue from streaming services accounts for a greater share of record industry revenues each year. Between 2008 and 2013, the proportion of total music

industry revenue from all forms of digital streaming services grew from 4% to 21%. Revenue from streaming services to all record companies during the first half of 2014 grew by 28% over the same period during calendar year 2013. Hr'g Ex. SX-12 at 14 (Kooker WDT).

242. The split between download and streaming service revenue at Sony Music illustrates the dramatic and continuing shift in recorded music revenues. During the *Web III* hearing five years ago, permanent downloads accounted for well over 90% of Sony Music's digital music revenues. By comparison, for Sony Music's most recent fiscal year (ended March 31, 2015), streaming revenues had grown to account for approximately 40% of Sony Music's digital revenues. Hr'g Tr. 366:9-367:6 (Apr. 28, 2105) (Kooker).

243. Revenues from access-based streaming services will continue to account for an ever-increasing share of copyright owners' digital (and overall) revenues over the 2016-2020 rate term. Hr'g Tr. 369:6-370:11 (Apr. 28, 2015) (Kooker); Hr'g Ex. SX-21¶ 29 (Wheeler WDT).

3. As the Recorded Music Business Shifts to Access Models, Copyright Owners Now Must Focus on Generating Revenues from Consumption by Listening

244. The shift to access-based streaming models has fundamentally changed the way that copyright owners focus on monetizing their content, and in particular on the importance of monetizing consumption through such access-based platforms. Put simply, copyright owners and recording artists are now focused on generating revenue directly from the act of listening to music and not solely from the sale of copies of music.

245. Historically, owners of copyrighted sound recordings have had to accommodate their views of consumption-by-listening to the fact that the United States does not provide a public performance right for terrestrial broadcasts. For many years, copyright owners have tried to make the best of this situation by trying to promote terrestrial airplay of particular sound recordings. These promotional efforts generally are part of an overall marketing plan and

typically focus on new releases. The purpose of this effort is to increase public awareness of such releases through terrestrial radio's broad (but geographically limited) audiences, and, given the constraints of the medium (such as single programs broadcast to the same broad but geographically limited audience), to generate some amount of conversion from listening to purchasing. Hr'g Ex. SX-4 ¶¶ 8-11 (Burruss WRT); Hr'g Tr. 7044:7-13 (June 1, 2015) (Burruss); Hr'g Tr. 2522:9-2523:9 (May 7, 2015) (Wilcox) ("[W]hen you're in the terrestrial mode with an AM/FM dial in front of you, and you're interested in a given type of music, you have limited choices. You may have—there may be only one station in your area that has that genre. There may be a couple. That's probably the most. And that goes to the issue of promotion in that situation of playing music can be—could be promotional, particularly if we're not receiving any money from it.").

246. In a world increasingly based on access through streaming rather than ownership by sales, copyright owners have a very different take on the exploitation and monetization of consumption by listening. As Dennis Kooker, President of the Global Digital Business and U.S. Sales Group for Sony Music explained:

> The way that we historically have gone to market is to focus on promotion at Terrestrial radio, taking our best content, making it available as part of the awareness building process, to hopefully get a small number of people to convert and actually go out and purchase an album at the time of release.
>
> When you think about the way that the access model and the access business is structured, ultimately, our revenue is driven by the consumption, itself; and therefore, the most valuable content is, therefore, the most popular most in demand content. And so shifting from, you know, thinking about making that content available to the consumer to drive to a sale actually is a completely wrong way to think about the access model. Ultimately, the consumption is the end game and shifting the way that we handle our promotion to drive people to that revenue-bearing consumption activity is incredibly important.

Hr'g Tr. 385:20-386:15 (Apr. 28, 2015) (Kooker).

247. Representatives of major and independent record companies echoed this fundamental shift in the way their businesses see the shift from ownership to access-streaming models. Simon Wheeler, Director of Digital and board member at Beggars Group, testified:

> "[C]onsumption-based streaming revenue, including webcasting royalty revenue, is already core revenue in our business model, and that will only increasingly be the case. Yet, core revenue needs to be able to support the core costs of a business. As the revenue mix of record companies shifts towards what I am seeing today in the Beggars Group and webcasting revenue becomes more and more a larger portion at the center of our revenue outlook, it is simply the case that we would license it at rates that anticipate the fact that it will be a center of our business, and therefore have to support the costs associated with our business model."

Hr'g Ex. SX-21 ¶ 29 (Wheeler WDT).

248. Aaron Harrison, Senior Vice President, Business & Legal Affairs, Global Digital Business, UMG Recordings, Inc., testified:

> "As a consequence of this shift from an ownership model to an access model, revenues from streaming services have become increasingly important to Universal's ability to recover the substantial investments it makes in the discovery and development of recording artists, and the production and marketing of recorded music. Going forward, we will not be able to rely on revenues from the sale of permanent downloads or CDs. Thus, revenues obtained from streaming services will need to increase to ensure Universal receives a fair return on its investment in the creation of music."

Hr'g Ex. SX-10 ¶ 12 (Harrison Corrected WDT).

249. Ron Wilcox, Executive Counsel, Business Affairs, Strategic and Digital Initiatives for Warner Music Group, testified:

> "WMG's overarching strategy for digital agreements is to find and exploit all potential avenues for monetizing the experience of listening to its recorded music. WMG is not interested in allowing its sound recordings to be used for free in the name of "promotion" alone. The fact is that, in 2014, the ubiquity and high quality of

> digital distribution have fundamentally transformed the concept of 'substitution.' Prospective consumers can obtain free access through streaming services—including many that operate pursuant to the statutory license—to a wide range of music whose selection is customized to her or his musical tastes, or that is contained on playlists curated by friends or popular tastemakers. The idea that such unlimited access—without some additional element to incentivize music purchasing—promotes sales is fanciful."

Hr'g Ex. SX-22 at 5 (Wilcox WDT)

250. Owners of copyrighted sound recordings, like owners of all businesses, want their business to grow, not stagnate. However, while there is a high demand for and consumption of copyrighted sound recordings through online streaming services, copyright owners are "struggling to monetize that at a rate that actually produces growth." Hr'g Tr. 369:16-370:6 (Apr. 28, 2015) (Kooker).

251. In an ownership-model world, copyright owners traditionally focused on transaction-based metrics, e.g., the number of copies of sound recordings sold. Hr'g Tr. 373:20-374:10 (Apr. 28, 2015) (Kooker).

252. The shift to monetizing listening-based consumption also has changed the metrics that copyright owners use to assess their returns on their investments in content creation. With the shift to access-streaming models, copyright owners have started to measure returns based on "average revenue per user, ARPU. How much revenue are we able to collect per user for the use of the service and for the use of the content." Hr'g Tr. 373:20-374:10 (Apr. 28, 2015) (Kooker); *see also* Hr'g Ex. SX-10 ¶ 13 (Harrison Corrected WDT) ("In our experience, a service's ability to return sufficient value to Universal depends on the amount of [ARPU] the service can generate.").

253. The ARPU from consumers in the access-streaming business can be significantly higher than the ARPU from sales of permanent downloads. The ARPU from ad-supported

streaming services, however, is significantly lower than the ARPU from subscription-based streaming services. As Mr. Kooker explained:

> "[T]he ARPU for the download business on a wholesale basis is around $50 a year that we receive from the consumer. For the paid subscription business, it's about $70 a year. So if you look at that comparison, if we were able to shift the buyers all into the paid subscription world, we would have a growing business. But on the other side of it, of the paid business, is the ad-supported business [i.e., services that offer a free-to-the consumer product that is monetized through advertising]. And the ad-supported ARPUs we estimate to be in about the $4 range per year on a wholesale basis."

Hr'g Tr. 374:11-375:15 (Apr. 28, 2015) (Kooker).

254. Copyright owners have tried to structure their agreements with directly licensed services to incentivize those services to convert consumers who utilize free-to-listen tiers to higher-ARPU subscription tiers. For example, [ ]. Hr'g Tr. 401:1-403:10 (Apr. 28, 2015) (Kooker).

255. Spotify is recognized as the market leader in subscription-based streaming offerings. That fact notwithstanding,]. Hr'g Tr. 404:5-18 (Apr. 28, 2015) (Kooker).

256. The existence of ad-supported services—in particular, services that operate pursuant to the statutory license—represents one of the most significant challenges to the ability of copyright owners and directly licensed services to convert free-to-listen consumers to the

higher-ARPU subscription offerings that are necessary to sustain and grow the recorded music business. As Mr. Kooker explained:

> "[I]t's challenging to convince a consumer to open their wallet and pay for something that is very similar to something that is available to them for free. So, you know, convincing of providing that value add that gets consumers to open their wallet is critical and difficult."

Hr'g Tr. 375:22-376:6 (Apr. 28, 2015) (Kooker).

C. Interactive And Non-Interactive Services Are Rapidly Converging

257. Section 114 distinguishes between "non-interactive services," which are eligible for the statutory license, and "interactive" services, which are not. 17 U.S.C. § 114; Hr'g Ex. SX-17 ¶ 35 (Rubinfeld Corr. WDT); Hr'g Ex. SX-3 ¶ 8 (Blackburn WDT). The line that the statute contemplates is between a service "that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient," and a service that does not. 17 U.S.C. § 114(j)(7); Hr'g Ex. SX-12 at 16 (Kooker WDT); Hr'g Ex. SX-3 ¶ 8 (Blackburn WDT). In the marketplace, the line between these two types of services is "increasingly blurred." Hr'g Ex. SX-3 ¶ 13 (Blackburn WDT); Hr'g Ex. SX-32 ¶ 25 (Wilcox WRT). As a result of technological evolution, marketplace development, and changing consumer preferences, nominally "interactive" and "non-interactive" services like Spotify and Pandora exist side by side in the same market, on the same platforms, while offering similar listening experiences. Hr'g Ex. SX-12 at 16 (Kooker WDT); Hr'g Ex. SX-21 ¶ 36 (Wheeler WDT). The practical divide that exists between such services is as much (if not more so) the result of the existence of the statutory license as it is of the fact that a Spotify listener can select a particular sound recording on-demand and be 100% assured of hearing it. The evidence shows that the convergence between the two types of services will only intensify

during the 2016-2020 rate term. Hr'g Tr. 6584:3-16 (May 29, 2015) (Kooker); Hr'g Ex. SX-27 at 2 (Kooker WRT).

1. Services Offer a Range of Products With Overlapping and Converging Functionality Across the Same Consumer Platforms

258. In today's streaming market, services defy easy categorization–they are not either "on-demand" or "non-interactive," "lean-forward" or "lean-back," "free" or "paid." Increasingly, services tend to offer all of the above functionality. Hr'g Ex. SX-17 ¶¶ 37, 50, 63, 69, 74 (Rubinfeld Corr. WDT). Or, as Pandora's CFO Michael Herring put it, [redacted]. Hr'g Tr. 3445:20-3446:3 (May 13, 2015) (Herring).

259. Interactive services, for example, no longer simply feature "on-demand" functionality that allows listeners to request the exact song they want to hear. Hr'g Ex. SX-17 ¶¶ 37, 55 (Rubinfeld Corr. WDT). In recent years, interactive services have "been focused on" developing curated and editorial lean-back offerings "to complement [the] lean-forward experience that they provide." Hr'g Tr. 378:6-21 (Apr. 28, 2015) (Kooker); Hr'g Tr. 6569:15-6570:23 (May 29, 2015) (Kooker).

260. This shift has occurred because streaming services recognize that consumers cannot be neatly classified as "lean-forward" or "lean-back" listeners. Hr'g Ex. SX-25 ¶ 10 (Harrison WRT). The music consumer "is both a lean-forward and a lean-back type of listener," and the consumer's particular preference "depends very much on the situation and the time of day" and the "mood that they're in." Hr'g Tr. 6570:18-23 (May 29, 2015) (Kooker); Hr'g Ex. SX-27 at 3 (Kooker WRT). In part because "discovery is an incredibly important part of the consumer experience with music," "even the most avid music consumer, at times, wants a lean-back experience." Hr'g Tr. 378:6-21, 380:23-381:6 (April 28, 2015) (Kooker); Hr'g Ex. SX-25

¶ 10 (Harrison WRT). [redacted]

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[redacted]

261. Today's interactive services try to meet this consumer demand by prominently featuring service-side playlists, radio components, and other non-interactive channels of music delivery. Hr'g Ex. SX-3 ¶ 13 (Blackburn WDT); Hr'g Ex. SX-32 ¶ 25 (Wilcox WRT); Hr'g Ex. SX-27 at 14 (Kooker WRT); Hr'g Tr. 3448:15-3449:2, 3449:15-3450:7 (May 13, 2015) (Herring). As Mr. Herring explained, [redacted]:

[redacted]

[redacted]

Hr'g Tr. 3446:2-11, 3449:15-3450:2 (May 13, 2015) (Herring).

262. Spotify, for example, initially offered only on-demand subscriptions. Hr'g Ex. SX- 17 ¶ 57 (Rubinfeld Corr. WDT). Shortly after its U.S. launch, however, Spotify added custom radio to its service and subsequently acquired The Echo Nest, an algorithmic recommendation engine, to provide personalization functionality much like Pandora. Hr'g Ex. SX- 17 ¶ 57 (Rubinfeld Corr. WDT); Hr'g Ex. SX-27 at 16 (Kooker WRT).

263. Spotify continued to develop its custom radio offering by adding a thumbs up/thumbs down feature and stations based on particular artists, songs, albums, or playlists. Hr'g Ex. SX-27 at 16 (Kooker WRT).

264. In December 2013, Spotify introduced its free, ad-supported mobile shuffle service, a playlisting service that randomly "shuffles" a mix or album rather than allow users to select particular songs. Hr'g Ex. SX-29 ¶ 192 (Rubinfeld Corr. WRT); Hr'g Tr. 1079:9-17 (April 30, 2015) (Harrison).

265. Spotify's user interface has become increasingly focused on its lean-back offerings, with curated playlists dominating the home page and spotlighting the service's browse functionality. Hr'g Ex. SX-27 at 16 (Kooker WRT); Hr'g Tr. 3450:24-3451:3 (May 13, 2015) (Herring); Hr'g Tr. 6596:15-23 (May 29, 2015) (Kooker). [redacted] Hr'g Ex. SX-269; Hr'g Tr. 3469:16-3470:15 (May 13, 2015) (Herring); Hr'g Ex. SX-1679 at 15.

266. Similar developments have been occurring across the streaming music space. Hr'g Tr. 1201:24-1203:7 (Apr. 30, 2015) (Wheeler). Numerous services now feature a variety of free and paid product offerings, including custom radio, curated mood-based playlists, and other passive, lean-back experiences. Hr'g Ex. SX-27 at 16-18 (Kooker WRT); Hr'g Ex. SX-25 ¶ 10 (Harrison WRT).

Rdio offers (i) ad-supported on-demand and customized radio on desktop for free; (ii) ad-free listening on desktop for $4.99; (iii) ad-free listening on all devices as well as offline listening for $9.99; (iv) and a $17.99 family plan. Hr'g Ex. SX-263 at 23. And just last month Rdio announced a further supplement to these offerings—a new "hybrid mobile product" that has "elements of on-demand but also radio elements." Hr'g Tr. 4921:7-12 (May 20, 2015) (Shapiro).

Rhapsody offers (i) an ad-free "unRadio" service for $4.99, plus (ii) a $9.99 "Premier" subscription that includes ad-free radio as well as on-demand access on all devices. Hr'g Ex. SX-263 at 23.

Slacker offers three tiers: (i) Slacker Basic Radio, an ad-supported tier with functionality that mirrors statutory services; (ii) Slacker Radio Plus, a $3.99 ad-free offering that includes off-line listening and unlimited skips; and (iii) Slacker Radio Premium, a $9.99 subscription tier that includes all the features of the Plus tier and also permits on-demand listening and user-created playlists. Hr'g Ex. SX-10 ¶ 20 (Harrison Corr. WDT).

Beats offers a $9.99 on-demand subscription service (also available as a limited free trial), as well as a free-to-the-consumer, mood-based radio product called "The Sentence." Hr'g Ex. SX-29 ¶¶ 179-180 (Rubinfeld Corr. WRT); Hr'g Ex. 2244 at 2; Hr'g Tr. at 3641:4-25 (May 13, 2015) (Littlejohn).

Amazon, which introduced an on-demand music streaming offering as part of its "Prime" annual subscription service in 2014, recently integrated ad-free radio as part of this offering. Hr'g Ex. SX-17 ¶ 43 (Rubinfeld Corr. WDT); Hr'g Tr. 7223:16-7224:10 (June 2, 2015) (Harrison); Hr'g Tr. 4309:3-7 (May 18, 2015) (Herring).

Google offers (i) a download store, (ii) free storage of up to 20,000 songs; as well as (iii) a $9.99 "All Access" subscription that includes ad-free radio, on-demand listening across all devices, and off-line listening. Hr'g Ex. SX-263 at 23. In addition, Google recently acquired Songza, a DMCA-compliant service that recommends various playlists based on time of day and mood or activity. Hr'g Ex. SX-17 ¶ 61 (Rubinfeld Corr. WDT); Hr'g Tr. 2535:6-10 (May 7, 2015) (Wilcox).

Apple's all-inclusive offerings include: (i) the iTunes download store; (ii) the free, ad-supported iTunes Radio service; (iii) a $24.99 annual iTunes Match subscription for access to ad-free iTunes Radio as well as cloud-based storage; and (iv) its forthcoming Apple Music service,

based on its acquisition of Beats. Hr'g Ex. SX-263 at 23; Hr'g Ex. SX-17 ¶ 43 (Rubinfeld Corr. WDT).

267. Lean-back offerings such as those described above are a significant part of the consumer listening experience on these services. Nearly [redacted] of UMG's plays on [redacted], for example, are programmed streams rather than on-demand plays. Hr'g Ex. SX-25 ¶ 11 (Harrison WRT). Similarly, there has been "massive growth on the playlist side" of Spotify's business, with approximately [redacted] of total listening of [redacted] repertoire occurring through playlists created by Spotify or third parties. Hr'g Ex. SX-27 at 16 (Kooker WRT); Hr'g Tr. 6599:22-6600:3 (May 29, 2015) (Kooker). [redacted]:

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Hr'g Ex. SX-269 at 13.

268. While some interactive services' streams may be on-demand plays that cannot be replicated on statutory services, many others are lean-back streams that are effortless in much the same way as streams on Pandora or iHeart. Hr'g Ex. SX-27 at 16 (Kooker WRT). As a result, attempting to draw a bright-line distinction between "interactive" and "non-interactive" services—as the Services attempted to do throughout the hearing—is overly simplistic and inaccurate.

269. Likewise, statutory services cannot be pigeonholed as "non-interactive" or "lean-back"; they too offer a broad range of options to consumers. Hr'g Ex. SX-3 ¶ 9 (Blackburn WDT). Much like interactive services, statutory services have made adjustments to their offerings in recent years in response to the same consumer demand for both "lean-back" and "lean-forward" listening options. Hr'g Ex. SX-27 at 3 (Kooker WRT). [redacted] Hr'g Ex. SX-1190. Similarly, in its internal [redacted]" Hr'g Ex. SX-2356 at 1.

270. As one part of this shift, while non-interactive services still offer some pure "lean-back" options (i.e., programmed radio and playlists that allow or require only limited input from the user), they also now feature some pure "on-demand" listening options. Hr'g Ex. SX-17 ¶¶ 53-54 (Rubinfeld Corr. WDT). In May 2013, for example, Pandora launched its Pandora Premieres feature, which "allows for on-demand selection of certain predetermined albums" before they are released for sale. Hr'g Ex. Pan. Ex 5002 ¶ 30 (Fleming-Wood WDT); Hr'g Ex. SX-17 ¶¶ 53-54 (Rubinfeld Corr. WDT); Hr'g Tr. 3444:15-24 (May 13, 2015) (Herring).

Similarly, Sirius XM has added on-demand talk and music content to its internet radio service. Hr'g Ex. SXM 6000 ¶ 28 (Frear WDT); Hr'g Tr. 5420:7-21, 5421:11-20 (May 22, 2015) (Frear). And in 2009, iHeart began featuring on-demand video content. Hr'g Ex. SX-17 ¶¶ 53-54 (Rubinfeld Corr. WDT).

271. Moreover, statutory services are increasingly offering functionality that comes close to replicating the on-demand listening experience within the confines of their ostensibly DMCA-compliant webcasting itself. Hr'g Ex. 17 ¶¶ 53-54 (Rubinfeld Corr. WDT); Hr'g Ex. SX-3 ¶ 9 (Blackburn WDT); Hr'g Ex. SX-12 at 16 (Kooker WDT). These services "employ sophisticated algorithms, user-interface controls, and other computer technology that allows users to communicate their preferences to the service, and the service to customize and curate programming tailored to the individual user." Hr'g Ex. SX-12 at 16-17 (Kooker WDT).

272. Custom radio services like Pandora, for example, allow listeners to seed stations based on a particular artist and give thumbs up/thumbs down feedback to customize their stations' song selection. Hr'g Ex. Pan. Ex. 5000 ¶¶ 33-34 (Westergren WDT); Hr'g Ex. Pan. Ex. 5002 ¶¶ 8-9 (Fleming-Wood WDT); Hr'g Ex. SX-3 ¶¶ 9, 12-13 (Blackburn WDT); Hr'g Ex. 17 ¶ 53 (Rubinfeld Corr. WDT). Pandora users can further customize their stations by adding multiple "seed" artists or tracks. Hr'g Ex. SX-27 at 10-11 (Kooker WRT).


Pandora
Safe With Me
by Sam Smith
on Nirvana
Sam Smith Radio
0:13
-2:51
Users can "Thumbs Up" and "Thumbs Down" tracks to tailor their taste for a particular station .
The station becomes more custom over time as you "Thumbs Up" and "Thumbs Down" songs. These songs are stored for your review at anytime.
Thumbed-up Tracks
Sort by Artist Date
Not In That Way by Sam Smith 01-05-2012
Work Song by Hozier 06-12-2013
Safe With Me by Sam Smith 10-22-2013
Make It Rain by Ed Sheeran 01-27-2015
Thumbed-down Tracks
Sort by Artist Date
Title by Meghan Trainor 08-15-2010
Rehab by Amy Winehouse 09-12-2010
La La La by Naughty Boy 01-05-2013
Take Me To Church by Matt McAndrew 07-04-2014
pandora.com
PANDORA
Sam Smith Radio
Upgrade
Create Station
3:01
-0:41
La La La
by Naughty Boy
on La La La (Single)
Sam Smith Radio
Over time the user can add and remove additional "seed" artists that will further customize the station.
Play Station
Like this station
Share
Edit
Station Seeds
Sort by Artist Date
Add
Meghan Trainor 01-05-2012
Hozier 11-15-2014
Ed Sheeran 01-15-2015
Sam Smith 02-10-2015

Hr'g Ex. SX-165 at 1-2. Additional customization occurs when a listener skips a song and when Pandora detects that a user has stopped listening. Hr'g Ex. 17 ¶ 53 (Rubinfeld Corr. WDT). This intensive individualized customization—through which Pandora "recognize[s] and respond[s] to each individual's tastes"—allows Pandora to deliver on its promise to provide "stations that play music you'll love – and nothing else." Hr'g Ex. SX-2299.

273. This functionality [redacted] Hr'g Ex. SX-2369 at 4-5 (Westergren Dep. Tr. 31:8-35:6, *Broadcast Music, Inc. v. Pandora Media Inc.*, Case No. 13 CV 4037 (S.D.N.Y. May 29, 2014)); Hr'g Tr. 3447:6-14 (May 13, 2015) (Herring).

274. iHeartMedia's custom iHeartRadio service, launched in 2011, offers its own Pandora-style personalized stations that approximate on-demand functionality. Hr'g Ex. SX-17 ¶ 58 (Rubinfeld Corr. WDT); Hr'g Ex. SX-27 at 6 (Kooker WRT). [redacted] Hr'g Tr. 4850:20-4853:10 (May 20, 2015) (Pittman); Hr'g Ex. SX-1683 at 4-5. Mr. Pittman [redacted] Hr'g Tr. 4854:23-4855:12 (May 20, 2015) (Pittman).

275. Moreover, the listening experience on iHeart's custom streaming is so "predictable and narrowly tailored" that at least with respect to highly popular artists and their works—which are the highest in demand across streaming services—the "user is very likely to hear the *exact* song or songs he or she had in mind within minutes of starting the station." Hr'g Ex. SX-27 at 7 (Kooker WRT). A series of experiments described in detail in Mr. Kooker's

written rebuttal testimony demonstrated that webcasting services—both simulcast and custom radio—are far from similar to the experience of listening to terrestrial radio and much more of a personalized stream tailored to exactly what that user wants to hear. *Id.* at 7-11.

276. Mr. Kooker conducted several experiments to "test" how comparable the custom radio offerings of iHeart and Pandora were to either (1) terrestrial radio or (2) the interactive offerings of on-demand services. Hr'g Ex. SX-27 at 7. The results were quite remarkable. For popular artists (those that would otherwise receive the most sales) seeded on iHeartRadio's custom product, 92% (23 out of 25) trials resulted in hearing the exact song—All About That Base. *Id.* at 8. In *every* trial the first song was either Meghan Trainor's first-most popular or second-most popular track. In a large portion of trials (68%) the station played three or more Meghan Trainor songs in the first seven songs played. This endeavor to frontload the songs of that artist (taking into account the limitations of the performance complement) so the seeded artists' songs are heard at the very beginning of the three-hour period gives iHeart functionality that competitive with interactive services. *Id* at 7. Notably, this stands in stark contrast to terrestrial radio, where the frequency of the rotation leaves little certainty that a listener will hear exactly what she wants when she wants it. *Id.* at n.7.

277. In response to consumer demand, Sirius XM has also introduced a subscription-only custom webcasting product, "My Sirius XM," "to give some aspect of control" to its users. Hr'g Tr. 5419:12-5420:1, 5456:23-5457:4, 5458:2-9 (May 22, 2015) (Frear). My Sirius XM offers different functionality than the personalized radio products offered by Pandora and iHeart, but the end result is the same: it lets users lean forward and affect their song selection. Hr'g Tr. 5455:6-5455:8 (May 22, 2015) (Frear); Hr'g Ex. SX-232 at 15. [redacted]

[redacted] Hr'g Ex. SX-232 at 9. Users of My Sirius XM lean forward [redacted] by moving sliders to tell the service whether it wants, for example, "more early '60s, more late '60s, more acoustic, more electric," [redacted]. Hr'g Ex. SX-232 at 15-21; Hr'g Tr. 5419:19-5420:6 (May 22, 2015) (Frear). My Sirius XM also [redacted] Hr'g Ex. SX-232 at 16. Sirius XM's internal consumer research shows that [redacted] Hr'g Ex. SX-1759 at 10.

278. It is therefore no longer just directly licensed "interactive" services that allow users to select their programming. Users of statutory services can also lean forward and influence what they hear. As Pandora founder Tim Westergren put it in 2010, "the beauty of [Pandora] is that you actually—believe it or not—do interact with it quite a bit." Hr'g Ex. SX-2369 at 1.

279. The extent of interaction and control permitted by statutory services is constantly evolving. As Pandora founder Tim Westergren recently stated, innovation in the streaming market is spurred by "consumers' expectation of interactivity and personalization." Hr'g Ex. SX-2369 at 3. For example, during a series of "meetups" with listeners in 2010, Mr. Westergren reported that he heard "a lot of interest in ability to control the stations in a more granular way," an "appetite for greater control over station curation – i.e. being able to control individual attributes," and "[m]ore and more people . . . asking about being able to integrate their personal

collection with Pandora[,] [p]erhaps allowing some on-demand listening through that." Hr'g Ex. SX-2369 at 2-3.

280. [Hr'g Ex. SX-268 at 9; Hr'g Tr. 3487:18-3489:17 (May 13, 2015) (Herring).

281. Hr'g Ex. SX-269 at 20; Hr'g Tr. 3490:2-9 (May 13, 2015) (Herring). [ ]

282. While it can be "tricky from a licensing perspective" for statutory services to meet this consumer demand (Hr'g Ex. SX-2369 at 2), statutory licensees recognize that consumers want a variety of ways to listen, and [

[redacted]]. Hr'g Ex. SX-29 ¶ 106 (Rubinfeld Corr. WRT); Hr'g Ex. SX-269 at 20-21; Hr'g Tr. 3490-10-3491:4 (May 13, 2015) (Herring).

283. [redacted] Hr'g Ex. 269 at 10; Hr'g Tr. 3461:5-3462:20 (May 13, 2015) (Herring). [redacted]]:

RESTRICTED GRAPHIC

[redacted]

Hr'g Ex. SX-269 at 42-43; Hr'g Tr. 3470:16-3473:5 (May 13, 2015) (Herring).

284. In another internal presentation, [redacted] Hr'g Ex. SX-1678 at 8. [redacted] Hr'g Ex. SX-269 at 183; Hr'g Tr. 3492:13-3493:14 (May 13, 2015) (Herring).

285. Pandora CEO Brian McAndrews recently described these efforts to make the "listening experience even more personalized" as being "in the very early stages." Hr'g Ex. SX-27 at 12 (Kooker WRT). But Pandora began addressing [redacted] in January 2015, when it introduced new features on its iPhone and Android app designed to allow listeners to "further personalize" their listening experience. Hr'g Ex. SX-404. These features included an "Add Variety" option, access to "Thumb History," and "Un-Thumb[ing]." *Id.* Several other [redacted]. Hr'g Tr. 3498:14-3503:12 (May 13, 2015) (Herring). [redacted]. Hr'g Ex. SX-269 at 43; Hr'g Tr. 3498:14-3503:12 (May 13, 2015) (Herring).

286. Pandora is hardly alone in strategizing about how to modify its service to meet the demands of consumers who want lean-forward listening features. [redacted]

[redacted] Hr'g Ex. SX-1189. [redacted]] Hr'g Ex. SX-1190 at 2.

287. Following on iHeart's [redacted]] Hr'g Ex. SX-95. Shortly thereafter iHeart and Warner engaged in negotiations for the First Amendment to the iHeart-Warner agreement that [redacted]]. Hr'g Ex. 34 (iHeart-Warner First Amendment) This agreement was a step *toward* the functionality of interactive services.

288. Despite negotiating for a [redacted]

RESTRICTED EMAIL

289. As the email explains, [

]

Hr'g Ex. SX-213.

290. The blurring of the lines between interactive and non-interactive services exists for simulcast as well as non-simulcast services. As a result of rapidly evolving technology, "

(Hr'g Ex. SX-2207), and the proliferation of

aggregator services like TuneIn, simulcasts also allow consumers to lean in and control their listening experience. "In practice, simulcast streaming services operate in such a way as to closely resemble the experience of on-demand listening." Hr'g Ex. SX-27 at 4 (Kooker WRT). When a user searches for a genre, geographic area, or even particular artist, simulcast aggregators like iHeart and TuneIn will instantly display not only a list of stations, but also the songs that have just started playing on those stations. Hr'g Tr. 5841:11-14 (May 26, 2015) (Dimick). This search functionality gives users the ability to immediately identify and access specific tracks essentially on demand. Hr'g Tr. 6556:10-6560:22 (May 29, 2015) (Kooker); Hr'g Ex. SX-27 at 3-6 (Kooker WRT). And once a live stream is accessed, a user on TuneIn can pause and record songs. Hr'g Tr. 5850:9-5851:7 (May 26, 2015) (Dimick).

291. Moreover, in sharp distinction to terrestrial radio, simulcast services are not geographically bound—they make thousands of stations available to listeners at the click of a button. Simulcast services therefore offer listeners the same wide range of listening options as other streaming services—an "almost infinite number of choices." Hr'g Tr. 2522:9-2523:9 (May 7, 2015) (Wilcox). A San Francisco resident, for example, can tune in to an indie music station in Seattle with ease, a listening option that would not be otherwise available—and an option that could displace other forms of music consumption. *Id*.; Hr'g Tr. 3906:11-3911:10 (May 14, 2015) (Peterson).

292. In addition, as a result of the significant improvements in broadband penetration, wireless networks, and mobile device technology, consumers' use of streaming services is increasingly mobile and ubiquitous—occurring not only on mobile phones, but also on iPads and other tablets, in cars, and even via gaming systems, alarm clocks, and refrigerators. Hr'g Ex.

SX-17 ¶ 45 (Rubinfeld Corr. WDT); Hr'g Ex. SX-12 at 11 (Kooker WDT); Hr'g Ex. SX-18 ¶ 52 (Rysman WRT).

293. In fact, mobile is the predominant mode of streaming today, and it is steadily increasing relative to streaming on the desktop. Hr'g Tr. 3443:9-16 (May 13, 2015) (Herring). During the first quarter of 2015, 83% of the hours streamed by Pandora occurred through mobile devices. *Id.* at 3442:18-24.

294. The changes in how consumers engage with streaming services reinforce the convergence in the market. The shift from desktop to mobile listening has affected how streaming services do business. Hr'g Tr. 3443:14-19 (May 13, 2015) (Herring). And it has affected interactive and non-interactive services in equal measure. As iHeart CEO Bob Pittman recognized, consumer demand for access [redacted]. Hr'g Tr. 4877:11-4878:1 (May 20, 2015) (Pittman). While Prof. Shapiro highlighted that "[t]here's a lot of work afoot by Pandora and others to get into the car" (Hr'g Tr. 2731:19-2732:19 (May 8, 2015) (Shapiro)), he neglected to mention that the "others" include interactive services like Rdio, Slacker, and Spotify. Hr'g Ex. SX-3 ¶ 39 (Blackburn WDT). This shift to mobile and in-car listening has spurred the growth of "lean-back" functionality among interactive services given that on-the-go and in-car listening is often incompatible with on-demand song selection. Hr'g Ex. SX-17 ¶ 56 (Rubinfeld Corr. WDT).

295. iHeart's [redacted] As Mr. Littlejohn elaborated at the hearing, broadcast radio's competitive environment [redacted]

[redacted] Hr'g Tr. 3659:14-3660:2 (May 13, 2015) (Littlejohn). Similarly, because broadcast radio is fundamentally incompatible with the new digital "listener environment," listeners do not migrate from streaming services to forms of consumption like terrestrial radio. Prof. Shapiro succinctly put it: "That's not the phase of the world we're in." Hr'g Tr. 4484:13-19 (May 18, 2015) (Shapiro). Rather than revert to means of consumption that are anachronistic in the new digital listening environment, listeners move from service to service. As Prof. Rubinfeld explained in his 2012 presentation to the FTC, the [redacted]. Hr'g Ex. NAB 4129 at 37.

2. Interactive and Non-Interactive Services Directly Compete for Listeners

296. In light of this functional and technological convergence to meet the demands of a consumer base that wants both lean-back and lean-forward listening options—and in a digital listening environment, interactive and non-interactive services naturally compete for the same listeners.[3] The [redacted] nature of streaming listeners only amplifies the competition between interactive and non-interactive services. [redacted]

[3] In adopting attributes that "get more and more similar over time," the services engage in a hotelling model of competition. Hr'g Tr. 2234:12-2236:13 (May 6, 2015) (Rubinfeld). At the same time, however, interactive services engage in product differentiation by seeking to capitalize on their features that cannot be fully replicated under the statutory license. *Id.* It is the hotelling competition phenomenon, however, particularly the interactive services' convergence with non-interactive services, that is most likely to affect the streaming landscape over the next rate term. *Id.*

[redacted]

297. Pandora repeatedly suggested during the hearing that terrestrial radio is "overwhelmingly" its largest competitor and that its competition with interactive services is not "so significant." Hr'g Tr. 2733:16-22 (May 8, 2015) (Shapiro).

298. As the evidence in the record makes abundantly clear, [redacted] interactive services "compete head-to-head for listener hours with services that operate under the statutory license." Hr'g Ex. SX-12 at 16 (Kooker WDT). Prof. Shapiro explained, [redacted] Hr'g Tr. 2717:10-25 (May 8, 2015) (Shapiro); Hr'g Tr. 4911:20-25 (May 20, 2015) (Shapiro).

299. [redacted] Hr'g Ex. 266 at 12; Hr'g Tr. 3483:23-3484:10 (May 13, 2015) (Herring). [redacted] Hr'g Ex. 266 at 15-21. [redacted]

[redacted] Hr'g. Ex. SX-2367; Hr'g Tr. 6163:25-6165:11 (May 27, 2015) (Fleming-Wood). [redacted]

300. [redacted] *Id.* at 2, 6. In the same email, iHeart also set forth [redacted] *Id.* at 6. [redacted] *See, e.g.*, SX-1262 at 4-11; SX-2157 at 5.

301. Likewise, Sirius XM [redacted] Hr'g Ex. SX-1759 at 15; Hr'g Tr. 5461:20-5463:3 (May 22, 2015) (Frear). [redacted] Hr'g Ex. SX-237 at 26.

3. The Only Dividing Line in the Purported "Upstream" Market Is the Statutory License: Absent the Statutory License, Non-Interactive Services Would Have to Compete with Interactive Services in Licensing from Copyright Owners

302. Coming into this hearing, Pandora undoubtedly was mindful of the fact that not only its consumer offering but [ ] were completely inconsistent with the purported hard-and-fast distinction between "lean back" and "lean forward" listening. Accordingly, Pandora and its economic expert, Prof. Shapiro, advanced a theory that, whatever the convergence in the purported "downstream" market for offerings to the consumer, non-interactive and interactive services participate in two discrete "upstream" licensing markets. Hr'g Ex. Pan. Ex. 5023 at Figure 5; Hr'g Tr. 2623:4-2626:2 (May 8, 2015) (Shapiro). According to this theory, services like Spotify and Rhapsody sit on one side of a hard and fast dividing line, notwithstanding that record companies also license these services' lean-back offerings, such as custom radio. *Id.* The evidence showed that this attempted construct of two discrete "upstream" markets is unsound. The only dividing line between services at the "upstream" level is the statutory license. Absent the statutory license, services like Pandora, iHeart and others who avail themselves of the statutory license would be in direct competition with Apple, Google, Spotify, Rhapsody and many others for the kinds of licensing terms they could obtain from copyright owners. Hr'g Tr. 1080:17-24 (April 30, 2015) (Harrison) (absent statutory license, UMG "would take the same approach" in negotiations with statutory services like Pandora as UMG does with non-statutory services); Hr'g Ex. SX-25 ¶ 30 (Harrison WRT); Hr'g Ex. SX-21 ¶ 36 (Wheeler WDT) ("I would expect that a negotiating framework for webcasting would largely approximate the on-demand service framework.").

303. Prof. Shapiro did no market-definition analysis to test whether his artificial construct of "two separate upstream markets" would withstand scrutiny. Nor did he reconcile

[ ] "substantial head-to-head competition" in the downstream market with his theory of "two separate upstream markets." Horizontal Merger Guidelines § 2.1.4. [ ] Hr'g Ex. SX-269 at 64-70.

304. Prof. Shapiro acknowledged that "from the record companies' point of view" there actually would not be two entirely separate upstream licensing market. Hr'g Tr. 4910:23-4911:10 (May 20, 2015). He recognized that the record company's "opportunity cost of licensing to [one] customer is going to depend on the rate set to other customers and the diversion between the target customer and other customers." *Id.* Accordingly, record companies' negotiations with interactive and non-interactive services would, in fact, be "connected." *Id.* In other words, when licensing to a statutory service like Pandora, record companies would consider the extent to which Pandora cannibalizes listeners from services that generate more value for the record company. Hr'g Tr. 4947:15-4949:7 (May 20, 2015) (Shapiro).

305. [ ] Hr'g Ex. SX-269 at 64. Mr. Herring testified that these]. Hr'g Tr. 4307:22-4308:21 (May 18, 2015) (Herring).

306. [

[redacted] Hr'g Ex. SX-263 at 23; Hr'g Tr. 3508:18-3509:2 (May 13, 2015). Pandora recognized that a consistent theme among its directly licensed competitors is that they [redacted] Hr'g Ex. SX-263 at 23. [redacted] *Id.* at 24

307. By contrast, Pandora candidly concedes that it [redacted] Hr'g Ex. SX-2356 at 2; Hr'g Ex. SX-3 ¶¶ 98, 102 (Blackburn WDT). Unsurprisingly, then, it keeps a relatively low ad load,[4] [redacted] Hr'g Ex. SX-1672 at 21; Hr'g Tr. 3548:9-24 (May 13, 2015) (Herring). [redacted] Hr'g Tr. 3432:23-3433:2, 3435:25-3436:4 (May 13, 2015) (Herring). Similarly, iHeart "promotes ad-free, uninterrupted listening on its custom stations" and does not offer a premium subscription option at all. Hr'g Ex. SX-12 at 15 (Kooker WDT); Hr'g Ex. SX-17 ¶ 72 (Rubinfeld Corr. WDT).

308. As long as the statutory license is available, there is little the record companies can do to encourage Pandora or iHeart to emphasize higher-ARPU offerings. Hr'g Tr. 6578:16-6579:9 (May 29, 2015) (Kooker). But this would not be the case in the hypothetical market.

[4] "Pandora is estimated to currently broadcast 3.18 30-second spots per hour (totaling a little over 90 seconds)," as compared to terrestrial radio's 13 minutes of advertising per hour. Hr'g Ex. SX-28 ¶¶ 34-35 (Lys WRT).

309. The predominance of the freemium model among directly licensed services is no accident. Because record companies share in their directly licensed partners' revenues, in their negotiations with services that include a free-listening tier, [ ]. Hr'g Ex. SX-12 at 22 (Kooker WDT); Hr'g Ex. SX-10 ¶¶ 13-15 (Harrison Corr. WDT); Hr'g Tr. 6575:21-6576:12 (May 29, 2015) (Kooker). In its agreement with [ ], for example, UMG requires a minimum ad load that increases with the number of months the user has been listening to the service. Hr'g Ex. SX-10 ¶ 13 (Harrison Corr. WDT). Similarly, [ ] Hr'g Ex. SX-10 ¶ 29 (Harrison Corr. WDT); Hr'g Ex. SX-29 ¶ 182 (Rubinfeld Corr. WRT).

310. Directly licensed services' freemium models currently are "competing for listeners with closely comparable services that pay substantially reduced rates and that make little or no effort to convert free listeners to paying subscribers." Hr'g Ex. SX-12 at 18 (Kooker WDT).

311. In the hypothetical marketplace, without a statutory license, copyright owners would be able to level this playing field. Rather than willingly subsidize any non-interactive service's attempt to grow its market share with a free user base, copyright owners, acting in their own economic self-interest, could incentivize non-interactive licensees to offer a [ ]. Hr'g Ex. SX-269 at 64. One way copyright owners could encourage non-

interactive services to generate more value is by negotiating [ ]. Hr'g Ex. SX-25 ¶ 30 (Harrison WRT); Hr'g Tr. 6579:2-9 (May 29, 2015) (Kooker). [ ] Hr'g Tr. 6648:3-13 (May 29, 2015) (Kooker).

312. Similarly, to the extent that pureplay services like Pandora simply cannot replicate (Hr'g Ex. SX-269 at 64), this asymmetry would be reflected in the rates a record company would be willing to accept from Pandora. In the hypothetical market, a one-stop, platform-level service that either (i) has a higher willingness to pay because of the horizontal nature of its business, or (ii) pushes users towards high-value modes of consumption, whether downloads or subscriptions, is naturally going to be the "target customer" of a willing seller. And in a willing buyer/willing seller negotiation in the absence of the statutory license, an economically rational record company would not give a statutory service a competitive advantage over its preferred, "target customers." Hr'g Tr. 4947:15-4949:7 (May 20, 2015) (Shapiro).

313. The fundamental implication of the convergence in the streaming market is simple. Consumers that want to listen to free, custom radio on the internet have a lot of choices. Record companies have an economic interest in this choice. A record company would be better off if a consumer opted for Spotify's free radio or Apple's—where the free streams bear higher royalties and are part of a broader ecosystem that pushes subscription or download sales—than if the consumer chooses Pandora. In the hypothetical market, therefore, no rational record company would willingly accept a materially lower rate from a service like Pandora that is in

direct competition with services that upsell listeners to more valuable products. A significantly lower rate would enable Pandora to grow its free, low-value radio service at the expense of the free radio services offered by Apple and Spotify, platforms that pay higher rates and generate more value for the record companies. As a matter of economic common sense, we can be confident that record companies would not risk their own bottom line by gifting Pandora or any other statutory service with a sizable discount off prevailing market rates.

VI. SOUNDEXCHANGE'S RATE PROPOSAL FOR COMMERCIAL WEBCASTERS

314. SoundExchange's rate proposal for commercial webcasters is set forth in the Proposed Rates and Terms of SoundExchange, Inc. (October 7, 2014). SoundExchange submitted proposed regulations (redlined to show changes from the current regulations) as an attachment to its Proposed Rates and Terms.

315. For commercial webcast transmissions and related ephemeral recordings by commercial webcasters as defined in 37 C.F.R. § 380.2(d), SoundExchange proposes that the appropriate royalty rate for eligible nonsubscription services for the period between 2016 to 2020 be the greater-of the following per-performance rate and percentage "Attributable Revenue."

	Per-play Rate	**Percentage of Attributable Revenue**
2016	$0.0025	55%
2017	$0.0026	55%
2018	$0.0027	55%
2019	$0.0028	55%
2020	$0.0029	55%

316. SoundExchange's Proposed Rates and Terms define "Attributable Revenue." *See* Proposed Rates and Terms at 6. "Attributable Revenue" is a webcaster's "Gross Revenue," subject to certain downward adjustments. *Id.* Gross Revenue includes all amounts paid,

payable, credited, or creditable to or on behalf of the webcaster. *Id.* at 5. To calculate Attributable Revenue, Gross Revenue is reduced by two sets of adjustments. First, Gross Revenue is reduced by certain costs, such as sales taxes. *Id.* at 6. Second, Gross Revenue is also reduced by revenues that are attributable to other products or services that are bundled with the webcasting service. *Id.* Under SoundExchange's rate proposal, a webcaster need only use a "fair method of allocation"—"a reasonable method, employed in good faith and in accordance with U.S. GAAP"—to allocate revenues. *Id.*

317. For noncommercial webcasters, SoundExchange proposes a minimum fee of $500 per station or channel, up to a maximum usage of 159,140 aggregate tuning hours. The same perperformance rates for commercial webcasters shall apply to usage by noncommercial webcasters in excess of 159,140 hours per month. *See* Proposed Rates and Terms of SoundExchange, Inc. at 4-5 (February 25, 2014).

318. The royalty fee for ephemeral copies shall be included within, and constitute 5% of, all such royalty payments. SoundExchange also has proposed corresponding amendments to the statutory license terms, as explained more fully in SoundExchange's Proposed Rates and Terms, described *infra* at Section XIX.

319. In addition, pursuant to 17 U.S.C. § 801(b)(7), SoundExchange submitted two settlements to the Judges for publication and adoption as the basis for statutory rates and terms for certain webcasting services: (1) an agreement with College Broadcasters, Inc. ("CBI"); and (2) an agreement with the Corporation for Public Broadcasting ("CPB") and National Public Radio ("NPR"); and (3) a settlement concerning noncommercial educational webcasters ("NEWs"). The Judges have published those settlements for comment, but have neither expressly adopted nor declined to adopt them. SoundExchange continues to support adoption of

those settlements. If the settlements are adopted, then the webcasting services that meet the eligibility definitions in the settlements should be subject to the rates and terms therein. If the settlements are not adopted, then those webcasting services should be subject to the rates and terms set in this proceeding.

VII. SOUNDEXCHANGE'S RATE PROPOSAL IS REASONABLE AND IS SUPPORTED BY A "THICK MARKET" OF BENCHMARK EVIDENCE

A. A "Greater-of" Structure Is Supported By Substantial Market Data And Is Economically Warranted

1. A "Greater-of" Structure Is Supported By Widespread Revealed Market Preferences

320. The streaming services market reveals a widespread preference for a "greater-of" structure. There can be little doubt about what structure a willing buyer and willing seller would agree to, because willing buyers and willing sellers have told us through their almost-uniform behavior in the marketplace that any contract between them would base royalties on a greater-of formula.

321. Most directly negotiated agreements between music streaming services and record companies incorporate a "greater of" rate structure in some form. Hr'g Ex.SX-17 ¶ 94 (Rubinfeld Corr. WDT); Hr'g Ex. SX-14 ¶¶ 25-32 (Lys WDT) (noting that of 62 label-service pairings Prof. Lys analyzed, 94% contain a "greater of " payment structure); Hr'g Tr. 1756:4-20 (May 5, 2015) (Rubinfeld).

322. Typically, this involves the greater-of two or more branches, including a per-play rate, a percentage of revenue, and, in many cases, per-subscriber payments and/or other adjustments (including guaranteed minimum total payments). Hr'g Ex. SX-17 ¶ 93 (Rubinfeld Corr. WDT); Hr'g Ex. SX-14 ¶¶ 27-32 (Lys WDT).

323. The majority of agreements with a greater-of structure include a broad "catch all" term that is designed to capture all the various types of income that could be earned by a service. Hr'g Ex. SX-14 ¶ 27 (Lys WDT). In addition, a majority of the agreements explicitly include two specific types of revenue: (a) subscription fees and (b) advertising revenue. *Id.* Other types of revenue specifically mentioned in the agreements include referral fees, affiliate fees, and ecommerce. *Id.*

324. Greater-of-structures with percentage of revenue shares are found in license agreements for both interactive and non-interactive streaming services. For the interactive service agreements that Prof. Rubinfeld examined, those with percentage of revenue prongs generally range between 50-60% of revenue, with the majority falling between 55-60%. Hr'g Ex. SX-17 ¶ 206 (Rubinfeld Corr. WDT); Hr'g Ex. SX-63 (App. 1a.)

325. The non-interactive service agreements that Prof. Rubinfeld and the other experts in this case have analyzed also have greater-of-structures with percentage of revenue shares.

326. The Apple iTunes Radio agreements with Warner and Sony [redacted] Hr'g Ex.SX-2070 at section 1(b), p. 1 (Apple-Warner Agreement); Hr'g Ex. SX-2071 at section 1(d), p. 2 (Apple-Sony Agreement).

327. The Warner-iHeartMedia agreement contains a greater-of structure that includes a prorated share of [redacted] Hr'g Ex.SX-33 at section 3(b)(2) at pp. 15-16. [redacted] Hr'g Tr. 7405:9-7406:3; 7415:1-18 (June 3, 2015) (Wilcox).

328. iHeartMedia's agreements with 27 independent labels also [

;] also included, [

.] Hr'g Ex. SX-29 ¶ 87 (Rubinfeld Corr. WRT); Hr'g Ex. IHM 3343 at 9; Hr'g Ex. IHM 3365 at 11; Hr'g Ex. IHM 3356 at 9-10.

329. The agreements between Universal, Sony, and Warner with Nokia for its MixRadio streaming service, which does not have on-demand functionality, [

.] Hr'g Ex. SX-29 ¶ 90 (Rubinfeld WRT). Hr'g Ex. SX-80

]; Hr'g Ex. SX-87

]; Hr'g Ex. SX-100

]

330. Likewise, Rhapsody's agreements with Universal, Warner, and Sony for its unRadio service, which does not have on-demand functionality,

]

331. The Pandora-Merlin agreement also includes a greater-of structure [redacted] Reflecting the terms of the Pureplay agreement (which as described separately in SoundExchange's Conclusions of Law and below makes the Pandora-Merlin agreement an improper benchmark), the agreement provides [redacted]. Hr'g Ex. PAN 5014 section 3(e). Merlin believed at the time it signed the Pandora-Merlin agreement [redacted] Hr'g Tr. 6896:3-6899:3 (June 1, 2015) (Lexton).

2. A Greater-of-Structure Provides Economic Benefits to Both Licensors and Licensees And Facilitates Beneficial Price Discrimination

332. The greater-of compensation structure provides economic benefits to both licensors and licensees, provides a reasonable sharing of the benefits of licensing among interested parties, and has positive economic efficiencies. *See* Hr'g Tr. 1756:21-1758:16 (May 5, 2015) (Rubinfeld).

333. The greater-of structure ensures that the recording companies providing the primary input to streaming services – the recordings themselves – are compensated reasonably, irrespective of the commercial success of the licensed service. Hr'g Ex. SX-17 ¶ 96 (Rubinfeld Corr. WDT). The per-play branch provides a guaranteed minimum payment per stream, compensating the record company for the usage of music even if the service earns low revenues or otherwise fails to monetize the use of music effectively. *Id*. The additional branch proposed here –a percentage of revenue – ensures that record companies will share in any potentially substantial returns that may be generated by services that succeed in the marketplace. *Id*. As Prof. Shapiro states with respect to the Pandora-Merlin agreement's greater-of structure, "[t]his

rate structure has the property of assuring that rights holders receive at least the specified per-play rate for each compensable performance of their sound recordings while also allowing the rights holders to benefit in the event that the non-interactive service is able to monetize its service sufficiently that the percent-of-revenue prong becomes operative." Hr'g Ex. PAN 5022 at 21 (Shapiro WDT).

334. Because the greater-of formula proposed as part of SoundExchange's rate proposal does not include either a per-subscriber or per user minimum fee and/or an overall minimum compensation guarantee – which is common in marketplace agreements – it is inherently conservative as compared to marketplace rates. Hr'g Ex. SX-17 ¶ 97 (Rubinfeld Corr. WDT).

335. A greater-of formula also is warranted because of the inherent risk asymmetry which exists under the statutory license. In the hypothetical marketplace in the absence of a statutory rate, record companies could withhold their catalogs to a service if the terms were not considered sufficient. Hr'g Ex. SX-17 ¶ 98 (Rubinfeld Corr. WDT). Under the statutory license, this no license "threat point" is not available to record companies. *Id*. Although both record companies and streaming services will face uncertainty and risk in the future with respect to the variability of consumer demand, that risk is greater for the record companies, because they do not have the option of refusing to license, while services have the option of adopting, or not adopting, the statutory license rates. *Id*. ¶ 100.

336. The greater-of formula accounts for this risk asymmetry by ensuring that involuntary licensors – the record companies – receive at least a minimum payment per play in return for creating the recordings that generates the financial rewards flowing to the streaming industry. Hr'g Ex. SX-17 ¶ 102 (Rubinfeld Corr. WDT). It also allows rights owners to be

compensated for a reasonable share of the revenues that are generated by successful services. *Id*. In the absence of a greater-of formula, a rate proposal premised solely on a per-play rate would not allow record companies to share in the upside benefits services obtain – a common feature of real-world agreements – thereby not capturing the entire value that record companies receive in the real world through their direct license agreements. *Id*. ¶ 103; *see also* Hr'g Ex. SX-14 ¶¶ 71-75 (Lys WDT).

337. The minimum per-play rate floor offers benefits to both record companies and services. For record companies, it provides them with a minimum reasonable return on their recordings and provides some compensation for the loss of the right to limit or exclude others from the use of their recordings, which they ordinarily would be entitled to in a market without a statutory license. Hr'g Ex. SX-17 ¶ 104 (Rubinfeld Corr. WDT). Streaming services also benefit from a greater-of structure with a percentage of revenue prong, because it allows the minimum per-play rate to be reduced, which would be the operative prong before a company obtains larger revenues triggering the percentage of revenue prong. *Id*. ¶ 95. This would reduce the costs and risks of entry by new services. *Id*.

338. Conversely, a pure per-play rate could create distortions in the marketplace. For example, a per-play rate that is not sufficiently high could preclude record companies benefiting from the contribution of their content to the success of a mature and successful business. Hr'g Ex. SX-14 ¶¶ 68-69 (Lys WDT). By contrast, if a rate were set too high, this could protect mature streaming businesses against new entrants.

339. A pure percentage of revenue approach also would create negative consequences. Hr'g Ex. SX-14 ¶¶ 46-49 (Lys WDT). If royalties were based solely on a percentage-of revenue basis, record companies would be at the whim of streaming services' business decisions. For

example, streaming services rationally may choose to engage in business strategies that discount current revenue in the hope of gaining market share in the future from other streaming services. *Id*. ¶ 47.

340. The greater-of formula with a percentage of revenue prong also enables a beneficial form of price discrimination. Hr'g Ex. SX-17 ¶ 112 (Rubinfeld Corr. WDT). All else being equal, services facing relatively low price elasticities will charge higher prices and generate greater revenues, and thus, those services are likely to pay on the percentage of revenue branch. *Id*. Conversely, those services facing relatively high price elasticities will, other things equal, charge lower prices and generate lower revenues, and thus are likely to pay royalties on a per-play basis. *Id*.

3. In the Absence of a Greater-Of Structure With A Percentage of Revenue Prong, SoundExchange's Proposed Per-Play Rate Would Be Higher

341. A greater-of structure, and specifically the additional of a compensation branch based on a percentage revenue, allows the per-play rate to be lower than it would without the revenue branch. Hr'g Ex. SX-17 ¶¶ 31, 95 (Rubinfeld Corr. WDT). In the absence of a greater-of structure, SoundExchange's per-play rate in its rate proposal would be higher. *See* Hr'g Tr. 1758:19-1759:16 (May 5, 2015) (Rubinfeld).

342. This is reflected in the actual marketplace agreements between record companies and streaming services. SoundExchange's proposed per-play rate is based on the stated per-play rates in interactive services agreements, plus any additional quantifiable contractually-specified considerations such as guaranteed advertising or non-recouped advances. Hr'g Ex. SX-17 ¶ 205 (Rubinfeld Corr. WDT).

343. Prof. Rubinfeld's calculated rates for the interactive streaming service agreements, as adjusted for interactivity, reflect the differences between stated per play rates and

effective per play rates based upon total compensation under an agreement, which typically result from payment under the percentage of revenue or per-subscriber minimum prongs in those agreements. *See* Hr'g Ex. SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex.16a); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

344. Prof. Rubinfeld calculates an adjusted stated per play rate, based on the stated rates in the interactive service agreements, any additional quantifiable consideration, and as adjusted for interactivity, of [redacted] *See* SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex.16a); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a). Prof. Rubinfeld separately calculates an *effective* per-play rate for the interactive service agreements, which reflect payments made pursuant to percentage of revenue or per subscriber minimum prongs, as adjusted for interactivity, of [redacted]. *Id*.

345. Thus, in the absence of a greater-of structure, and to reflect the effective per-play rate for the interactive service agreements, the per-play rate set forth in SoundExchange's rate proposal would need to be significantly increased.

B. SoundExchange's Proposed Per-Play Rates, Based Upon the Interactive Service Agreements, Are Reasonable And Appropriate

1. The Interactive Service Agreements Are A More Important Benchmark Than In Prior Proceedings

346. SoundExchange's per-play rate proposal is principally derived from Dr. Rubinfeld's analysis of the interactive service agreements. These agreements have long served as a benchmark in these proceedings. And the record in this proceeding demonstrates that they are even more appropriate as benchmark evidence than they were in prior proceedings.

347. Agreements between interactive services and record labels have been considered as benchmark evidence by the Judges, going back to the *Web II* proceeding. As the Judges recognized in *Web II* with respect to interactive and non-interactive services, both "have similar

buyers and sellers and a similar set of rights to be licensed (a blanket license in sound recordings)," they both reflect "input markets and demand for these inputs is driven by or derived from the ultimate consumer markets in which these inputs are put to use," and from the perspective of consumers, "music is delivered to consumers in a similar fashion, except that, as the names suggest, in the interactive case the choice of music that is delivered is usually influenced by the ultimate consumer, while in the non-interactive case the consumer usually plays a more passive role," which can be "accounted for" through an interactivity adjustment. *See Web II*, 72 Fed. Reg. 24084, 24092 (May 1, 2007). Although the Judges highlighted certain issues with respect to Dr. Pelcovits's analysis of the interactive benchmark in the *Web III Remand*, which SoundExchange has addressed in this proceeding, it still found the "interactive benchmark analysis" to be of "assistance in establishing a zone of reasonableness in this proceeding." *Web III Remand*, 79 Fed. Reg. 23102, 23115 (Apr. 25, 2014).

348. The record demonstrates that the interactive services presented by SoundExchange in this proceeding have evolved considerably and today are even more appropriate as benchmarks for setting the rate for non-interactive services than the interactive services that the Judges considered in the *Web II* and *Web III* proceedings.

349. For example, in the *Web III Remand* decision, the Judges described interactive services as those offering "on-demand" streaming that allows listeners to "request the exact song he or she wishes to hear." *Web III Remand*, 79 Fed. Reg. 23102, 23115 (Apr. 25, 2014). But as described above, the interactive services that exist today – such as Spotify, Google Play, and Apple/Beats, none of which even existed at the time of *Web III* in 2009 – are platform-level services that offer a broad range of features encompassing both non-interactive, "lean-back" functionality, such as curated stations and playlists, as well as traditional "on-demand"

functionality that allows listeners to request the "exact" song they wish to hear. *See supra* Section V.C; *see also* Hr'g Ex. SX-17, ¶¶ 52-74 (Rubinfeld Corr. WDT). The evolution of the platform-level, "one-stop shopping" model has resulted from services that were previously solely on-demand adding additional customizable and curated radio and other "lean-back" functionality, services that were previously just radio adding on-demand functionality, and new services, like Google Play and Beats, launching at the outset with a whole range of functionality. *Id*. And all services now offer mobile applications, which increasingly is the primary means by which consumers stream music. *Id*.

350. Pandora's own CFO testified at length about various interactive services that now offer "lean back" products in order to stay "relevant in the lean-back listening world." Hr'g Tr. 3443:20-3450:23 (May 13, 2015) (Herring). According to Mr. Herring, "some of the on-demand businesses have started to blur the line a little bit," offering curated playlists to target the lean-back listening market. *Id*. at 3446:2-3450:23. Simon Fleming-Wood, Pandora's Chief Marketing Officer, defined Pandora as offering "something that we refer to as lean-back listening, where people go in wanting a radio-like experience where they want music played for them." Hr'g Tr. 6135:10-13 (May 27, 2015) (Fleming-Wood). Mr. Fleming-Wood states that "most" interactive services have "what they would call the radio function," that combines both "lean- back" offerings and higher control functions. *Id*. at 6142:19-6143:13. [redacted] Hr'g Ex. SX-2244 at 2, 17. [redacted]. *See, e.g.*, Hr'g Ex. SX-2356 at 2. [redacted]

[redacted] *See, e.g.*, Hr'g Ex. SX-1719 at 10.

351. Pandora [redacted]. *See* Hr'g Ex. SX-278 at 7. As Pandora noted in an internal business deck, [redacted] *Id*. Further, Pandora noted that [redacted] *Id*. Pandora itself acknowledged that [redacted]

352. The increasing convergence and competition between interactive and non-interactive services, and particularly in the mobile context, make the interactive services more appropriate benchmarks in this proceeding than in prior proceedings. *See* Hr'g Tr. 1785:11-22 (May 5, 2015) (Rubinfeld); *see also* Hr'g Ex. SX-17 ¶¶ 159-162 (Rubinfeld Corr. WDT). The competition among and substitution between interactive and non-interactive services have intensified with the continued entry of new services and with the industry transition from sales of downloads and CDs to streaming. Hr'g Ex. SX-17 ¶¶ 159-162 (Rubinfeld Corr. WDT).

353. In the *Web III Remand* decision, the Judges, quoting a SoundExchange witness, also described "[a]dvertising-supported (nonsubscription) on-demand interactive streaming" as

"'experimental' and not yet 'mature.'" *Web III Remand*, 79 Fed. Reg. 23102, 23115-16 (Apr. 25, 2014).

354. Today, however, "free" interactive services are far from "experimental" or "not mature." Indeed, they are well established and are a critical component of the "freemium" business model in which services have a free offering that provides a path to conversion to subscription services. For example, Spotify entered the U.S. market in 2011, after the *Web III* proceeding ended. *See* Hr'g Ex. SX-17 ¶ 43 (Rubinfeld Corr. WDT). In addition to its subscription-based service offering, Spotify offers a free, ad-supported service and the vast majority of Spotify's users use only the free ad-supported service. *See* Hr'g Ex. SX-29 ¶ 191 (Rubinfeld Corr. WRT). Of Spotify's 60 million active users, approximately 75%, or 45 million, are active users of the free service. *Id*.

355. As Pandora itself has internally noted [ ] Hr'g Ex. SX-278 at 24.

356. To highlight both of these developments which have changed since the Web III proceeding, below is a timeline describing some of the noteworthy events.

2011:

> Spotify entered the US market and added a radio product two months later.
>
> Slacker, which previously offered just a radio product, launched a premium service offering full on-demand capability.

2012:

> Spotify added a "thumbs up/thumbs down" option to its radio feature, similar to Pandora, as well as a radio service for iOS mobile devices for free and premium users.

2013:

> Rdio, which initially offered just on-demand functionality, expanded radio personalization by adding the ability to search and create radio stations by record label as well as personalized stations based on song, artist or genre. It also introduced the ability to vote on tracks to improve stations.
>
> Rhapsody improved its radio customization by incorporating Echo Nest, an algorithmic recommendation engine, into a new radio service.
>
> Google introduced Google Play All Access, an on-demand subscription service which also featured a radio product.
>
> Apple launched iTunes Radio, an ad-supported service.

2014:

> Rhapsody expanded its radio service with a separate ad-free subscription option (unRadio).
>
> Rdio launched an ad-based, free version with its paid subscription tier.
>
> Beats Music launched both on-demand and curated radio products.
>
> Apple acquired Beats Music
>
> Spotify acquired Echo Nest, an algorithmic recommendation engine.

Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-130 (Rubinfeld Corr. WRT Ex. 2); *see also* Hr'g Ex. SX-17 ¶¶ 52- 74 (Rubinfeld Corr. WDT).

357. In sum, since the *Web III* decision, interactive services have evolved from simply being "on-demand" services and now encompass a range of functionality including radio, lean-back experiences, and customizable radio that are the core of non-interactive services. Moreover, free-tier offerings of non-interactives are now well-established in the marketplace and are no longer "experimental."

2. The Interactive Services Benchmark Is Drawn From A Thick, Representative Market of Agreement Data, In Contrast to the Services Proposed Benchmarks

358. The interactive service agreements are also an important benchmark in this proceeding because SoundExchange's analysis of those agreements is based upon a thick, representative market of agreement data. This market involves a broad spectrum of labels, including both major and independent record companies; a wide variety of different services including large, corporate players like Spotify, Google, and Apple/Beats to smaller startups like Rara that have more specialized offerings, and an extensive period of time going back over the past 4 years, with a focus on the last year of available data to ascertain current trends.

359. When conducting a benchmark analysis, it is important to examine as broad a range of market data as possible, with varying sellers and buyers, for varying types of services, at varying price points. *See, e.g.*, Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld). If the focus is on a single agreement, or even a set of agreements that reflect a very small percentage of the market, there is a serious risk that such agreements are aberrational and cannot be universalized as a benchmark for all parties subject to the statutory license. *Id*.

360. The Judges themselves have repeatedly cautioned against relying upon agreements struck between a limited set of unrepresentative buyers or sellers. *See, e.g., Web III Remand* at 23108 ("[T]o the extent [a buyer] is not sufficiently representative of all webcasters (or representative at all of other webcasters)," an analysis of such buyer "would yield an inaccurate royalty rate."); *SDARS II* at 23,061 (criticizing potential benchmark that "represent[s] a sliver of the universe of rights holders for sound recordings.").

361. The issue of representativeness is particularly important in a market in which the statutory license, as discussed at Section III.B, *supra*, can "crowd out" a whole range of agreements that otherwise would have been consensually negotiated above or near the existing

statutory license. Hr'g Tr. 6029:14-6030:4; 6034:4-6036:14 (May 27, 2015) (Talley). The remaining observable agreements, particularly those that are most directly affected by the statutory shadow, suffer from selection bias and a downward bias created by the existing statutory license. *Id*.

362. An appropriate statutory rate should therefore aim for some central measure (e.g., the mean or median) of a heterogeneous range of agreements and prices that would plausibly result from bargaining between buyers and sellers. Hr'g Ex. SX-19 at 28 (Talley WRT). By contrast, it is particularly challenging to rely upon a single agreement and rate, such as Pandora-Merlin or iHeart-Warner, and apply that rate "across the industry." *Id*.

363. By contrast, in analyzing the interactive services space, Prof. Rubinfeld analyzed more than 80 label-service pairs between interactive streaming services and major and independent record labels going back over the past 4 years. *See* Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2); Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld). These agreements include those struck by large platform-level streaming services such as Spotify or Google Play, and smaller streaming services like Rara and Classical Archives. *Id*. These services, as noted, offer a broad range of service offerings, including non-interactive, lean back options like curated radio in addition to traditional on-demand options. *See* Section V.C., *supra*.

364. Prof. Rubinfeld's review also included agreements with both major and independent labels, including independent labels such as Beggars Group, Secretly Canadian, and Merlin. *See* Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2); Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld).

365. Moreover, the agreements Prof. Rubinfeld reviewed were for interactive services that had both free and subscription tiers, such as Spotify. The free tiers of such services typically are a means by which services can incentivize conversion to their paid subscription tiers. *See* Hr'g Ex. SX-17, ¶¶ 50, 173 (Rubinfeld Corr. WDT) (noting that "[ ] both operate directly licensed free radio services which are explicitly designed to motivate listeners to convert to paid 'on demand' service").

366. To reflect the most current trend in rates – and to respond to the Judges' critique of Dr. Pelcovits' analysis – Prof. Rubinfeld's reported calculations are based upon only the last year of available data. *See* Hr'g Ex. SX-17 ¶¶ 120 & n.87, 140 (Rubinfeld Corr. WDT). From the more than 80 label-service pairs Prof. Rubinfeld reviewed, he calculated effective per-play rates from 45 different agreements, and adjusted minimum per-play rates from 26 agreements (and any amendments thereto). *See* Hr'g Ex. SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

367. These agreements not only reflect a vast array of different services and labels, but they also reflect a wide range of prices. For example, the weighted average minimum per play rates for the interactive agreements range [.] *See* Hr'g Ex. SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a). And even within a particular service, there can be substantial variation in rates reached with various labels. *See id*. (e.g., [ ]).

368. Even where labels may have similar stated per play rates, other forms of consideration may differ. For example, the major labels [.] *See* Hr'g Ex. SX-29, ¶ 67 (Rubinfeld Corr. WRT); Hr'g Ex. SX-136 (Rubinfeld Corr. WRT Exs. 8B, C, and D).

369. iHeartMedia has suggested that its agreements with 27 independent record labels should be equally weighted to the number of interactive service agreements Dr. Rubinfeld has analyzed. But the concept of representativeness is not simply a counting game – rather, the Judges must examine the nature of the agreements, the parties to the agreements, the overall effect on the market those agreements may have had, and whether the rates in those agreements can be universalized across the industry. These 27 agreements were all between iHeartMedia and independent labels, who not only may lack the bargaining power that a major label would have, but who also may have unique incentives and business motivations that cannot be extrapolated to the entire industry. *See* Hr'g Ex. SX-29 ¶¶ 84-85 (Rubinfeld Corr. WRT).

370. For example, Mr. Barros, CEO of Concord Records, who entered into one of these direct agreements with iHeart, testified that "while every record company may have certain differences in its repertoire, for us, issues like whether a music service will pay for performances of Pre-72 recordings have a significant impact on our assessment of the value we receive from licensing our repertoire to a service. That issue, therefore, has impacted our negotiations for direct licenses with digital music services, including our license with iHeartMedia. While Pre-72 recordings are one example of a particular concern for Concord, other labels may have their own particular issues that affect their licensing practices. Such idiosyncratic reasoning is especially true among independent record companies who vary greatly in shape and size and often can be driven in their decision-making by a host of label-specific considerations." Hr'g Ex. SX-1 ¶ 12

(Barros WRT). Concord therefore specifically entered into its direct agreement with iHeart because of [redacted]. *See* Hr'g Ex. SX-1 ¶ 21 ("Given Concord's unique catalog with its high number of Pre-72 sound recordings, we needed iHeartMedia to [redacted]]

371. Moreover, the number of plays represented by these agreements with independent labels on iHeartRadio are again a "sliver of the universe of rights holders for sound recordings." iHeartMedia's own data [redacted.] Hr'g Ex. SX-29 ¶ 84 (Rubinfeld Corr. WRT). By contrast, Dr. Rubinfeld's analysis of the interactive streaming service agreements, which encompasses every major streaming service provider, captures the overwhelming majority of interactive *and* non-interactive performances (e.g., through the radio product) in the overall interactive space.

3. The Interactive Services Benchmark Is Least Affected By the Shadow of Statutory License and Involves Same Sellers and Similar Buyers For A Similar Grant of Rights

372. As discussed above, *supra* Section III.B, the interactive service agreements are the least affected by the shadow of the statutory license in this proceeding, rendering them particularly appropriate as a benchmark.

373. In addition to the absence of the shadow of the statutory license, there must also be similarity in parties and the rights to be licensed. Contrary to some of the Services' suggestion at the hearing, the Judges in the past have not required that the parties or the rights be *identical* to those that exist under the statutory license for the benchmark to be appropriate, nor

have they weighted the absence of the statutory license factor as equivalent to the similarity in parties and rights. Indeed, in *Web II* the Judges found the interactive service agreements to be appropriate, noting that both "have similar buyers and sellers and a similar set of rights to be licensed (a blanket license in sound recordings)." *Web II*, 72 Fed. Reg. 24084, 24092 (May 1, 2007). And as discussed, *supra*, interactive services and non-interactive services are even *closer* in similarity today than they were in *Web II* or *Web III* proceedings.

4. Dr. Rubinfeld's Calculations of The Adjusted Per-Play Rates

374. Prof. Rubinfeld derived a rate proposal from record companies' most recent agreements with 13 interactive services.[5] To do so, he performed a series of calculations and adjustments to align the agreements with the value and rights exchanged under the statutory license. These calculations are summarized below.

a. *Initial per-play calculation*

375. Prof. Rubinfeld began by determining the minimum per-play rate defined in each agreement. Hr'g Ex. SX-17 ¶ 205 (Rubinfeld Corr. WDT). Where the agreement specified more than one such per-play rate, he calculated the average per-play rate for all of the service's "interactive" offerings. *Id.* To take one example, Prof. Rubinfeld's calculation of the benchmark

[5] In total, Prof. Rubinfeld reviewed hundreds of agreements spanning four years and involving 88 label-service pairs (including 21 different digital streaming services and six separate record companies). Hr'g Ex. SX-69 (Rubinfeld WDT App. 2). While agreements with "Category B" and "Category C" services informed and corroborated Prof. Rubinfeld's benchmark calculation, these agreements were not incorporated into his benchmark rate calculation. Hr'g Ex. SX-17 ¶¶ 19-29, 31 (Rubinfeld WDT). In addition, for four of the "Category A" services that were then-recently released, performance data was not yet available, so they were likewise not factored into Prof. Rubinfeld's benchmark rate calculation. Hr'g Ex. SX-17 at 4, n.2 (Rubinfeld WDT). Finally, to avoid any bias from outdated market information, Prof. Rubinfeld excluded data that pre-dated June 2013. Hr'g Ex. SX-17 ¶ 140 (Rubinfeld WDT).

rate for [ ] agreement with [ ] began with the agreement's stated minimum per-play rate of [ ]. Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

376. Many of the interactive service agreements reviewed by Prof. Rubinfeld, such as those with [ ], specified no minimum per-play rate. Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a). For these services, record companies are paid under other payment branches, such as per-subscriber minima and revenue shares. Hr'g Ex. SX-17 ¶ 205 (Rubinfeld Corr. WDT). Because they have no minimum per-play rate, these services are not included in Prof. Rubinfeld's benchmark calculation. *Id.*

377. However, for all of the majors' interactive service agreements reached between June 2013 and May 2014, Prof. Rubinfeld also calculated the agreements' effective compensation per play. Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a). This calculation was derived by dividing the total content fees paid to the record company by the record company's total number of plays. *Id.* To return to the [ ] example, while the stated minimum per play rate in the agreement was [ ], the total effective compensation per play was far more: [ ] *Id.* For purposes of deriving a benchmark calculation for his per-play rate proposal, however, Prof. Rubinfeld relied only on the agreements' stated minimum per play rates, even if the record companies were actually paid under other payment branches that conveyed substantially more compensation per-play. Had Prof. Rubinfeld instead relied on the average effective per play rates in the interactive service agreements, his proposed rate would have been nearly twice as high. Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a) (showing average adjusted effective per play rate of [ ]).

b. ***Valuation of non-per play financial consideration and non-monetary sources of value***

378. The interactive agreements all included a variety of non-per play consideration. In a few cases,[6] this additional consideration, like non-recoupable cash payments and advertising commitments, had an express financial value. Hr'g Ex. SX-17 ¶ 218 (Rubinfeld Corr. WDT). In these instances, Prof. Rubinfeld used the service's performance statements to calculate the per-play value of the consideration (i.e., he divided the payment by the number of plays), and then added this per-play value to the minimum per-play rate. However, to be conservative, Prof. Rubinfeld did *not* incorporate any such value in his benchmark calculation where it was not expressly quantifiable. *Id.* Similarly, even though the agreements provide the record companies with a variety of other benefits (e.g., data provisions, equity stakes), Prof. Rubinfeld conservatively did not account for this value in his benchmark calculation. *Id.*

c. *Interactivity adjustment*

379. Prof. Rubinfeld then adjusted the per-play fee to adjust for the value of interactivity. He determined the incremental value consumers place on "interactivity" by comparing the average retail subscription prices for "interactive" and "non-interactive" services. Hr'g Ex. SX-17 ¶ 207 (Rubinfeld Corr. WDT). At the time of his written direct testimony, the average price for interactive services was $9.86, while the average price for non-interactive services was between $4.84 and $5.27, a ratio of 1.87-2.04. *Id.* Based on this ratio, Prof. Rubinfeld applied a discount factor of 2.0 to adjust for the value of "interactivity." *Id.* Applied to the [ ] per-play fee in the [ ] example, the interactivity adjustment yielded an adjusted rate of Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).[7]

[6] Namely, [ ] agreements with [ ]. Hr'g Ex. SX-59 (Rubinfeld WDT Ex. 16a).

[7] At the hearing, the Services suggested in their questioning of Professor Rubinfeld that his inclusion of Rhapsody unRadio, Nokia MixRadio+, and Slacker RadioPlus on the "non-
(footnote continued)

380. Prof. Rubinfeld's 2.0 adjustment factor was likewise conservative in light of the 1.9 factor implied by the Prof. McFadden's conjoint survey. Hr'g Ex. SX-17 ¶¶ 171, 209 (Rubinfeld Corr. WDT). Prof. McFadden conducted a conjoint survey to determine the value that future consumers of digital streaming services place on the features of those services. Specifically, Prof. McFadden determined the value that future consumers place on features that are not available under the statutory license, such as the ability to play tracks on-demand, the ability to listen to tracks "offline," and the ability to skip songs in an unlimited manner. Hr'g Ex. SX-15 ¶ 9 (McFadden WDT).

381. Relying upon the entire sample of respondents to Prof. McFadden's survey, Prof. Rubinfeld summed the average willingness to pay values[8] for various attributes for hypothetical interactive and non-interactive services. *See* Hr'g Ex. SX-17 ¶ 209 (Rubinfeld Corr. WDT), SX-56 (Rubinfeld Corr. WDT Ex. 14). On the interactive side, Prof. Rubinfeld included the following attributes: (1) Unlimited Skips; (2) Offline Listening; (3) On-Demand (Desktop &

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interactive" side of the subscription price ratio was improper because, although those services do not have "on-demand" functionality, they may have additional functionality that renders them non-DMCA compliant and ineligible for the statutory license. Hr'g Tr. 2041:23-2053:1 (May 6, 2015) (Rubinfeld). Because Professor Rubinfeld was attempting to isolate the value of interactivity and more specifically on-demand functionality, the fact that such services may have included additional non-DMCA compliant functionality does not undermine the primary purpose of the exercise. But moreover, the Services' argument ultimately does not get them anywhere. If one were to exclude these three subscription services from the ratio, the interactivity adjustment actually becomes *smaller* – with the resulting per-play rate *increasing*. Removing those services (Rhapsody unRadio at $4.99; Nokia MixRadio+ at $3.99; and Slacker RadioPlus at $3.99) from the non-interactive side of the ratio results in a new interactive-to-non-interactive ratio of $9.86/$5.24-$5.99, or an interactivity adjustment of 1.64 - 1.88, which is significantly less than the 2.0 adjustment Professor Rubinfeld used.

[8] As Professor Rubinfeld explained in response to Dr. Peterson's criticism, it was proper for him to rely on average, as opposed to individual, willingness to pay values. Hr'g Tr. 1878:8-1879:14 (May 5, 2015) (Rubinfeld). This is because although there is "heterogeneity in the answers of respondents of Professor McFadden's conjoint study that would suggest different willingnesses to pay," those "individual estimates are not statistically significant," and when you rely on averages, you "get much more statistically reliable results." *Id*.

Mobile); (4) Addition of Mobile Service; (5) Playlists from Both Algorithm and Tastemakers; (6) No Advertising; and (7) Catalog from 1M to 20M+. *Id*. On the non-interactive side, Prof. Rubinfeld including these attributes but excluded the following features not offered by statutory services: (1) Unlimited Skips; (2) Offline Listening; and (3) On-Demand (Desktop & Mobile), and he substituted a catalog size of 1M to 10M, instead of 1 to 20M+, consistent with the non-interactive catalog sizes in the market. *Id*.

382. These calculations result in an interactivity ratio of 1.90, which indicates that the assumed interactivity ratio of 2.0 Prof. Rubinfeld utilized is conservative.

d. *Royalty-bearing plays adjustment*

383. Next, to ensure that statutory services' per-play payments do not constitute a greater percentage of revenue than they do for interactive services, Prof. Rubinfeld further adjusted the rate downward based on the slightly higher number of royalty-bearing plays on statutory services. Hr'g Ex. SX-29 ¶ 214 (Rubinfeld Corr. WRT).

384. Statutory services tend to pay for a higher number of plays because they must pay for skips, while directly licensed agreements typically define "royalty-bearing plays" to exclude at least some skips. Hr'g Ex. SX-17 ¶ 212 (Rubinfeld Corr. WDT). The difference in number of royalty-bearing plays is ultimately small, however, for a few reasons. As an initial matter, directly licensed services usually limit the number of skips permitted. Hr'g Ex. SX-17 ¶ 214 (Rubinfeld Corr. WDT). Moreover, statutory services like Pandora and Sirius XM contend that they are not required to pay for pre-72 sound recordings under federal copyright law. Hr'g Ex. SX-17 ¶ 213 (Rubinfeld Corr. WDT). Directly licensed services, on the other hand, are usually contractually bound to pay for such recordings. *Id.* As a result, the differences in the services' treatment of skips and pre-72 recordings largely cancel each other out, and the ratio of royalty-bearing plays is close to one. *Id.* ¶ 217.

385. Prof. Rubinfeld's calculation of a 1.1 adjustment factor involved three steps. First, he estimated the number of royalty-bearing plays on a hypothetical service that does not pay for skips based on a few reasonable assumptions about the average length of skips, number of skips, minutes of ads per hour, and song length. Hr'g Ex. SX-17 ¶ 216 (Rubinfeld Corr. WDT); Hr'g Ex. SX-57 (Rubinfeld Corr. WDT Ex. 15a). Second because Prof. Rubinfeld did not have access to Pandora's internal performance metrics, he estimated the number of Pandora's royalty-bearing plays per hour using data publicly reported in Pandora's SEC filings. Hr'g Ex. SX-58 (Rubinfeld Corr. WDT Ex. 15b). Prof. Rubinfeld took the ratio of these two figures to derive an adjustment factor of 1.1. Hr'g Ex. SX-57 (Rubinfeld Corr. WDT Ex. 15a).

386. Returning again to the example, this adjustment factor further reduced the [ ] benchmark rate from to . Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

387. Prof. Katz has suggested that Prof. Rubinfeld's number-of-plays adjustment, while necessary, was improperly calculated. Hr'g Ex. NAB 4015 ¶¶ 101-104 (Katz AWRT). He attempted to demonstrate this with his own alternative calculation of an adjustment factor. *Id.* But his erroneous alternative calculation, once corrected for a basic error, in fact corroborates Prof. Rubinfeld's adjustment.

388. Prof. Katz asserted that the proper adjustment factor is 1.2. Hr'g Ex. NAB 4015 ¶ 104 (Katz AWRT). He derived this number from internal Pandora performance data contained in Table D.1 of Prof. Shapiro's written direct testimony, excerpted below. *Id.*

RESTRICTED GRAPHIC

Using the data in the first two rows above, Prof. Katz determined that Pandora averages [ ] plays per hour. He used the same chart to derive Pandora's skips per hour . He then calculated what he calls "an appropriate adjustment" by dividing the total number of plays from the number of plays minus skips: Hr'g Ex. NAB 4015 ¶ 104 (Katz AWRT).

389. Prof. Katz's calculation contained a critical omission: he failed to account for Pandora's failure to pay for pre-72 recordings under the statutory license. Hr'g Ex. SX-17 ¶ 213 (Rubinfeld Corr. WDT). As set forth in the chart above, of Pandora's ad-supported plays and of its subscription performances are pre-72 sound recordings for which it does not pay statutory royalties. These performances would be royalty-bearing on a directly licensed service.

390. By only accounting for the difference in the services' treatment of skips, Prof. Katz's calculation fails to capture the *net* differential in the number of royalty-bearing plays. Once the approximately [ ] non-royalty-bearing plays per hour on Pandora's side of the

ledger are accounted for, the Pandora data Prof. Katz relied upon yields the same adjustment factor calculated by Prof. Rubinfeld: [= 1.13.

e. *Indie adjustment*

391. Prof. Rubinfeld also adjusted the benchmark rate for each service to account for independent record companies' deals and streams. Hr'g Ex. SX-17 ¶¶ 220-225 (Rubinfeld Corr. WDT). He assumed that independent record companies would, on average, likely negotiate less beneficial arrangements with interactive services than would major labels. Hr'g Ex. SX-17 ¶¶ 220, 223 (Rubinfeld Corr. WDT). In particular, he assumed that "in separately negotiated agreements independent record companies would not receive any of the non-per-play financial or other unquantified consideration major record companies receive (e.g., MFNs, advertising guarantees, or upfront guaranteed fees)." *Id.* ¶ 223. A comparison of Apple's agreements with indies and majors for its iTunes Radio service—[ ]. Hr'g Ex. SX-128 ¶ 29 (Rubinfeld Corr. WRT App. 2).

392. Independent labels account for an average of 24% of the streams on interactive services, and Prof. Rubinfeld assumed that plays were distributed accordingly for each of the benchmark services. Hr'g Ex. SX-17 ¶ 225 (Rubinfeld Corr. WDT). In calculating an adjusted rate for each label-service pair, he assumed that 24% of the plays would not receive any per play compensation beyond the stated minimum per play rate. Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

f. *Revenue-weighted average across all service-label pairs*

393. Each of the individual service-label agreements for which Prof. Rubinfeld performed calculated an adjusted rate are separate potential benchmarks. Hr'g Ex. SX-17 ¶ 203

(Rubinfeld Corr. WDT). To summarize the benchmark rate across all service-label pairs, Prof. Rubinfeld chose to use the revenue-weighted average, rather than the simple average, which was significantly higher. *Id.*; Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a) (showing simple average of [redacted] as compared to revenue-weighted average of [redacted]

394. Prof. Rubinfeld testified that a revenue-weighted average best represents the "market" rate because it weights towards those services that would be expected to have a greater impact on willing buyer/willing seller rates. Hr'g Ex. SX-17 ¶ 203 (Rubinfeld Corr. WDT).

395. A service's number of streams would be a less preferable means by which to measure size for weighting purposes. As Prof. Rubinfeld explained, "[r]evenue-weighting places relatively less weight on services obtaining lower revenue per stream. It is not a long-run market equilibrium for services to 'buy' streaming share by deriving exceptionally low revenue from their service (either as fees or as ad revenues). In the long run, such services will either increase their rates or cease to exist." Hr'g Ex. SX-17 ¶ 203, n. 122 (Rubinfeld Corr. WDT). To put it another way, because a willing seller would be more interested in licensing to a buyer that generates more revenue per stream than less, a more efficient revenue-generating service should be weighted more heavily in the calculation of a market average.

396. Prof. Katz advocated for a stream-weighting approach in his rebuttal testimony. Hr'g Ex. NAB 4015 ¶¶ 42-44 (Katz AWRT). His very own hypothetical demonstrated the problems with this approach. *Id.* ¶ 43. He considered two hypothetical services each, with 500 performances: one earning $0 in revenue and the other earning $0.0030 in revenue per play. *Id.* When calculating an average royalty rate, under Prof. Katz's stream-weighting approach, the service not earning any revenue for its plays (ostensibly free trials on a subscription tier, or plays with no advertising on a free tier) would be weighted equally as the service earning revenue. *Id.*

But a free trial could not exist independently in the market, and a free service attracting no advertisers would not be a viable going concern. Hr'g Ex. SX-17 ¶ 203 n. 122 (Rubinfeld Corr. WDT). They are therefore plainly less relevant for purposes of calculating a market average. *Id.*

g. *Adjustment for 2016-2020 period*

397. After calculating the revenue-weighted average of the agreements' adjusted minimum per play rates – [redacted] – Prof. Rubinfeld made a final adjustment to account for the fact that the rates will not go into effect until 2016 and will remain in effect through 2020. Hr'g Ex. SX-17 ¶ 137 (Rubinfeld Corr. WDT). Based on (i) the ever-increasing convergence in the retail prices of statutory and non-statutory services, (ii) the rate escalation in the iHeart-Warner agreement, and (iii) the escalation approved by the Judges in Web III, Prof. Rubinfeld applied a modest annual escalation of $0.00008 per year. *Id.* ¶¶ 138-141.

398. Such an adjustment is conservative in a streaming market that is rapidly changing. Hr'g Ex. SX-17 ¶ 138 (Rubinfeld Corr. WDT); Hr'g Tr. 2736:8-16 (May 8, 2015) (Shapiro) (Q. "[W]e might have a whole new industry by the time you get back [in a few weeks]." A. "I'm with you."). Agreements negotiated in the market cover far shorter periods than the statutory license's five-year term and, even so, often contain escalating rates. [redacted]. In a hypothetical negotiation, a rational record company would negotiate annual rate increases to protect itself against the risk of what might occur over a five-year term.

399. After making the foregoing calculations and adjustments, Prof. Rubinfeld derived benchmark rates as follows:

2016	$0.0025
2017	$0.0026

2018	$0.0027
2019	$0.0028
2020	$0.0029

Hr'g Ex SX-17 ¶ 228 (Rubinfeld Corr. WDT); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

5. The Services' Critique of the Interactivity Adjustment Is Misplaced

a. *Subscription Price Ratio*

400. The Services' claim that comparing subscription prices for interactive and non-interactive services does not accurately measure the value of interactivity is incorrect. A comparison of interactive and non-interactive subscription prices is the most accurate and reliable way to isolate and measure the value of interactivity. It is an apples-to-apples comparison, is the cleanest path to isolating the value of interactivity, and provides a proper basis for the interactivity adjustment. *See* Hr'g Ex. SX-29 ¶ 171 (Rubinfeld Corr. WRT); Hr'g Tr. 6307:2-6308:6 (May 28, 2015) (Rubinfeld).

401. Other methods of attempting to isolate interactivity are inaccurate and improper. For example, if one were to compare average revenues per user (ARPUs) for subscription services (i.e., monthly subscription prices) to ARPUs for ad-supported services, that would mix apples-and-oranges, as differences in business models could mask or distort the value of interactivity. Hr'g Ex. SX-29 ¶ 171 (Rubinfeld Corr. WRT); Hr'g Tr. 6307:2-6308:6 (May 28, 2015) (Rubinfeld). Whereas monthly subscription prices are largely constrained by market forces, and are less sensitive to advertising and/or content strategies, ARPUs for ad-supported businesses may be largely dictated by strategies that determine the frequency and intrusiveness of ads as well as other policies (e.g., daily skip limits or listening limits).

402. Likewise improper is a comparison of profitability, as Prof. Katz attempts with his proposed interactivity adjustment of 7.9 based on a comparison of interactive and non-interactive

services' profits per stream. As Prof. Katz testified, central to his model was the assumption that the cost per play is the same for interactive services as it is for non-interactive services. *See* Hr'g Tr. 3101:1-7 (May 12, 2015). This assumption was premised upon Pandora's non-licensing overall costs being 7.5 times greater than those of all of the interactive services combined, such that Pandora's costs are equivalent to those of each interactive service on a per-play basis. *See* Hr'g Tr. 3101:14-17 (May 12, 2015).

403. Prof. Katz did not examine any particular costs of an interactive service like Spotify to support his assumptions. *See, e.g.*, Hr'g Tr. 3110:1-5 (May 12, 2015) ("But you didn't look into how much Spotify has spent on its algorithm during that 12-month period, correct? A. No, I did look into it. I didn't find data."). He acknowledged to the Judges that such an approach was "speculative." *Id*. at 3123:5-14 ("[Judge Strickler:] So my question is: If you don't have -- if you can't make that allocation, how can we rely on Table 6 with regard to the interactive costs if we have no way of -- you just made an assumption about cost and they were equal, but then you said, but Spotify, we just don't know, so I am just assuming costs are equal to noninteractive. That at first blush sounds kind of speculative. THE WITNESS: I will accept your characterization of that."). Moreover, he acknowledged that a service's profitability on a per-play basis, and in turn its revenues and costs on a per-play basis, could reflect the fact that services like Pandora may not be trying to maximize profits in the short-term, but rather are focused on growing their user base. *See id.* at 3126:3-25. This renders relying on per-play profitability unreliable, because again, it may reflect individual business decisions and strategies rather than the market value of interactivity.[9]

[9] Focusing on profitability also raises the possibility that streaming services would have a disincentive to control costs, because they know that if their costs are higher – and thus profits (footnote continued)

404. It is proper to assume that the ratio between subscription prices and royalty rates for interactive services would be the same as the ratio between subscription prices and royalty rates for non-interactive services. This is because (1) music is the key input for both interactive and non-interactive services; (2) there's very little substitutability in terms of that input (e.g., streaming services cannot start selling used cars instead of streamed music); and (3) the downstream elasticity of demands are relatively similar for both interactive and noninteractive services. *See* Hr'g Tr. 6308:7-6311:7 (May 28, 2015) (Rubinfeld). Under these conditions, it is reasonable and proper to assume that the ratio between subscription prices and royalty rates for interactive services would be the same as the ratio between subscription prices and royalty rates for non-interactive services. *See* Hr'g Tr. 6308:7-6311:7 (May 28, 2015) (Rubinfeld) (discussing Lerner equation); *see also* Hr'g Tr. 6054:4-6055:22; 6057:15-6058:22 (May 27, 2015) (Talley) (because downstream consumer streaming market "exhibit these types of high price elasticities," one "would expect those elasticities, in fact, to be passed up to the demand for the input" and noting a "very strong tie between the downstream market and the upstream market").

405. Prof. Shapiro himself acknowledges the relationship between subscription prices in the downstream market and royalties paid in the upstream market. *See* Hr'g Tr. 2625:8-14 (May 8, 2015) (Shapiro) (noting that interactive services licensing market "feeds into the downstream market because Spotify and Rhapsody pay these royalties, and that affects their cost

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are lower – the interactivity adjustment could be higher, and thus the royalty rate lower. *See* Hr'g Tr. 2861:14-22 (May 11, 2015) (Katz) ("Q: Professor, if we were to focus on profits over revenues in that regard, and, therefore, we'd be looking at nonlicensing costs, doesn't that create a disincentive for services to control their costs, knowing that if their costs are higher, that as a consequence, the royalty rate would be lower? A: So I want to be careful about how I'm using one of the things.").

structure. And then they, of course, then, compete downstream through their services and their subscription rates for listeners.").

406. The data itself also reveals a very strong correlation between consumer subscription prices and licensing rates. Although various interactive services are offered at a variety of subscription prices in the marketplaces, the royalties paid represent a nearly constant percentage of those services' subscription revenues. *See* Hr'g Ex. SX-29 ¶ 172 (Rubinfeld Corr. WRT), Hr'g Ex. SX-143 (Rubinfeld Corr. WRT Ex. 15); Hr'g Tr. 1870:17-1871:11; 1875:18-1876:13 (May 5, 2015) (Rubinfeld) [redacted]).

407. A comparison of interactive and non-interactive subscription prices is the most accurate and reliable way to isolate and measure the value of interactivity. The comparison of subscription rates is an apples-to-apples comparison, is the cleanest path to isolating the value of interactivity, and provides a proper basis to measure the interactivity adjustment. *See* Hr'g Ex. SX-29 ¶ 171 (Rubinfeld Corr. WRT); Hr'g Tr. 6307:2-6308:6 (May 28, 2015) (Rubinfeld).[10]

408. To address the issue of ad-supported services, Prof. Rubinfeld also analyzed and compared the ARPU of ad-supported interactive and ad-supported non-interactive services. *See*

[10] In the four months between the submission of Prof. Rubinfeld's written direct testimony and the submission of his written rebuttal testimony, the distance between the subscription prices for interactive and non-interactive services had already narrowed. Hr'g Ex. SX-29 ¶ 251 (Rubinfeld Corr. WRT); Hr'g Ex. SX-146 (Rubinfeld Corr. WRT Ex. 18). While this updated data would support a smaller interactivity adjustment of 1.8, to be conservative Prof. Rubinfeld made no upward adjustments to his benchmark calculation. *Id.*

Hr'g Ex. SX-29 ¶¶ 164-69 (Rubinfeld Corr. WRT), Hr'g Ex. SX-142 (Rubinfeld Corr. WRT Exs. 14A, 14B). As Prof. Rubinfeld notes, differences in these ARPUs may reflect differences in business models of the services and not differences that are solely reflective of the value of interactivity. *Id*. ¶ 165.

409. The ARPU ratio for Spotify and Pandora for their ad-supported services for the period running from the third quarter of 2011 to the third quarter of 2014 is [ ]. Hr'g Ex. SX-29 (Rubinfeld Corr. WRT) ¶ 165, Hr'g Ex. SX-142 (Rubinfeld Corr. WRT Exs. 14A, 14B). For the third quarter of 2013 to the second quarter of 2014 – the period used in the calculations leading to SoundExchange's rate proposal – the ratio [ ]. *Id*. If one were to use this 2.0 factor to adjust rates from paid offerings only, and separately used [ ] to adjust rates from free offerings, the resulting weighted average benchmark rates would exceed the rates that SoundExchange proposed. *Id*.

410. The adjustment of 2.0 also is consistent with the ongoing convergence between interactive and non-interactive services, which would justify a smaller interactivity adjustment than used in the *Web II* or *Web III* proceedings. *See* Hr'g Ex. SX-29 ¶ 174 (Rubinfeld Corr. WRT).

b. *Conjoint Survey*

411. The Services also have levied a number of groundless attacks on Prof. McFadden's survey.

412. During the cross-examination of Prof. McFadden, the Services attempted to fault Prof. McFadden for purportedly not including all relevant feature attributes in his survey. The Services focused on two attributes in particular (1) high audio quality, and (2) social networking functionality. Hr'g Tr. 916:8-941:5 (Apr. 29, 2015) (McFadden). As Prof. McFadden testified, there "is a trade-off in these studies between having extremely detailed lists of specifications and

having somewhat arrogate or generic descriptions of specifications. There's a problem with presenting people with too much of a flood of specifications. That's a standard problem in market research and one where there are essentially standard recipes which say you cannot have too many different attributes." *Id.* at 914:4-13. Accordingly, attempting to include every potentially relevant feature of a streaming service could have undermined the accuracy and reliability of the survey itself. *Id*.

413. But moreover, excluding these features, if anything, made the survey more conservative. If these features had been included, this would have only decreased, not increased, the resulting interactivity adjustment. That is because high audio quality and social networking functionality are features of *both* interactive and non-interactive streaming services. If one adds a value to both sides of a ratio, that makes the resulting ratio smaller (e.g., 8/4 =2; 10/6=1.67).

414. As Mr. Fleming-Wood testified at the hearing, "premium audio quality," at 192 kilobits per second (kbps) is offered through Pandora One, a non-interactive subscription service. Hr'g Tr. 6192:1-6 (May 27, 2015) (Fleming-Wood). Audio quality with a minimum of 192 kbps or higher is also offered through several non-interactive services or service tiers in addition to Pandora, such as Apple (256 kbps), and Rdio (192 kpbs). (Hr's Ex. IHM 3646 at 2 (*Time Magazine*, "13 Streaming Music Services Compared by Price, Quality, Catalog Size and More," March 19, 2014, relied upon by Prof. McFadden's team). Moreover, several interactive subscription services have comparable audio quality, such as Rhapsody (192 kpbs) and Xbox Music (192 kpbs). *Id.*[11]

[11] Offering multiple tiers of audio quality attributes would have potentially been even more overwhelming for respondents, such as 128 kbps (Slacker), 192 kpbs (Pandora, Rdio, Xbox Music, and Rhapsody), and 256 kbps (Apple), and 320 kbps (Spotify, Beats, Google). Hr'g Ex. IHM 3646 at 2. And because interactive services and non-interactive services share the same (footnote continued)

415. Similarly, both non-interactive and interactive services offer social networking functionality. As Pandora's marketing video states, "Because music is often a shared experience, Pandora listeners can share their stations with others. For example, listeners can click the Options button and make their stations visible to other listeners, find other listeners who like the same music, or associate their Pandora account with their Facebook account and share things such as what station they are listening to or what song they thumbed up." Hr'g Tr. 6129:23-6130:6 (May 27, 2015) (Fleming Wood). Similarly, Spotify also offers social networking integration in its product. *See* Hr'g Ex. IHM 3645 at 4 (Spotify "offers tight integration with Facebook"). Again, this is an example in which the missing attribute would be added to both sides of the ratio, thereby *decreasing* the resulting discount factor.

416. The Services also rely on a "qualitative" survey conducted by Prof. Hauser that purportedly demonstrates that respondents to Prof. McFadden's survey misunderstood the incentive alignment of the survey and the various feature descriptions of the streaming services.

417. Prof. Hauser's qualitative survey, however, does not undermine the accuracy or reliability of Prof. McFadden's conjoint survey.

418. First, as Prof. Hauser acknowledged, a conjoint survey is supposed to replicate real-world decision-making. *See* Hr'g Tr. 5592:1-5 (May 22, 2015) (Hauser) ("Professor Hauser, you agree, don't you, that conjoints are supposed to replicate real world decision-making; is that right? A. Yes, that's the goal."). The feature descriptions used by Prof. McFadden's survey that Prof. Hauser's survey purportedly found confusing are the precise terms used in the real world by streaming services. *Id.* at 5592:6-5599:7. And as Prof. Hauser

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levels of audio quality across the spectrum, it would have been impossible to break out levels of audio quality falling within the interactive vs. non-interactive bucket.

acknowledged, consumers in the real world have various levels of expertise with respect to the features of streaming services at the time of purchase. *Id*. at 5598:18-22 ("Q. And you agree, don't you, that in the real world consumers have different levels of expertise with respect to specific features of streaming services at the time of purchase? A. Oh, I absolutely agree.").

419. Prof. Hauser's survey thus demanded a higher level of feature comprehension than consumers have in the real world, belying the fundamental purpose of the conjoint survey, which is to replicate real-world decision making. As Prof. McFadden explained, "descriptions of features that we use are, as I described earlier, distilled from websites of the vendors of streaming services and from Internet comparisons of streaming services. The language here is -- and the definitions are apparently relatively standard among the people who are consumers of these services. So I think there is a content validity to these descriptions quite independently of whether a person drawn into a survey would, when asked do they understand this language, expressed some difficulties with it." Hr'g Tr. 903:5-18 (Apr. 29, 2015) (McFadden).

420. Prof. Hauser's survey also is not probative of respondents' understanding of the features of the survey, because it was simply a memory test which asked respondents to repeat what they had seen on a previous screen. As Prof. Hauser acknowledged, respondents were not presented with the language describing the incentive alignment or features when they were asked by his questioners to describe their understanding of them. *See* Hr'g Tr. 5600:16-21 (May 22, 2015) ("My question was: At the time they are asked, what is their understanding of incentive alignment? They are not, at that point, looking at the screen which defines incentive alignment; is that right? A. Exactly."). The inability of a respondent to articulate back a precise understanding of what he or she previously read, however, does not mean that they do not sufficiently understand the feature for purposes of placing a willingness-to-pay value on it, as

Prof. McFadden explained. *See* Hr'g Tr. 903:19-904:5 (Apr. 29, 2015) (McFadden) ("So I think, depending on how a question about do you understand something is asked, you can often have people say that, well, yes, I have a problem understanding in a situation where, in fact, in terms of actually making a decision on the basis of it, they don't have a problem with it at all. So I think one response that I have is that it's speculation that the rate of people who say they don't understand the verbal wording of the question would suggest that that translates into some kind of direct bias or error in people's responses."); Hr'g Ex. SX-2368 at 4-5 (McFadden Supp. WRT) ("Professor Hauser requires his subjects to engage in a memory test—to recall from memory or experience and verbalize definitions judged to be correct by Prof. Hauser's coders for each of the product features that I use in my survey. This cognitive task is quite different from the cognitive task of evaluating product profiles, where the reliability of a survey simply requires that participants perform this task in a survey experiment similarly to the way they would in a real market.").

421. And in the context of consumer confusion, courts repeatedly have rejected these sorts of "memory tests" as flawed and not probative on the question of confusion. *See, e.g.*, *Starter Corp. v. Converse, Inc*. 170 F.3d 286, 297 (2d Cir.1999) (affirming exclusion of survey that "was little more than a memory test, testing the ability of the participants to remember the names of the shoes they had just been shown and gave no indication of whether there was a likelihood of confusion"); *Instant Media, Inc. v. Microsoft Corp*., 2007 WL 2318948, at *15 (N.D. Cal. Aug. 13, 2007) ("Microsoft's survey is little more than a 'memory test,' measuring how many respondents who had just read the source indicators 'Instant Media' and 'I'M' on a website could accurately recall them. Such a survey is useless in the Court's analysis in likelihood of confusion.").

422. Moreover, Prof. Hauser's requirement of a precise understanding of exactly how the incentive alignment in the survey operated demanded a higher-level of comprehension than

what incentive alignments are intended to accomplish. As Prof. Hauser testified, the "goal of incentive alignment comprises three components: the respondents believe (1) it is in their best interests to think hard and tell the truth; (2) it is, as much as feasible, in their best interests to do so; and (3) there is no way, that is obvious to the respondents, they can improve their welfare by 'cheating.'" Hr'g Ex. SX-IHM 3124 ¶ 19 (Hauser WRT). That does not require people to understand the precise mechanics of how an incentive alignment operates, as Prof. McFadden has explained. *See* Hr'g Tr. 905:17-906:7 (Apr. 29, 2015) (McFadden) (incentive alignment "simply asks people to be careful and accurate in their responses" and example of how incentive alignment worked, that Hauser found confusion in, was "essentially an example which showed them it was in their economic interest to be truthful in their responses"); Hr'g Ex. SX-2368 at 3 (McFadden Supp. WRT) ("In other words, the real value of an incentive alignment mechanism is to focus participants on responding as they would in a real market. Even if comprehension isn't perfect, focusing the participants' minds on market choices using incentive alignment improves the accuracy of the responses.").

423. Finally, Prof. Hauser did not report to the Judges survey answers by respondents which demonstrate a high level of respondent understanding to the survey.[12] Amongst other questions, Prof. Hauser does not discuss one of his "close out" questions, which asks participants, "did you or did not understand the explanations of features in the survey?" Prof. McFadden has reviewed his classifications of the participants, and he records 84.9% of

[12] It appears that Prof. Hauser's recollection of which questions he did and did not code may be incorrect. Prof. Hauser testified that they coded 1-36 and beyond that, "We ran out of time in coding. That's all." Hr'g Tr. 5635:7-8 (May 22, 2015) (Hauser). A further review of his backup shows that, at least for video coding, Prof. Hauser did not go in sequential order. He did not code questions 10, 14, 23, 29, 32, or 33, all of which went to the level of understanding of the survey and respondents' decision-making process.

participants self-reporting that they understood the features discussed in the choice sets, while 11.3% report not understanding all the features, and 3.8% give answers that are ambiguous." Hr'g Ex. SX-2368 at 4 (McFadden Supp. WRT). As Prof. McFadden explains, this "question gives insight into whether the participants themselves believed that they understood the features sufficiently to choose among the options," and that a "participant may not fully understand every feature, but may understand enough to weigh the choices, especially when the uncertain features are not relevant to his decision making." *Id*. at 4-5. Unlike Prof. Hauser's "memory test" approach, this question demonstrates "that the participants generally believed that they had sufficient information and understanding to choose their preferred plans from among those presented." *Id*. at 5.

424. Similarly, Prof. Hauser did not report to the Judges the responses to Question 34, which asked his respondents, "if you were presented with these options and had to spend your own money, would you choose the same options?" in which he finds that 83% of respondents say that they would make the same choices, 13.2% state that they would make different choices, and 3.8% of the responses are ambiguous. Hr'g Ex. SX-2368 at 2 (McFadden Supp. WRT). As Prof. McFadden explains, the "responses to [this question] indicate that the incentive alignment in my survey was robust and effective. The essential feature of incentive alignment in conjoint surveys is to induce truthful responses," and "there is substantial evidence that response quality is not degraded so long as respondents respond to instructions to pay attention and choose as they would in a real market, even if they do not understand specifically how the incentive alignment operates." *Id*. at 3.

C. SoundExchange's Proposed Percentage of Revenue Prong Is Reasonable And Appropriate

1. A 55% Revenue Share Is Supported By Market Data

425. Prof. Rubinfeld derived his proposal for the percentage-of-revenue branch by surveying the minimum revenue shares contained in his interactive benchmark agreements. Hr'g Ex. SX-17 ¶ 206 (Rubinfeld Corr. WDT); Hr'g Ex. SX-63, App. 1a (Rubinfeld Corr. WDT App. 1a). The revenue share in the agreements with these 13 services ranged between 50 percent and 60 percent of the services' revenues, with the majority falling between 55 percent and 60 percent. Based on this range, he proposed a minimum revenue share of 55%. *Id.*

426. In addition, a number of non-interactive services and/or non-subscription services have percentages of revenue prongs that are within the range of what SoundExchange has proposed.

427. Rhapsody's agreements with Universal, Warner, and Sony for its unRadio service, which does not have on-demand functionality, [ ] For Universal, [ ] (Hr'g Ex. IHM 3476 at 2 (Universal-Rhapsody Term Sheet, April 18, 2014)); for Warner, [;] (Hr'g Ex. SX-100, at Exhibit A, SNDEX 0049495 (Warner-Rhapsody, Letter Agreement, April 21, 2014)), and for Sony] (Hr'g Ex. SX-80 AGMT-000195-196; AGMT 000241-244 (Sony-Rhapsody, Content Integration Agreement, April 1, 2014)).

428. The agreements between Universal, Sony, and Warner with Nokia for its MixRadio streaming service, which does not have on-demand functionality, . Hr'g Ex. SX-17 ¶ 90

(Rubinfeld Corr. WDT); Hr'g Ex. SX-80 [redacted]; Hr'g Ex. SX-87 [redacted]; Hr'g Ex. SX-100 [redacted]

429. Rdio's free radio service [redacted]

430. Other non-interactive services have percentages of revenue which are slightly below 55%, but far higher than 2.0 adjustment applied to the 55% prong. [redacted] Hr'g Ex. SX-2070 at section 1(b), p. 1 (Apple-Warner Agreement); Hr'g Ex. SX-2071 at section 1(d), p. 2 (Apple-Sony Agreement). [redacted] Hr'g Ex. SX-33 at section 3(b)(2), pp. 15-16.

2. SoundExchange's Proposed Definition of Revenue Is Workable and Appropriate

431. SoundExchange's proposed broad definition of "Attributable Revenue" is reasonable and supported by the evidence in the record. Prof. Lys reviewed 62 voluntary agreements between record labels and webcasters and determined that most (77%) of these agreements contain a "broad 'catch all' term that is designed to capture all the various types of income that could be earned by a service." Hr'g Ex. SX-14 ¶¶ 26, 27 (Lys WDT). Prof. Lys also explained that a "broad" definition of revenue is one way to "mitigate the risk" of a

percentage-of-revenue royalty. Hr'g Tr. 1460:5-17 (May 4, 2015) (Lys). In particular, a "broad" definition reduces the ability of a webcaster to "reshuffl[e] [its] revenues across buckets." *Id.*

432. Ron Wilcox testified that WMG's agreements [redacted] Hr'g Ex. SX-22 at 13 (Wilcox WDT). As with SoundExchange's rate proposal, WMG's agreements [redacted] *Id.* Mr. Wilcox explained that [redacted] *Id.*

433. The definition of revenue in the Pandora – Merlin agreement is consistent with SoundExchange's proposal and is, in some respects, [redacted] than SoundExchange's definition of revenue. Under the Pandora – Merlin agreement, [redacted] Hr'g Ex. PAN 5014 ¶ 1(n) (emphasis added). ["[redacted] *Id.* [redacted] *Id.* at § 1(o).

434. In its Proposed Rates and Terms, Pandora inexplicably narrows its definition of revenue to include only subscription revenue and advertising revenue. Pandora's Proposed Rates and Terms at 4. Pandora does not provide any basis for offering a definition of revenue that is

narrower than the definition in its own benchmark agreement. And Pandora's narrow definition of revenue is inconsistent with the broad definition of revenue in the majority of the agreements analyzed by Prof. Lys. Hr'g Ex. SX-14 ¶¶ 26, 27 (Lys WDT).

435. SoundExchange's proposal that webcasters use a fair method of allocation to allocate revenues among components of a bundled product is reasonable and supported by the evidence. Prof. Lys testified that it is common for companies to allocate revenues across multiple elements of a sale. Hr'g Tr. 1492:1-9 (May 4, 2015) (Lys). According to Prof. Lys, accountants are "trained to do this" and there are accounting standards that guide accountants in performing such allocations. *Id.*

436. Unlike SoundExchange's proposal, Pandora's rate proposal does not describe any approach or framework for allocating revenues among components of a bundled product. *See* Pandora's Proposed Rates and Terms at 4. For instance, Pandora's rate proposal does not address how to allocate subscription revenues if a webcaster were to bundle a non-music service and a webcasting service for a single subscription fee.

437. Prof. Roman Weil's testimony is not inconsistent with SoundExchange's proposal of a fair method of allocation. Prof. Weil testified that there is no "*uniquely correct* way to allocate revenues among business activities." Hr'g. Ex. NAB 4011 at 4 (Weil WRT) (emphasis added). Prof. Weil admitted, however, that by use of the phrase "uniquely correct" he meant that there are many approaches to allocation, but no reason to pick one over the other. Hr'g Tr. 3954:18-21 (May 14, 2015) (Weil). And Prof. Weil also admitted that accountants are "often" called upon to allocate revenues between business activities and that there are accounting principles that guide such allocations. Hr'g Tr. 3955:3-8 (May 14, 2015) (Weil).

438. SoundExchange's proposal does not require a webcaster to select a "uniquely correct" method of allocation. Instead, SoundExchange's proposal requires only that the method of allocation be a "reasonable method, employed in good faith." Proposed Rates and Terms at 6.

439. Similarly, Prof. Weil testified that any attempt to allocate revenues would be "arbitrary." Hr'g. Ex. NAB 4011 at 8 (Weil WRT). But he admitted that the word "arbitrary" in this context does not mean that allocation of revenue is "random or capricious." Hr'g Tr. 3961:21 – 3962:8 (May 14, 2015) (Weil) Rather, allocation is "a matter of discretion." *Id.* SoundExchange's rate proposal does not preclude such discretion.

3. Applying An Interactivity Adjustment To the Percentage of Revenue Prong Would Be Inappropriate

440. It would be inappropriate to apply a 2.0 adjustment to SoundExchange's proposed percentage of revenue prong of 55%. First, applying the adjustment to the percentage of revenue prong would be a form of double counting since non-interactive service revenues are already discounted by the differences in market prices between interactive and non-interactive subscription services. *See* Hr'g Ex. SX-17 ¶ 211 (Rubinfeld Corr. WDT); *see also* Hr'g Tr. 1814:8-13 (May 5, 2015) (Rubinfeld) ("I would be double counting, because the percentage of revenue is reflecting the intensity of use"); *id*. at 1818:12-24 (noting that applying ration of 2:1 to percentage of revenue "would not be appropriate"). Since non-interactive services generate less revenue than interactive services per user– indeed, at approximately a 2:1 basis with respect to subscription prices, which is the foundation of the interactivity adjustment to begin with – applying the same percentage already results in a lower royalty payment for them; discounting that percentage again would be double counting. *Id*. at 1819: 3-25 (going through example percentages and discounts to demonstrate double counting phenomenon and noting that 2:1 adjustment is "clearly inappropriate").

441. And as noted, Section VII.A.1, *supra*, several non-interactive service agreements have percentage of revenue prongs that are close to SoundExchange's rate proposal, and are nowhere close to a 2.0 adjustment to the 55% prong.

D. The Services' "Effective" Or "Workable" Competition Criticisms Are Misplaced

442. As discussed above and in SoundExchange's Conclusions of Law, the willing buyer / willing seller standard as adopted by Congress does not impose any "effective" or "workable" competition requirement.

443. To the extent there is such a standard, however, it is readily satisfied in the context of the interactive services agreements, as there is more than sufficient evidence in the record demonstrating that (a) competitive forces from the downstream consumer market are determining price in the upstream licensing market, and (b) the services have bargaining power in their negotiations with the record labels and the labels are not dictating price. *See Web III Remand*, 79 Fed. Reg. 23102, 2314 n.37 (focusing on whether "evidence demonstrates that sufficient competitive factors existed to permit" agreements "to serve as useful benchmarks, and does not demonstrate that the rates in" agreements "approximated monopoly rates"); *Web III*, 76 Fed. Reg. 13026, 13028 (focusing on whether party "exercise[d] such monopoly power as to establish them as price-makers" thereby "mak[ing] negotiations between the parties superfluous.").

1. The Licensing Rates in the Interactive Market are Constrained by Substantial Downstream Competition

444. The evidence has shown as both a matter of economic theory and fact that significant competitive forces in the downstream consumer market have determined the prices charged in the upstream royalty market. These forces render the interactive benchmark sufficiently "competitive" under any reasonable standard the Judges could impose.

a. ***Economic Theory: Downstream Competition In the Interactive Streaming Market Mitigates Any Market Power In The Upstream Licensing Market***

445. As Prof. Shapiro previously has written, "In all industries, *a major factor in mitigating the exercise of market power*, particularly during periods of high demand, is the price responsiveness of final demand," and "[t]he *willingness of demanders not to consume if market prices are too high provides a fundamental incentive for suppliers to bid closer to their marginal costs*. Suppliers facing a price response of final demand that bid significantly above their true willingness to supply, risks being left out of the, market." Hr'g Tr. 5047:11-5048:3 (May 20, 2015) (Shapiro) (emphasis added); *see also id*. at 5048:18-19 ("Well, look, I stand by it. Don't get me wrong. I stand by it.").

446. In determining the extent to which the downstream market's price sensitivity may be passed upstream to the demand for an input like content licenses, the "key two factors" are first, an "elastic downstream demand curve," and second, the significance of the "expenditure on that input versus other inputs," i.e., "the cost intensity of that particular input that we're interested in." Hr'g Tr. 6054:23-6054:7 (May 27, 2015) (Talley) (describing these factors in the context of the "Hicks-Marshall" formula).

447. Those factors are present here, given that (1) there are "certain types of alternatives at the downstream level, like the cost of threat of piracy or other outlets, YouTube, for example," that "give rise to high price elasticity"; and (2) the "variable costs associated with licenses is, in fact, a very significant cost share of the cost of the services," and thus those "elasticities" would "be passed up to the demand for the input as opposed to less cost intensive inputs." Hr'g Tr. 6054:3-6058:2 (May 27, 2015) (Talley); *see also id.* at 6058:3-22 ("[T]o the extent that the conditions are there, and I think they are, for high elasticity downstream markets

to have that elasticity passed up to the licensing market as a significant cost share, I see a very strong tie between the downstream market and the upstream market").

448. Prof. Talley specifically modeled how competition in the downstream consumer market can discipline and constrain the range of negotiated prices in the upstream market. *See* Hr'g Ex. SX-19 at 44-45 & Figure III. As Prof. Talley concluded, the "presence of downstream competition in the consumer market from free or low-cost alternatives (such as other lower-priced competing subscription services, piracy, YouTube, and the like), will cause the WBWS price to be tightly clustered, reducing variations due to differences in bargaining power. *Id*. at p. 35; *id*. at pp. 44-45; *see also* Hr'g Tr. 6053:13-19 (May 27, 2015) (Talley) (describing modeling and noting that the "price distributions that emerged both went down. They shifted downward. And they also became more compressed" which is "symptomatic" of "a more elastic demand curve."). Thus, "even in circumstances where the seller has considerable bargaining power, the downstream consumer market will discipline and constrain the range of prices that the parties would agree to in licensing agreements. Negotiated rates will reflect such competition, with only modest price variations due to differences in bargaining." *See* Hr'g Ex. SX-19 at 44-45 & Figure III; *see also* Hr'g Ex. SX-29 ¶ 132 (Rubinfeld Corr. WRT).

b. *Economic Facts*

449. The following two critical economic facts are undisputed by the Services and their experts: first, that the downstream interactive services consumer market is highly competitive, reflecting high cross elasticity of demand; and second, that prices in the upstream licensing market have been constrained and reduced by this downstream competition.

(i) The Downstream Market is Highly Competitive and Reflects High Cross Elasticity of Demand

450. The interactive streaming consumer market has proven to be highly competitive over the years, with the entry of a number of new major participants – including Spotify, Google, Beats, and Apple – and a fall in retail prices for interactive services. *See* Hr'g Ex. SX-29 ¶ 131 (Rubinfeld Corr. WRT). Interactive streaming service subscription prices have dramatically fallen over time, from an average of $13.50 per month at the time of *Web III* (*Web III Remand*, 79 FR 23117, n.46) to $9.99 – and in some cases, less – today. *See* Hr'g Ex. SX-29 ¶ 131 (Rubinfeld Corr. WRT); Hr'g Ex. SX-143 (Rubinfeld Corr. WRT Ex. 15); Hr'g Ex. SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-45 (Rubinfeld Corr. WDT Ex. 5).

451. The competition and the price constraints in the interactive streaming consumer market are the result of a number of free and low-priced competitive alternatives that interactive streaming services face, including piracy, YouTube, and free ad-supported, non-interactive services like Pandora, which as discussed, directly compete with interactive services like Spotify. *See supra* Section V.C; Hr'g Ex. SX-29 ¶¶ 133-136 (Rubinfeld Corr. WRT), Hr'g Ex. SX-19 at 19-20 (Talley, WRT).

452. As Spotify's CEO Daniel Ek has stated, the "'hardest thing about selling a music subscription is that most of our competition comes from the tons of free music available just about everywhere. . . . Here's the overwhelming, undeniable inescapable bottom line: the vast majority of music listening is unpaid. If we want to drive people to pay for music, we have to compete with free to get their attention in the first place.'" Hr'g Ex. SX-29 ¶ 136 (Rubinfeld Corr. WRT) (quoting Daniel Ek, I'm Spotify CEO Daniel Ek. And These Are the Facts, Digital Music News (November 11, 2014) http://www.digitalmusicnews.com/permalink/2014/11/11/im-spotify-ceo-daniel-ek-facts). Prof. Shapiro agreed that there "is a meaningful degree of

competition between pirate services and legitimate interactive services." Hr'g at 5049:10-25 (May 20, 2015) (Shapiro).

453. The Services rely heavily on statements made by UMG and Prof. Rubinfeld in their submissions to the FTC regarding the "must have" nature of the major labels' catalogs. In doing so, however, the Services selectively ignore other statements made by UMG and Prof. Rubinfeld regarding the nature of competition within the streaming services market, how such competition affected and reduced price within the upstream licensing market, and how the acquisition would not lessen competition within that market – all of which served as the building blocks to the FTC's ultimate decision not to block the acquisition.[13]

454. For example, Prof. Rubinfeld gave a presentation to the FTC staff on May 10, 2012. *See* Hr'g Ex. NAB 4129. In that presentation, Prof. Rubinfeld had a section [

[13] Notwithstanding that the FTC concluded that in the interactive streaming space, "the music is more complementary than substitutable in this context, leading to limited direct competition between Universal and EMI," and that a focus of its investigation was the "impact of the acquisition on the development of interactive music streaming services," and whether "Universal would have enhanced bargaining leverage after the acquisition, allowing it to extract from streaming services superior financial terms, or advantaged positioning for its content," the FTC approved the transaction, and has not instigated any subsequent investigation into any record label relating to its "must have" status for streaming services. Statement of Bureau of Competition Director Richard A. Feinstein In the Matter of Vivendi, S.A. and EMI Recorded Music September 21, 2012. The FTC further noted in its statement closing its investigation of the acquisition of EMI by UMG, that it "did not find sufficient evidence to support the concern that Universal's acquisition of EMI would significantly increase the potential for coordination among recorded music companies" and emphasized "competitors' ability to monitor each other or respond to competitive activity." *Id*.

[redacted] Hr'g Tr. 1842:4-12 (May 5, 2015) (Rubinfeld).

455. Prof. Rubinfeld also had a section of his FTC presentation entitled [redacted] *Id.*; *see also* Hr'g Tr. 1842:13-1845:15 (May 5, 2015) (Rubinfeld).

456. Prof. Rubinfeld testified at the hearing that he included [redacted]

[redacted][14]

457. As Prof. Rubinfeld testified, through [redacted]

[redacted]

Hr'g Tr. 1842:21-1843:20 (May 5, 2015) (Rubinfeld).

458. The presentation further noted that [redacted]

[redacted]

Hr'g Ex. NAB 4129 at 42; *see also* Hr'g Tr. 1854:9-15 (Rubinfeld) (May 5, 2015).

(ii) Prices in the Upstream Licensing Market Have Been Constrained and Reduced By Downstream Competition

[14] Further, the competitive threat from pirated music for interactive streaming services is likely to strengthen, not dissipate, over time. *See* Hr'g Ex. SX-24 ¶¶ 58-61 (Blackburn WRT). For example, the group of music consumers aged 35 or less comprise 44 percent of music buyers, yet they constitute a larger share of those who make use of pirated services. *Id*. Indeed, approximately 75 percent of those whose use p2p downloading services, locker downloaders and stream ripping technologies are 35 or younger. *Id*. Further, the competitive threat that pirated content represents is even more pronounced because many individuals consume both authorized and pirated content, meaning that such consumers can potentially be swung in either direction. *Id*.

459. Substantial evidence submitted in these proceedings demonstrate that downstream competitive forces have in fact constrained and reduced prices in the upstream licensing market, notwithstanding the purported "must have" status of the major labels' catalogs.

460. Prof. Shapiro agreed that there "is a meaningful degree of competition between pirate services and legitimate interactive services," that "competition has affected the price in the upstream licensing market," and that this competition "has caused the record companies to lower their prices to interactive streaming services." Hr'g Tr. 5049:10-25 (May 20, 2015) (Shapiro) (further noting that "I think two episodes where the price came down. The interactive price in the interactive upstream market came down in response to piracy."). As Prof. Shapiro stated in his written rebuttal testimony, the "rates paid by interactive services have been falling as a result of competition from piracy." Hr'g Ex. PAN 5023 ¶ 7 (Shapiro WRT). Prof. Katz also acknowledged that "interactive services face competition downstream from free alternatives like piracy and YouTube and Pandora," and that "these free alternatives push down the price that the record companies can charge to interactive services." Hr'g Tr. 2973:8-19 (May 11, 2015) (Katz) (noting that "they do have some sort of an effect, and I believe it's in a downward direction so, yes, at that level I agree with you.").

461. Second, the various submissions UMG made to the FTC provided specific examples where record labels had [redacted]

[redacted] Hr'g Ex. PAN 5349 at 52.

462. In a separate submission focused on streaming services, UMG stated [redacted]

c. *The Services' Responses to Downstream Competition Are Unavailing And Demonstrate The Unworkable Nature Of Their "Effective"/"Workable" Competition Standard*

463. The Services' response to this substantial evidence that downstream competition has substantially constrained and reduced the prices that record labels can charge streaming services has not been to contest any of it.

464. Instead, the Services first have argued that competition in the downstream market is irrelevant because the rate in the upstream market technically is still a "monopoly" rate, regardless of whether the prices in the upstream market have decreased and been constrained by competitive factors in the downstream market. *See, e.g.*, Hr'g Tr. 2976: 3-15 (May 11, 2015)

(Katz) ("Q. So, for example, it doesn't matter to effective competition in that upstream market whether the downstream consumer demand affects the prices that the record companies can charge to interactive services, correct? A. There would still be the case that there would not be competition upstream, that's correct."); Hr'g Tr. 5049:22-5050:3 (May 20, 2015) (Shapiro) ("The interactive price in the interactive upstream market came down in response to piracy, which I will -- as I have stated, remains a monopoly price but as often happens, a monopoly price moves in response to external factors."); *Id*. at 5054: 4-12 ("The fact that Prof. Rubinfeld's benchmark is based on monopoly rates remains true whether or not there is some degree of competition downstream between the interactive services and the statutory services.").

465. The Services' insistence on describing this as a "monopoly" rate to the exclusion of all other considerations is misplaced. Even assuming that the major labels are effectively "monopolists" because of the complementary nature of their catalogs—wwhich SoundExchange does not agree with—a monopolist facing a highly elastic demand curve, as is the case here, might "technically," in a "very pedantic sense" be a "monopolist," but it is a benign monopolist: (i)"it's not going to able to charge rates" above competitive levels because "downstream end users are going to flee if those rates end up being passed on to them"; (ii) it's "not going to be able to constrain quantity the way that monopolists sometimes do," and (iii) the degree of any "dead weight loss would be actually quite small for a monopolist who is facing a very, very elastic demand." Hr'g Tr. 6049:6-23 (May 27, 2015) (Talley). Indeed, Prof. Katz himself acknowledged that the price that emerges as a result of downstream competition could be the same as the price that emerges through "effective competition," however that phrase is understood. *See* Hr'g Tr. 2977:1-9 (May 11, 2015) (Katz) ("[I]f these other factors were to push the price low enough despite the absence of effective competition, you might have a price that

started looking similar. I mean, it's conceivable, if you're talking about hypotheticals, that you could have a monopoly that faced demand, that only allowed it to charge a very low price. So that's possible."); *see also id.* at 2978:19-22 ("[Y]ou might get prices that nonetheless started being close to what you would see if the market had been effectively competitive").[15]

466. Second, the Services hypothesize that the prices *could have been lower* if there was more direct price competition between labels in the upstream licensing market. *See, e.g.*, Hr'g Tr. 2983:4-23 (May 11, 2015) (Katz) ("piracy has not pushed price so low that" it could not go "lower"). The Services, however, offer no evidence or analysis demonstrating how much, if at all, the rates from the interactive streaming market would have been lower in the presence of what they describe as "effective" or "workable" competition. Indeed, Prof. Katz acknowledged that he has no idea what the rates would be in the interactive service agreements if they *did* purportedly reflect effective competition. *See id.* at 2945:14-17 ("Q. You can't tell us what the rates would have been in those agreements if they did reflect effective competition, correct? A. That's correct."). This is because the "concept of effective competition doesn't give you a

[15] Indeed, Prof. Katz acknowledged that it was at least conceivable that piracy could drive down prices in the interactive space to such an extent that they could be *below* competitive levels. *See* Hr'g Tr. 2982:4-2983:15 (May 11, 2015) ("JUDGE STRICKLER: Professor, if I may, you talked -- in response to Mr. Pomerantz's questions about piracy, you pointed out that price could be driven down to marginal cost because of piracy, but you could still, perhaps, be in a monopoly situation, price suppresses the demand -- piracy -- excuse me -- suppresses the demand curve. Assuming we were in such a situation, does that change the way the rate needs to be set in the sense that now we have a different concern, perhaps a more alarming concern about the ability of the record companies which supply the music to be able to cover their fixed costs and including their normal profits when you've got this outside force, piracy, driving everything down? I'm not taking issue with your point that it might still be a monopoly price, but at that point it might be a benign monopoly price in the sense that it creates a whole new problem, prices are too low, through no fault of the services, through no fault of the record companies, through no fault of those darn pirates. . . . THE WITNESS: So as a logical possibility or as a hypothetical, yes").

precise number by itself," it is a "fuzzier concept," Hr'g Tr. at 5660:16-21 (May 26, 2015) (Katz).

467. The Services' "effective"/"workable" competition argument ultimately collapses upon itself at this point because, as Prof. Katz acknowledged, there is no "bright line that separates an effectively competitive market from a market that is not effectively competitive," Hr'g Tr. 2803:9-12 (May 11,2015) (Katz) ("A. No, I don't believe there is."), and there is a broad spectrum between perfect competition and monopoly that effective competition, whatever it is, lies somewhere within, *id*. at 2949:15-20 ("Q. You agree that there's a spectrum that you've used in your textbooks that has perfect competition on one end and monopoly on the other end, correct? A Yes.").

468. Thus, even if the prices in the upstream licensing market for interactive streaming services could in theory have been lower if there were more direct price competition between labels in the upstream licensing market, the Services have not demonstrated that the existing prices would not have been within the *range* of prices that would have emerged from an "effectively" or "workably" competitive market. For that reason, amongst others, there is simply no basis for the Judges to reject the interactive services benchmark on the basis that they were not derived from "effective" or "workable" competition.

2. The Negotiations Between The Labels And Interactive Streaming Services Demonstrate That The Labels Are Not Price Makers And The Labels Are Not Price Takers

469. The evidence regarding the interactive streaming services' negotiations with the labels makes clear that the labels did not "exercise such monopoly power as to establish them as price-makers" thereby "mak[ing] negotiations between the parties superfluous." *Web III*, 76 Fed. Reg. 13026. These were prolonged, hard-fought negotiations, in which the interactive streaming services demanded and obtained material, preferred terms. As Prof. Katz

acknowledged, he reviewed contracts where Spotify "may have paid a lower percentage than some other companies. It's conceivable that that was in the exercise of bargaining power." Hr'g Tr. 2981:19-2982:3 (May 11, 2015) (Katz).

470. The Services have attempted to downplay such negotiations by claiming that even monopolists will negotiate at times, for example, to uncover another side's willingness to pay. But the type of bargaining that exists here is not simply that of a monopolist attempting to determine another side's willingness to pay values. Rather, such negotiations demonstrate that the services have real bargaining power, and are negotiating and obtaining significant concessions on terms from the record labels. As Prof. Rubinfeld described, the negotiations here are different – they involve "real give and take," where the labels "have in mind a particular goal, but they have to give up something," which is "consistent" with the "view that there's some bargaining power on the part of the services." Hr'g Tr. 1863:7-15 (May 5, 2015) (Rubinfeld). Moreover, such negotiations could not be viewed in any event as revealing the "whole extent of the possible bargaining range"; at best, they would only reveal "something about the other party's willingness to pay or willingness" to sell. *Id*. at 1864:2-1865:8.

471. Warner's negotiations with interactive streaming services are hard fought, take place over many lengthy periods of time, and are not a superfluous exercise in which Warner ultimately dictates the price. Hr'g Ex. SX-32 ¶ 28 (Wilcox WRT). These negotiations have involved services with a range of negotiating power, from "large multifaceted companies that can both make offers and exert pressures beyond the bounds of the particular agreement being negotiated (for example, AT&T, Apple, Google) to smaller startups or companies with a niche product." *Id*.

472. In its negotiations with Warner, for example, [ ]

473. Similarly, in its negotiations with [ ]

474. [ ]

475. Smaller services [ ]

[redacted]. Hr'g Ex. SX-27 at 19-20 (Kooker WRT); Hr'g Ex. SX-79 (Kooker WRT Ex.10).

476. Similarly, [redacted].

477. Likewise, in the [redacted]

478. [redacted]

479. [redacted]

480. Finally, Amazon wielded its bargaining leverage in UMG's failed negotiations with Amazon regarding its Prime music services. UMG did not reach an agreement on economic terms, but the service launched without streaming rights to any of UMG's repertoire. Amazon continues to offer its service without UMG's sound recordings. [redacted] ¶ 27 (Harrison WRT); Hr'g Ex. SX-85.

481. In sum, the major labels' negotiations with the interactive streaming services are real, substantive negotiations, in which the interactive streaming services have exercised their bargaining power to obtain significant concessions on material terms.

3. There Is No Evidence That The Interactive Services Market Is Collusive

482. Nor is there any evidence that the labels in the interactive market have engaged and/or are engaging in "collusion" with one another. *See* Hr'g Ex. SX-29 ¶¶ 119-122 (Rubinfeld Corr. WRT).

483. If the major recording labels were truly negotiating together as a monopoly, then one would expect to observe all licensees paying a "monopoly price" for sound recordings. *See id*. As noted above, an analysis of the contracts shows the contrary. [redacted] *See id.* Hr'g Ex. SX-29 ¶¶ 119-122 (Rubinfeld Corr. WRT); Hr'g Ex. SX-140 (Rubinfeld Corr. WRT Ex. 12a). [redacted] *See id.*

484. This rate dispersion also belies the suggestion made at the hearing by the Services that the major labels were all using MFNs to ensure that they received the same rates as one another. Nor in any event is there anything inherently anti-competitive about MFNs. Hr'g Tr. 1864:21-1865:3 (May 5, 2015) (Rubinfeld) ("[I]n general, we see MFN clauses in a variety of

industries some of which are very competitive, some of which are not. And MFN clauses in some cases can be very procompetitive, and in some cases they can be harmful to competition.").

485. Moreover, the implicit notion in the Services' arguments that the major labels have somehow improperly acquired their market share has absolutely no evidentiary basis in these proceedings. The major labels' acquisition of market share is entirely consistent with releasing a greater share of high-quality artists that the public enjoys listening to, on streaming services and through other means. *See* H'rg Ex. SX-269 at 74 ([ ]) ([ ]); Hr'g Tr. 6050:16-22 (May 27, 2015)(Talley) ("[C]ompanies that make very, very high-quality services or products may end up gaining very dominant positions in the market. But it's not necessarily something that we should be incredibly concerned about simply because it's their investments in quality that have put them there, and it's creating value for the market.").

486. To the extent, however, the Judges do hold that some "competition" standard is required by the statute, the Services' proposed standard is vague and indeterminate, and ultimately unworkable. Moreover, any such competition standard that could be imposed here would be readily satisfied by the substantial evidence presented that downstream competitive forces have substantially constrained and reduced prices in the upstream interactive services' licensing market, and that the hard-fought, protracted negotiations between the labels and services demonstrate that the labels do not "dictate" price and the services are not "price-takers" in the interactive streaming space.

E. Non-Interactive And Non-Subscription Benchmarks Also Support SoundExchange's Rate Proposal

487. To the extent that the statutory shadow does not entirely foreclose these non-interactive agreements from being considered as benchmark evidence, the iHeart-Warner and

Apple-Sony and Apple-Warner agreements, when viewed properly, support SoundExchange's rate proposal.

1. The iHeart-Warner Agreement

488. As discussed, the iHeart-Warner agreement is anchored by the statutory rates and therefore impacted by the "shadow." *See* Section III.B, *supra*. Nonetheless, properly analyzed the iHeart-Warner agreement results in effective rates that support SoundExchange's rate proposal.

489. As explained in Section IX.C.2 *infra*, Warner viewed the consideration it received under the iHeart-Warner agreement as significantly greater than what it would have received under the statutory license. Indeed, as the deal has performed, Warner [ ]. As Prof. Rubinfeld has analyzed the iHeart-Warner performance for the eight months following execution, [ ]. This rate is conservative because it allocates only [ ]. This is consistent with internal Warner documents [ ]. Hr'g Ex. SX-296 at 16. Furthermore, even analyzing the average expected (rather than performed) effective rate, a range of expectation analyses using both iHeart and Warner models support SoundExchange's rate proposal.

2. The Apple-Sony and Apple-Warner Agreements

490. As discussed in greater detail below, *infra* at Section XI Sony and Warner's agreements with Apple for its iTunes Radio Service also support SoundExchange's rate proposal.

491. Just like Pandora and other non-interactive services, iTunes Radio is not an "on-demand" service; it therefore equally has the ability to steer listeners to music offered by different labels, including independents. Hr'g Ex. SX-29 ¶¶ 114, 118 (Rubinfeld Corr. WRT). Thus, under the Services' argument, the catalogs of the major labels are not "must-haves" for Apple. *Id*. In addition, Apple occupies a unique position in the marketplace and possesses significant bargaining power in its negotiations with record labels. *Id*. The Apple Warner/Sony Licenses can hardly be construed as instances where the labels had all or most of the bargaining power. Moreover, like other non-interactive services, iTunes Radio is primarily an ad-supported service and not (acknowledging some revenue from "iTunes Match" subscribers) a subscription-based service. Accordingly, there would be little if any differential in ARPUs between iTunes Radio and other non-interactive services. *Id*.

492. The rates in the Apple iTunes Radio agreements—from either a performance or a projections perspective—support SoundExchange's rate proposal. With respect to the Apple license with Warner, Dr. Rubinfeld calculated an effective per-play rate based on performance data starting at [redacted] and for Apple's license with Sony, he calculated a per-play rate starting at [redacted] Hr'g Ex. SX-69 at 10, 13 (Rubinfeld Corr. WRT App. 2). These calculations are nearly identical to those Apple produced in the litigation in response to the Services' subpoena seeking information regarding the effective per play rate of the service.

493. With respect to parties' projections at the time they entered into the deal, the evidence in the record that exists demonstrates that the parties' projected effective per-play rates were far closer to SoundExchange's rate proposal than to the Services' proposed rates.

3. Section III.E Agreements

494. The licenses between the major and independent record labels and primarily non-interactive and/or non-subscription services or service tiers—including Music's "The Sentence,"

Spotify's free tier, Rhapsody's unRadio, and Nokia MixRadio—also provide support for SoundExchange's rate proposal. *See* Section XI, *infra*.

495. For example, the rates for "The Sentence" are expressly applicable to the free, non-interactive offering of Beats, and contemplate [Given that the statutory license does not require a commitment by a statutory licensee to offer a higher ARPU subscription offering, SoundExchange has analyzed the rates that would apply when there is no or little conversion. the stated rates agreed to between Beats Music and Universal, Warner, and Sony, [,] range from] per play in 2014, as compared to Prof. Rubinfeld's rate proposal, which would start at $.0025 in 2016. Hr'g Ex. SX-29 at 39 ¶ 162 (Rubinfeld (WRT).

F. SoundExchange's Rate Proposal Allows The Record Labels To Recover Their Fixed, Recurring Costs

496. The interactive service agreements are a proper benchmark for an additional reason – their economics enable record labels to recover their recurring fixed costs (which are described in greater detail, *infra* Section IV). *See also* Hr'g Tr. 6066:16-21 (May 27, 2015) (Talley) (noting costs "in finding talent, which can be quite difficult, promoting talent, assembling talent, recording with high quality rather than garage-level recording. And these are all components of what are essentially recurring or quasi fixed costs."); *see also* Hr'g Ex. NAB 4129 at 21 (Rubinfeld May 2012 presentation to FTC for UMG/EMI acquisition) (noting that "Many costs designated as 'fixed' (e.g., overhead, G&A) are recurring, and affect the incentives

to develop new artists and new products" and that "Savings in fixed costs are likely to increase incentives to invest in development of new artists and products by reducing hurdle rates").

497. Profs. Shapiro and Katz's economic analysis of the hypothetical marketplace is flawed because it does not take into account the recording industry's fixed, recurring costs. Prof. Shapiro's reliance on marginal-cost pricing conditions under the Lerner equation ignores record companyies' fixed and quasi-fixed costs. *See* Hr'g Tr. 6060:1-16 (May 27, 2015) (Talley). Similarly, Prof. Katz's bargaining model ignores recurring fixed costs; had he "allowed for the possibility of fixed costs," he "would have had to contend with the difference between marginal cost pricing and average cost pricing in competitive markets. No firm facing constant marginal cost would ever enter (or remain in) a market where it was constrained to price at marginal cost, unable to recoup its fixed costs (along with a reasonable return). And yet, Prof. Katz identifies the 'competitive price' in his model as the point where price equals marginal cost." Hr'g Ex. SX-19 at 16-17 (Talley WRT).

498. Thus, by failing to recognize fixed costs, Prof. Shapiro and Katz identify "competitive prices" that in actuality "fall []below what economic theory would predict." *Id*. If a record company's fixed costs cannot be recovered, pricing at the Lerner equation or marginal-price level, it would be operating at a loss and would not be able to sustain its operations. *See* Hr'g Tr. 6061:4-11 (May 27, 2015) (Talley). In the extreme the labels would go out of business, though they could also dial back those fixed costs, and "that would give rise to fewer investments in the development, the assembly, the recording, the promotion of some of these talents that presumably are viewed as quite attractive to the public." *Id*. at 6067:4-12.

499. Agreements that allow labels to recover their fixed costs will be those where the seller's willingness to pay will encompass a price that meets its "average cost constraints." *Id*. at

6061:15-25. In such a market, one would expect to see a "differential distribution of prices," i.e., "price distribution based on the deals that are struck between buyers and sellers." *Id*. at 6062:25-6063:6.

500. As discussed above, the interactive service agreements, reflecting a wide spectrum of record labels and streaming services, and least affected by the shadow of the statutory license, are precisely that – they show a differential distribution of prices. Moreover, given the thick, representative market of data the interactive service agreements reflect, they do not pose the risks presented by benchmarks based upon a single deal, like the Pandora-Merlin agreement, i.e., a single price point that might not reflect the average cost constraints of the broader market of record labels.

G. SoundExchange's Rate Proposal Is Conservative

501. SoundExchange's rate proposal is supported by an expansive array of market evidence. This includes agreements between major and independent record companies and both interactive and non-interactive services.

502. Viewed holistically, the market evidence demonstrates that in the absence of the statutory license, record companies would negotiate rates for services like Pandora or iHeart that would be in close proximity to the rates negotiated with major, platform-level streaming service providers like Spotify, Google, or Apple/Beats. The rates would be comparable – and certainly not a 50% discount, as called for in the interactivity adjustment – and the contractual incentives to *convert* listeners to paying subscribers also would be present.

503. Viewed from this perspective, SoundExchange's rate proposal is inherently conservative.

VIII. PANDORA'S RATE PROPOSAL IS NOT SUPPORTED BY ADMISSIBLE OR COMPETENT EVIDENCE

A. Overview Of Pandora Rate Proposal

504. Pandora proposes a greater-of royalty rate structure for all webcast performances and related ephemeral recordings by commercial webcasters. *First Amended Proposed Rates and Terms of Pandora Media, Inc.*, at 4-5 (February 23, 2015) ("Pandora Rate Proposal"). Under Pandora's proposal, a commercial webcaster will pay the greater of (i) a usage-based royalty computed on a per-performance basis; or (ii) 25% of a defined portion of "Revenue" from "Eligible Transmissions." Pandora Rate Proposal, at 4 (Proposed Section 380.3(a)(1)).

505. Issues concerning the specifics elements of Pandora's rate proposal will be discussed in Section VIII.E, *infra.*.

B. Pandora Failed To Provide An Appropriate And Representative Benchmark By Relying Upon a Single, Experimental License That Derives From Non-Precedential Statutory Rates And Applies To A Sliver Of The Market.

506. Pandora's primary benchmark for its rate proposal is a single license (the "Merlin License") executed in June 2014 between Pandora and the Music and Entertainment Rights Licensing Independent Network ("Merlin"), a global rights agency that negotiates on behalf of independent record label and distributor members. Hr'g Ex. Pan 5022 at 23-24 (Shapiro WDT). Pandora contends the Merlin License provides an "excellent benchmark" for a statutory license rate applicable to the entire webcasting industry because, according to Pandora, the Merlin License (a) "involves the very rights that are at issue in this proceeding"; (b) "involves the same sellers"; (c) "involves the same buyer" (e.g. Pandora); and (d) "was negotiated under workably competitive conditions." *Id.*

507. Each of these assertions is disproven by the unrefuted evidence in the record described below.

- *Same Rights*: The Merlin License covers rights and creates obligations that are *unavailable* under the statutory license. Moreover, to the extent that the License relies upon the rates and terms that otherwise apply to Pandora under its existing statutory license, the Merlin license merely reflects the shadow of a non-precedential and inadmissible statutory settlement.

- *Same Sellers*: The Merlin License is Pandora's first direct license with record companies, and it is only with independent record companies that represent less than [redacted] of Pandora's performances. It does not and cannot represent what the record companies, including all three majors, comprising Pandora's other [redacted] of performances, would negotiate for in the hypothetical marketplace.

- *Same Buyer*: When Pandora contends that the Merlin License has the same buyer, it uses the singular form intentionally. This is a license that applies to only one webcaster, a webcaster that is utterly unique from others that would exist in the hypothetical marketplace, and whose uniqueness was a meaningful factor in the negotiations of the license.

- *Negotiations:* Pandora asserts that this negotiation came under "workably competitive" conditions – a phrase that lacks definition in itself – but ignores the other important conditions of this negotiation: that the Merlin license was an experimental modification of statutory conditions that inextricably bounded the negotiation of the license. In fact, this was a singular license negotiated not just under the shadow of the statutory license but under the overhang of this very proceeding.

508. These concerns only provide part of the explanation for why the Merlin License fails as a benchmark. Even were the agreement not deficient in all of these ways, the application of a single license plucked from under the shadow of the statutory license, rather than a true "thick market" analysis, would suffer from the very downward selection bias that the hypothetical market analysis attempts to avoid. Moreover, by relying solely on an experimental license during its trial stage, the Judges would risk the possibility that the license fails to work in practice. The plain and unfortunate reality is that the utter failure to implement and operationalize the Merlin License in the marketplace would palpably affect any negotiations that would occur between hypothetical (and actual) buyers and sellers for future years, such as the ones at issue in this proceeding.

509. Even were this single license sufficient to bear the analytical weight of an entire industry, it would not support Pandora's rate proposal. As described below, this is because Pandora has failed to account for Merlin's expectations of value, selectively omitted key consideration and value in their presentation to the Judges, and failed to adjust for the undeniable reality that different record companies – especially the majors – would negotiate different rates and terms in a hypothetical or actual marketplace.

1. The Core Provisions Of The Pandora-Merlin License Are Derived From The Pureplay Statutory License

a. *The Terms Of The Merlin License Are Derived Directly From The Non-Precedential Pureplay Settlement Agreement*

510. [redacted]

511. This is not an accident. In the words of Pandora's economist, [redacted]

[redacted]

512. The other Pandora witness to address the Merlin license, Mr. Herring, also confirmed [redacted]

513. The defined "Term" for the Merlin license ends on [redacted] Hr'g Ex. PAN 5014 § 1(r); Hr'g Tr. 4665:20-4667:9 (May 19, 2015) (Shapiro). Thus, [redacted]

514. The Merlin license also provides that "[redacted]

[redacted] Hr'g Ex. PAN 5014 § 15(b). Put another way, if Pandora loses its ability to access repertoire through the statutory license, then [redacted].

515. The definition of "Service" under the Merlin license, which is important to determining [redacted] Hr'g Ex. SX-13 ¶ 30 (Lexton WRT).

516. Each of these core contractual provisions evidences the unbreakable relationship between the Merlin license and the Pureplay Settlement Agreement. [redacted]

[redacted]

517. This relationship renders the Merlin license both an inadmissible and improper benchmark. First, as fully described in SoundExchange's Conclusions of Law, evidence which requires the Judges to "take into account" the rates or terms of the non-precedential Pureplay Settlement Agreement must be stricken from this determination. *See* SoundExchange's Proposed Conclusions of Law § III. Thus, this license and the related testimony should be stricken. Second, even if consideration of such evidence were legally permissible, the Merlin license was unquestionably negotiated under the heavy shadow of the existing statutory license and should therefore be allotted little to no weight. *See* Section VIII.B.1.b, *infra*.

518. The shadow of the statutory license makes the Merlin license uniquely ill-suited to serve as a benchmark for the rate period at issue in this proceeding. [redacted] It would be entirely circular and wholly inappropriate to allow a license that [redacted]

519. This application of Web IV rates [redacted] demonstrates that the Merlin license is inextricably tied to the statutory license and is, at most, merely a modification of whatever prevailing statutory rate Pandora pays. It cannot therefore speak to what a willing buyer would agree to with a willing seller in the absence of a statutory license.

b. *The Negotiation Of The Merlin License Was Directly Dependent On The Existence Of The Statutory License*

520. Mr. Lexton testified that this was a very unusual negotiation for Merlin because [redacted] Hr'g Ex. SX-13 ¶ 26 (Lexton WRT). Both Merlin and Pandora knew that the negotiation both started at [redacted] *Id.* Unlike negotiations with services that do not operate pursuant to the statutory license, Merlin knew Pandora could walk away from negotiations at any point and still use Merlin's content. Not only could Pandora walk away, Pandora knew the exact price of walking away, as it would merely have to pay the Pureplay rate that Pandora was already paying. *Id.* As such, the Pureplay Settlement Agreement eliminated Merlin's ability to withhold its content and Merlin's ability to negotiate for headline or stated royalty rates above the Pureplay rates. *Id.*

521. Mr. Wheeler also testified that "[]in this instance, because the statutory license was in place, Pandora would have access to our material whether or not we concluded a direct license with them" which removed one of the "main levers" of a record company because access to repertoire is a record company's "main leverage in negotiating a license." Hr'g Tr. 7090:18-7091:6 (June 1, 2015) (Wheeler). He also confirmed that "[b]ecause Pandora knew of the

statutory rates, that provided a natural ceiling on the level of rates [Merlin] could negotiate." *Id.* at 7091:11-13.

522. Merlin Board Member and Jagjaguwar Co-Founder, Darius Van Arman, succinctly summarized the effect of the Pureplay Settlement Agreement on these direct license negotiations. When asked whether his labels would have opted in to the Pandora-Merlin license in the absence of a statutory license, Mr. Van Arman was unequivocal in stating they would not have. Hr'g Tr. 7152:15-18 (June 2, 2015) (Van Arman). He elaborated further: [redacted] *Id.* at 7155:6-12.

523. The powerful effect of the statutory license on these negotiations was reflected in internal discussions at Merlin. [redacted]

524. The powerful effect of the statutory license on this direct license was also reflected in the negotiations *between* Pandora and Merlin. The statutory license created the agenda and the backdrop upon which negotiations occurred. [redacted] From the start, the

reference point for the negotiations was simple: what Pandora was already paying under the Pureplay Settlement Agreement.

525. As the negotiations continued, the Pureplay license set the agenda for what could and could not be negotiated, and affected what would and would not be accepted by the parties. [redacted].]

526. The record is replete with evidence—ranging from the terms of the license, to the witness testimony about the license, to the contemporaneous negotiating documents—that points to one powerful conclusion: The Merlin license was born of and bound to the Pureplay Settlement Agreement that provides Pandora access to repertoire irrespective of a direct license. It therefore cannot and does not represent what a willing buyer and seller would agree to in the absence of the Pureplay Settlement Agreement or statutory license in general.

2. The Merlin-Pandora Agreement Is An Improper Benchmark Because It Is Not Representative of the Broader Market

527. The Merlin license represents only one label-service pair agreement among the constellation of a thick market. To pluck it out, isolate it, and then use it to prop up the rate for the entire market, as Pandora and Prof. Shapiro propose to do, raises several significant and independent concerns of representativeness. However, as discussed in Section VII, *supra*, the

need to utilize a representative "thick market" of data is core to an appropriate benchmark analysis.

528. As attempted in prior proceedings, Pandora has proposed a direct license as a benchmark to "have the surface appeal of a comparable benchmark because [the Merlin license] involve[s] the same sellers and buyers as the target market." *Cf. SDARS II*, 78 Fed. Reg. at 23063 (Apr. 17, 2013). As in prior proceedings, "[a] closer examination, however, reveals the weaknesses of the [Merlin license] as a data set." *Id.* Specifically, the reliance on a singular, experimental agreement results in an anemic benchmark that does not approximate the variation in willing buyers or sellers, cover the universe of sound recordings, license the same rights, or have a sufficient track record of operation to credibly reflect the workings on the marketplace.

a. *Pandora is Not a Representative Buyer*

529. Pandora, as a singular buyer, cannot itself represent the buyers of the hypothetical marketplace, particularly given its unique position in the actual marketplace. As the Judges have previously recognized, "[i]n the hypothetical marketplace we attempt to replicate, there would be significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors. Congress surely understood this when formulating the willing buyer/willing seller standard." *Webcasting II*, 72 Fed Reg. at 24087 (May 1, 2007). "To the extent [a buyer] is not sufficiently representative of all webcasters (or representative at all of other webcasters," an analysis of *only* what that buyer would agree to is likely to "yield an inaccurate royalty rate." *Webcasting III Remand*, 79 Fed. Reg. at 23108 (Apr. 25, 2014). This is just as true for Pandora's benchmark analysis based solely on one webcaster's willingness to pay as it was for Dr. Fratrik's model based solely on one webcaster's cost structure.

530. The reliance on a sole buyer is uniquely troublesome in the webcasting marketplace where there are thousands of actual webcasting licensees, who differ in size, business model, sophistication, and any myriad of other ways. *See, e.g.*, Hr'g Ex. SX-3 ¶¶ 22-26.[16]

531. Pandora is, without question, the largest webcaster operating in the United States. It has the largest audience, the largest revenue, and the largest sales force. *See, e.g.*, Hr'g Ex. SX-3 ¶¶ 23-24, 51-52; Hr'g Tr. 3434:13-3435:15 (May 13, 2015) (Herring). That Pandora occupies a dominant position in this marketplace only further emphasizes how *un*representative Pandora is among webcasters as a whole.

532. Pandora used its size and scale as part of its pitch to Merlin for this license. *See, e.g.* Hr'g Ex. SX-104 at 2 ([”]). And, the benefits of that size and scale affected the value Merlin members put on the benefits that Pandora was offering as part of the direct license. Hr'g Tr. 7099:12-23 (June 1, 2015) (Wheeler). Those benefits would not apply in a negotiation between any other webcaster and a record company.

533. Pandora has provided no evidence whatsoever to suggest that it is a representative buyer in the webcasting market. In fact, the evidence suggests that Pandora regards itself as unique from other webcasters. *See, e.g.* Hr'g Ex. PAN 5012 at 11 (noting Pandora's "significant competitive strengths" among webcasters including its 77.6% share of Internet Radio listening).

[16] Here, Pandora's assertion of a sole-buyer direct license benchmark is even more troublesome than the prior attempt by SIRIUS XM to do the same in the satellite radio proceeding because, in the satellite radio market, SIRIUS XM *is* the sole provider of satellite radio service. *SDARS II*, 78 Fed. Reg. at 23065 (Apr. 17, 2013).

534. As Prof. Talley observed, Prof. Shapiro failed to perform any analysis of meaningful allocations of buyer-side power, including, for instance, whether Pandora's unique position in the market affected the terms of the Merlin license. *See* Hr'g Ex. SX-19 at 6, 24-27 (Talley WRT) The failure to analyze, much less adjust, for Pandora's representativeness of all webcasters is fatal to their analysis, and a sufficient reason to reject a benchmark analysis predicated solely on one buyer.

b. *Merlin is Not a Representative Seller*

535. Merlin serves only the independent recorded music sector. Membership is only open to businesses which own or control rights in master recordings and which have an annual share of the global market for recorded music that is *less* than 5%. This restriction also applies to a case in which a record company is owned in whole or in part by a company with more than a 5% share of the global recorded music market. Therefore, not every recorded music company can become a Merlin member, including, most notably, the three major recorded music companies. Hr'g Ex. SX-13 ¶ 14 (Lexton WRT).

(i) The Merlin License Does Not Cover Major Record Companies

536. The major record labels are not members of Merlin and are not buyers under the Merlin license. As the Judges have previously observed, major record labels "by virtue of the depth and breadth of their music catalogues, make up a critical portion of the sound recording market." *SDARS II*, 78 Fed. Reg. at 23063 (Apr. 17, 2013).

537. The sound recordings of major record labels are critical to Pandora's operation. When asked in the course of this proceeding [ ] Hr'g Tr. 4254:3-8 (May 18, 2015) (Herring).

Pandora's internal business documents, prepared for and presented to its Board of Directors for a key October 2014 "Strategy Day"—Pandora's only such meeting of its Board—reflect just how very different the service would be. [ ] And, those figures significantly understate the value of a direct license with a major record label because those percentages merely reflect the repertoire *owned* by major record labels; they do not include the percentage of independent label recordings that is *licensed and distributed* by one of the three majors.

538. Sound recordings controlled by major record labels comprise [ ]

RESTRICTED GRAPHIC

SX-269-074

539. [

[redacted]

[redacted]

[redacted].]

540. If Pandora were to lose access to the repertoire that comprises [redacted] of its spins and [redacted] of its most played sound recordings, it truly would be, in the words of Mr. Herring, a [redacted] Hr'g Tr. 4254:3-8 (May 18, 2015) (Herring). "It would be difficult to imagine a successful [Pandora] service that did not have access to the types of recordings that the major labels possess." *Cf. SDARS II*, 78 Fed. Reg. at 23063-64 (Apr. 17, 2013).

541. Those figures are understated when compared to what could be covered between Pandora and a willing major record company in the hypothetical or actual marketplace. They are based on sound recording ownership and therefore those figures do not include additional sound recordings that are owned by independent record companies but are licensed and distributed by major record companies, even though such recordings could be covered under a direct license with a major record company. Inclusion of such recordings would only *increase* the major record label [redacted].]

(ii) The Merlin License Covers a Limited Number of Independent Record Labels

542. While many record labels could become Merlin members, [redacted] – members for whose rights Merlin can negotiate a license with a digital music service, number about [redacted]. Hr'g Ex. SX-13 ¶ 13 (Lexton WRT). Of those, only roughly [redacted] are record label members. Hr'g Tr. 6860:4-12 (June 1, 2015) (Lexton). The balance is comprised largely of aggregators and distributors.

543. Merlin's total membership as of February 2015, including members who Merlin typically only represents in copyright infringement proceedings, includes roughly [ ] distributors, aggregators, and labels, who, in sum represent recordings of over [ ] labels spread across [ ] different countries. Hr'g Ex. SX-13 ¶ 10 (Lexton WRT).

544. When reference is made to Merlin representing the rights of roughly 20,000 record labels, approximately [ ] of those labels come from the rights represented by the nearly [ ] distributor and aggregator members. Hr. 6860:4-9, 6865:17-6866:9 (June 1, 2015) (Lexton).

545. Distributors and aggregators work to secure opportunities for their clients – record labels or individual artists – to have their music heard. But, like Merlin, distributors sometimes have opt-out or opt-in policies for their own clients, meaning that there are two different decision points – at the label-distributor level and at the distributor-Merlin level – to opt sound recordings out of Merlin licenses. Hr'g Ex. SX-13 ¶ 17 (Lexton WRT).

546. The consequence of these structures is that Merlin's share of performances on any particular service [t.] Hr'g Ex. SX-13 ¶ 18 (Lexton WRT). In fact, as of October 2014, Pandora's own witnesses testified that the Merlin license covered only [of Pandora performances. Hr'g Ex. PAN 5022 at 26 (Shapiro WDT).

547. There remains a significant challenge to [.] Hr'g Ex. SX-13 ¶ 18 (Lexton WRT). As of February 2014, Pandora and Merlin continued to [ ] even though there were only [ ] months left on the license. *Id.*

548. The data matching challenges impair any ability to assess the amount of repertoire or record labels covered by the license. Though Prof. Shapiro contended that there were over [ ] labels participating in the license as of October 2014, the only Merlin license reporting statement in the evidentiary record indicates that as of February 2015, only [ ] Merlin labels and sub-labels were paid directly by Pandora under the terms of the license. Hr'g Ex. SX-2310 ([ ]

549. In fact, some of the Merlin labels that have opted in to the Merlin license include labels that do not otherwise regularly operate in the United States. For instance, Mr. Lexton estimated that [ ] percent of the label members opted into the Merlin license do *not* actively participate in the U.S. marketplace. Hr'g Tr. 6863:20-6864:8 (June 1, 2015) (Lexton).

550. Mr. Lexton estimates [ ] *Id.* at 6871:17-24.

(iii) Merlin's Motivations As A Global Rights Agency

551. One of the motivations for the Merlin license was unique and particular to Merlin as an organization. [.] Hr'g Ex. SX-13 ¶ 45 (Lexton WRT).

552. Also, Merlin's core remit is to represent its members in negotiating licenses with digital music services in the hope of overcoming market fragmentation issues that have historically challenged the independent music sector. *Id.* ¶ 12. Thus, part of Merlin's core remit,

and really its core function in the digital licensing space is *to reach agreements* so that each Merlin member can have the opportunity to decide whether to participate in the deal.

553. Merlin typically receives an administrative fee from its members when it completes a license and, unremarkably, does *not* receive an administration fee ("admin fee") if no license is reached. While Merlin is not a distributor or aggregator, this dynamic is similar in this respect: If a distributor is not opted into a license, it cannot assess a distribution fee against any of its clients who chose to participate in that license. Similarly, if Merlin does not agree to a license, it cannot assess an admin fee against the royalties earned by its participating members. [.] Hr'g Ex. SX-13 ¶ 56 (Lexton WRT). Thus, Merlin's incentive to agree to a license as a global rights agency, much like its distributor or aggregator members' incentives, is not the same as the incentive of a record company.

c. *The Merlin License Only Covers a Sliver of Webcasting Performances*

554. As of October 2014, Pandora's Prof. Shapiro testified that the Merlin license covered only [of Pandora performances. Hr'g Ex. PAN 5022 at 26 (Shapiro WDT). Without any steering, there is no dispute that the Merlin license [ ]. Even with steering, Pandora's most current information estimates that the Merlin license covers [ ]. Hr'g Tr. 4236:2-6 (May 18, 2015) (Herring). Therefore, as the Judges found in *SDARS II* when the estimated works licensed under the proffered direct licenses were 2%-4% of the total works performed by Sirius XM, the Judges should "evaluate the [Merlin license for what it is], which is to say, a very small subset of the sound recording market." *Cf. SDARS II*, 78 Fed. Reg. at 23063 & n.28.

555. As described *supra* in Section VII, Dr. Rubinfeld's analysis, by contrast, analyzed a much greater number of label-service pairs over a much longer time period involving a wide range of prices, forms of consideration and a vast array of different services and labels.

556. Moreover, the Merlin license only covers independently-owned sound recordings. A license that does not cover works owned by major record companies simply does not address "the universe of sound recordings available for licensing under the statute." *SDARS II*, 78 Fed. Reg. at 23064 (Apr. 17, 2013). Even if the works licensed by the Merlin license "represent the kinds of sound recordings performed on [Pandora]," that "does not diminish the importance of the catalogues of the major labels," particularly given [ ]. *Id.* at 23063-64. And, thus, sole reliance on the Merlin license only offers information about the value of independently-owned sound recordings in the target hypothetical market.

d. *The License Includes Certain Rights That Are Not the Same as the Statutory License*

557. The Merlin license is not, in fact, a license for the same rights as the statutory license. As discussed *infra* Sections VIII.D and VIII.F, the Merlin license includes a number of different considerations, benefits, and rights that are unavailable under the statutory license.

558. As the Judges have noted previously with respect to direct licenses, the "additional considerations and rights granted in the" Merlin license "that are beyond those contained in the Section 114 license weaken the" Merlin license's "comparability as a benchmark." *Cf. SDARS II*, 78 Fed. Reg. at 23064 (Apr. 17, 2013). For instance, in prior proceedings the Judges noted that a direct license was weakened as a benchmark because it includes a "waiver of the sound recording complement of the statutory license." *Id.*

559. The Merlin license includes a [.] Hr'g Ex. PAN 5014 § 2(c).

560. Merlin also agrees to [.] *Id.* § 1(c)(v).

561. The Judges have also noted previously that provisions that affect the administration of the license, such as ones that avoid the statutory apportionment of royalties between record companies and artists, may weaken the comparability of a benchmark. *SDARS II*, 78 Fed. Reg. at 23064 (Apr. 17, 2013).

562. Under the Merlin license, Pandora agrees that] Hr'g Ex. PAN 5014 § 13. There is no provision of the statutory license that [.]

e. ***The Merlin License Was Negotiated Directly In the Shadow of this Proceeding***

563. While it may well be true that one consideration of the negotiation of many, if not most, licenses between digital music services and record companies is the possibility that the license will be used in a proceeding before the Judges, the danger that such consideration will bias the negotiation and terms of the license is acutely present when a party proposes a single agreement as its only benchmark. In such a case, if there is a strategic bias reflected in the agreement – one that would not be present in the target hypothetical market where no statutory license (and no statutory proceeding) exists – it will fully distort the analysis of the agreement.

564. This concern is most serious when the willing buyer in the license has never before executed a direct license with a record company, does so after the commencement of the proceeding, and submits that license as the benchmark for the entire marketplace.

565. The Merlin license is Pandora's first direct license.. Hr'g Ex. PAN 5007 ¶ 24 (Herring WDT). Pandora's only other direct license with a record company was with Naxos and was signed in January 2015. Hr'g Ex. PAN 5016 ¶ 51 (Herring AWRT).

566. The Merlin license was executed on June 16, 2014. Hr'g Ex. PAN 5007 ¶ 24 (Herring WDT). That was several months *after* the commencement of the proceeding and Pandora's filing of its petition to participate. It was also a mere few months *before* Pandora submitted its written direct testimony in this proceeding.

(i) The Merlin License Was Heavily Influenced By the Need for Evidence In This Proceeding

567. Mr. Herring has testified under other that [.] Hr'g Tr. 4241:22-4242:6 (May 18, 2015) (Herring.)

568. That testimony is corroborated by a key Pandora strategy document. [

] *Id.* The slide in full states as follows:

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569. That is the strategy that Pandora pursued. That direct licensing strategy has yielded two direct licenses – the Merlin license and the Naxos license. Those are the only two licenses that Pandora has offered as possible benchmark evidence.

570. Mr. Herring also testified that [.] Hr'g Tr. 4239:24-4240:8 (May 18, 2015) (Herring).

571. The importance of this objective was implicitly recognized in an e-mail exchange between Pandora's CEO, Brian McAndrews, and Mr. Herring at the time of the announcement of

the Merlin license. *See* Hr'g Ex. SX-2233. In reply to Mr. Herring's observation that [ ] Mr. McAndrews provided a lengthy response:

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572. Mr. McAndrews [ ]

573. Mr. McAndrews noted that the [

574. Mr. McAndrews identified [

.]

575. Mr. McAndrews concluded by asking [

Id. at 1.

f. *The Merlin License Is Unrepresentative Because of Its Experimental Nature*

576. Because the Merlin license was Pandora's first-ever direct license with a record company, the contractual arrangement it provides is necessarily untested and experimental.

577. In fact, it was Pandora's CEO, Brian McAndrews, who stated very clearly on the day of the license's announcement: [

[redacted]

Hr'g Ex. SX-2233 at 1. Mr. Herring testified that he [redacted] with that statement. Hr'g Tr. 4247:15-4248:4 (May 18, 2015) (Herring).

578. In fact, even after the Merlin license was executed, Pandora's Chief Scientist, Eric Bieschke acknowledged internally that it was "[redacted]. Hr'g Ex. SX-1706.

579. The independent record companies also viewed the Merlin license as an experiment. Mr. Lexton characterized the license as [redacted].] Hr'g Ex. SX-13 ¶ 27 (Lexton WRT); *see also id.* ¶ 25 ("Due to the fact Pandora offered us [redacted], we understood this as an opportunity for experimentation given and within the constraints imposed by Pandora's existing statutory rates.); Hr'g Ex. SX-21 ¶¶ 9-11 (Wheeler WDT).

580. The untested and experimental nature of the Merlin license calls into question the propriety of that sole license being the basis for a five-year statutory rate for the entire industry.

g. *The Lack of Performance and Implementation of the Merlin License Undermines Its Use as a Benchmark*

581. What little evidence there is in the record about the actual experience of the Merlin all suggests that the license is not a reliable benchmark to reflect the behavior of the marketplace.

582. Pandora has internally acknowledged its challenges with implementing the Merlin license. For instance, on October 6, 2014, Mr. Herring sent an email [redacted]

[redacted] *See* Hr'g Ex. SX-1747. The first bullet of the first page of that presentation states in bold: [redacted] *Id.* In considering the question, [redacted]] *Id.* at 4; *see also* Hr'g Ex. SX-2237 [redacted]

583. In fact, the record evidence demonstrates that this license has not been implemented in any meaningful way. Hr'g Ex. SX-13 ¶¶ 59-63 (Lexton WRT); Hr'g Ex. SX-31 ¶¶ 25-29 (Wheeler WRT); Hr'g Ex. SX-30 at 6-8 (Van Arman WRT); *see also* Hr'g Ex. SX-2310 ([redacted]]).

584. These serious implementation issues have impacted negatively the willingness of the sellers to consider entering into this license in any future period. Mr. Van Arman testified that, [redacted] Hr'g Tr. 7158:23-25 (June 2, 2015) (Van Arman); *see also* Hr'g Tr. 7104:17-7110:2 (June 1, 2015) (Wheeler) ([redacted]"]).

585. There are a host of challenges with relying upon a single license to characterize the state of the entire webcasting market. Those challenges, however, are compounded when the single license is a trial experiment that has failed to deliver on the implementation of its terms.

C. Reliance On A Single Agreement To Benchmark The Entire Industry Would Suffer From A Downward Selection Bias

586. As described in Section VII.B.2, *supra*, Prof. Talley analyzed and testified to the significant difficulties in both selection bias and downward bias that are co-mingled with issues of representativeness when looking at a very small sample of agreements, negotiated in the shadow of the statutory license. Those concerns are certainly applicable to the Merlin license – a singular agreement negotiated directly in the shadow of the statutory license.

587. Mr. Van Arman testified why such reliance on a statutorily-based agreement will result in a race to the bottom that does not reflect the behavior of the market absence the statutory license. He testified:

Hr'g Tr. 7155:6-20 (June 2, 2015) (Van Arman).

D. Properly Understood, The Pandora-Merlin License Does Not Support Pandora's Rate Proposal.

1. Pandora Incorrectly Valued The Merlin License

588. In Merlin's view, the consideration provided by the Pandora – Merlin agreement was, "at worst, no lower than the compensation under the existing statutory rates paid by

Pandora." Hr'g Ex. SX-13 at 18 (Lexton WRT). The evidence shows that Merlin and its members placed significant value on the unique consideration available under the agreement—consideration unavailable under the statutory license. *See* Section VIII.D.1.b. This consideration included [ ] *Id.*

589. The evidence also shows that Pandora offered some of this valuable consideration to Merlin to induce Merlin to enter the agreement and that Merlin specifically bargained for the other portions of this consideration. This account is confirmed by the negotiating history of the agreement as well as Pandora's own internal documents.

590. Pandora asks the Judges to adopt the Pandora – Merlin agreement as a benchmark agreement, but it now claims that the unique consideration that Merin received under the agreement—the very consideration that induced Merlin to enter the agreement—has zero value. Pandora's rate proposal does not include any of this consideration—[ ] Nor has Pandora adjusted the effective rate in its proposal to account for these valuable forms of consideration.

591. Pandora takes the position that these items of consideration lack value because Merlin did not specifically quantify their value when it entered the agreement. But the fact that Merlin and its labels did not develop a specific model to quantify these provisions does not mean that they were not a part of the benefit of the bargain. Darius Van Arman testified that his record

labels lack the resources to perform the type of quantitiative analysis that Pandora now suggests is necessary. Yet Mr. Van Arman had no trouble recognizing that these terms could have significant value for his labels:

Hr'g Tr. 7157:15 – 7158:2 (June 2, 2015) (Van Arman).

592. In sum, Pandora offered Merlin a deal that had consideration that flowed in both directions. Yet Pandora now wants the Judges to consider only the consideration that *Pandora* received, without accounting for the consideration that *Merlin* received. When the consideration that Merlin received is properly accounted for it becomes clear that, just as Mr. Lexton testified, the Pandora – Merlin agreement was, "at worst, no lower than the compensation under the existing statutory rates paid by Pandora." Hr'g Ex. SX-13 at 18 (Lexton WRT).

a. *Pandora Incorrectly Focused Solely On Its Own Subjective Expectations.*

593. Pandora's analysis of the Pandora – Merlin agreement is based on Pandora's own expectations, not Merlin's. According to Prof. Shapiro, his "calculation of the effective per-play rate from the Merlin Agreement is based on a careful reading and analysis of the agreement itself, on information provided to [him] by Pandora, and on information [he] learned through interviews with Pandora employees." Hr'g Ex. PAN 5022, App. D at 1 (Shapiro WDT).

594. Prof. Shapiro acknowledged during cross-examination that he calculated the effective rate of the Pandora – Merlin agreement by relying on Pandora's expectations. In response to the question "you calculate the effective rate of the Merlin agreement based on Pandora's expectations, correct," Prof. Shapiro responded: "That's correct." Hr'g Tr. 4669:9-12 (May 19, 2015) (Shapiro).

595. Neither Prof. Shapiro's written direct testimony nor his written rebuttal testimony contain any analysis of the value of the agreement based on Merlin's expectations. *See* Hr'g Ex. PAN 5022, App. D at 1 (Shapiro WDT). Prof. Shapiro also agreed during cross-examination that his analysis was not "based on any evidence of Merlin's expectations." Hr'g Tr. 4670:9-17 (May 19, 2015) (Shapiro).

596. Despite his admission that he did not consider Merlin's expectations in valuing the Pandora – Merlin agreement, Prof. Shapiro acknowledged on cross-examination that he thought it was important to know Merlin's expectations in order to do a "proper analysis" of the Pandora – Merlin agreement:

> Q. "But your understanding is that it's important to know what Merlin's expectations were in order to do a proper analysis, correct?"
>
> A. "*I think it's informative*. Both sides are informative. Yes, that's my view."
>
> . . . .
>
> Q. So it's important for us to look into what Merlin expected, correct?
>
> A. It's relevant. Depends on the basis of the information. Might not be reliable, but I agree, in principle, *that's something I want to look at*.

Hr'g Tr. 4670:18 – 4671:15 (May 19, 2015) (Shapiro) (emphasis added).

597. Prof. Shapiro's analysis of the iTunes Radio agreements illustrates why it is inappropriate to consider the expectations of only one party to an agreement. Hr'g Ex. PAN 5365 at 13 (Shapiro SWRT). In valuing the Sony – Apple agreement, Prof. Shapiro considered both Apple's expectations and Sony's expectations. He concluded that the effective rate based on Apple's expectations differed significantly from the effective rate based on Sony's expectations. *See* Hr'g Ex. PAN 5365 at 13-16 (Shapiro SWRT). This shows that Prof. Shapiro recognizes that considering the expectations of only one party to an agreement may produce a one-sided view of the agreement's value.

598. In sum, Prof. Shapiro recognized the importance of considering Merlin's expectations regarding the agreement, yet admits that he did not perform any analysis based on those expectations. Instead, Prof. Shapiro's valuation of the Pandora – Merlin agreement is based on a one-sided analysis of Pandora's expectations.

599. Nor did Prof. Shapiro rely on Pandora's expectations from *before* Pandora entered into the Pandora – Merlin deal. [ ] And Pandora has not presented any documents that show its pre-deal expectations. Accordingly, there is no assurance that the "expectations" that Prof. Shapiro relied on were not created expressly for this case or that they represent Pandora's best expectations regarding the Merlin agreement.

b. ***Prof. Shapiro Ignores Important Consideration Of Significant Value To Merlin.***

(i) [ ]

600. [redacted]

601. [redacted]

602. [redacted] Despite the fact that Prof. Shapiro recognized that this term was a benefit to Merlin and a liability to Pandora and despite not knowing what value Merlin attached to this provision, Prof. Shapiro assigned this provision zero value in valuing the Pandora – Merlin agreement. Hr'g Ex. PAN 5022, App. D at 6 (Shapiro WDT).

603. [redacted]

[redacted]

604. [redacted]

605. [redacted]

[redacted]

606. [redacted]

(ii) [redacted]

607. [redacted]

608. [redacted]

609. [redacted]

610. [redacted]

611. [redacted]

[redacted]

612. [redacted]

613. [redacted]

[17] [redacted]

614. [redacted]

615. [redacted]

[redacted]

616. [redacted]

617. [redacted]

618. [redacted]

619. [redacted]

(iii) [redacted]

620. [redacted]

621. [redacted]

[redacted].]

622. [redacted]

623. [redacted]

624. [redacted]

625. [redacted]

626. [redacted]

[redacted]

627. Simon Wheeler testified that one of Beggars Group's motivations for opting in to the Pandora – Merlin agreement was the ability to "tap into" these promotional opportunities that were unavailable under the statutory license. Hr'g Ex. SX-31 ¶ 23 (Wheeler WRT). Mr. Wheeler noted that shortly after the agreement was announced he attended a meeting with Pandora to discuss these opportunities. *Id.*

628. [redacted]

629. [redacted]

(iv) [redacted]

630. [redacted]

[redacted]

631. [redacted]

632. [redacted]

633. [redacted].]

634. [redacted]

635. [redacted]]

636. [redacted]]

637. First, at the time Pandora and Merlin entered the Pandora – Merlin agreement, Pandora was not offering this data to artists or other labels. As Prof. Shapiro recognizes, at the

time he filed his written direct testimony in October, Pandora had still not rolled out its "Artist Marketing Platform," which would have provided access to this data to other artists. Hr'g Ex. PAN 5022, App. D at 14 (Shapiro WDT). [redacted]

638. [redacted]

639. [redacted]

c. *Providing The Non-Statutory Consideration Under The Pandora – Merlin Agreement Imposes Significant Costs On Pandora.*

640. Providing the consideration agreed to under the Pandora – Merlin agreement imposes costs on Pandora. Prof. Shapiro ignores these costs in valuing the agreement.

641. [redacted]

642. [redacted]

643. Prof. Shapiro's analysis of the Pandora – Merlin deal does not account for any of the costs that Pandora agreed to incur to meet its obligations under the Pandora – Merlin agreement.

2. The Definition of Revenue In Pandora's Rate Proposal Is Inconsistent With the Pandora-Merlin Agreement

644. The Pandora-Merlin agreement defines revenue [redacted] *Id.* [redacted] *Id.* at § 1(o).

645. In addition, the definition of revenue under the Pandora – Merlin agreement does not [redacted]. *Id.*

646. By contrast, the definition of "Revenue" in Pandora's rate proposal is narrower:

> Revenue is all money earned by Licensee consistent with Generally Accepted Accounting Principles ("GAAP") which is derived by the Licensee from making Eligible Transmissions in the United States, and shall be comprised of the following:
>
> (a) Subscription revenue earned by Licensee directly from U.S. subscribers for making Eligible Transmissions; and
>
> (b) Licensee's advertising revenues, or other monies received from sponsors, if any, attributable to advertising on channels making Eligible Transmissions, other than those that use only incidental performances of sound recordings, less advertising agency and sales commissions.
>
> For the avoidance of doubt, Revenue shall exclude revenue from activities other than making Eligible Transmissions.

Pandora Proposed Rates and Terms at 4.

647. First, the Pandora – Merlin agreement [Pandora does not explain why the Judges should narrow the definition of revenue from its own benchmark agreement. Moreover, Pandora has not made any adjustment to the percentage of revenue to account for the fact that the revenue base is narrower.

648. Second, under the Pandora – Merlin agreement,] *Id.* Again, Pandora has narrowed the definition of revenue from the Pandora – Merlin agreement without explaining why its own benchmark agreement should be rejected and without making any adjustment for the narrow definition in its proposal.

649. Third, the Pandora – Merlin agreement does not [,] yet Pandora's rate proposal does. Again, Pandora has not explained the departure from its own benchmark agreement.

3. The Evidence Demonstrates That Pandora Would Provide Better Rates And Terms To Major Record Labels Than Merlin Received

650. Were the Judges to determine that the Merlin license informed the zone of reasonable rates in the target market, the appropriate consideration would be to recognize that Pandora would have had to provide better rates and terms to remainder of the marketplace, particularly to the major record companies.

a. *No Major Record Company Has Accepted Pandora's Proposal*

651. No major record company has agreed to a direct license with Pandora or any other webcaster on the same rates and terms of the Merlin license. This is even though Mr. Herring acknowledged that Pandora [ ]. Hr'g Tr. 4203:5-7 (May 18, 2015) (Herring).

652. The absence of any license with a major record company or any additional licenses besides the one with Merlin member, Naxos, discussed *infra* is notable. In a prior proceeding, a service argued, as Prof. Shapiro does here, that a direct license with a group of independent record companies demonstrates that "record labels engage in price competition aimed at increasing their market share through increased plays on [the service], thereby reducing the royalty rates demanded, which reflects what would happened in the market as a whole in the absence of a statutory rate." *SDARS II*, 78 Fed. Reg. at 23064 (Apr. 17, 2013). The Judges observed, "It may well be that independent record labels took the [d]irect [l]license offer because of the valuable non-statutory benefits discussed above, and there is testimony in the record to this effect." *Id*. "Further, independent labels may have a greater incentive than majors to secure

performances of their works on services . . . which would increase the attractiveness of a [d]irect [l]icense relationship. *Id.* "Although major labels also must compete with other majors and with independent labels for airplay, none was apparently so motived by that concern to negotiate separately with," in this case, Pandora. *Id.* "Therefore, the differing motivations of the 'sellers' in the proposed [d]irect [l]icense benchmark suggest a weakness regarding comparability to the target market." *Id.* The same facts apply here as there has been a notable *absence* of major record companies agreeing to licenses with Pandora on the same or equivalent terms to the Merlin license.

b. *Other Licenses Between Non-Interactive Services And Record Companies Confirm That [ ]*

653. Though no major record company has agreed to a license with Pandora, the record in this proceeding includes licenses between major record companies and non-interactive webcasting services, namely the iHeartMedia-Warner license and the licenses for iTunes Radio between Apple on the one hand and Sony and Warner on the other hand. In each of those direct license situations, the non-interactive service provided [ ]. This is particularly telling because the services do *not* claim that licenses between non-interactive services and a major, such as iHeartMedia and Warner, suffer from any purported lack of effective competition. Thus, if agreements between iHeartMedia demonstrate that [ ], there is no reason to believe that a similar dynamic would not occur in a hypothetical marketplace between Pandora and a major record company.

654. iHeartMedia's direct licenses demonstrate exactly that: [

[redacted]

[redacted]]. As discussed in Section IX, *infra*, a comparison of those licenses, [redacted]

[redacted]

655. Similarly, the evidentiary record concerning Apple's licenses with Sony, Warner, and independent record companies for its iTunes Radio service demonstrates that [redacted]

[redacted]] *See* Section XI.A *infra*

656. Those licenses comprise are the only other sets of non-interactive service license proffered as possible benchmarks in this proceeding. [redacted]

[redacted]

[redacted]] There is no evidence in the record to suggest Pandora would be otherwise, particularly when no major record company has accepted the rates and terms of the Merlin license.

c. *Merlin Members Recognize That A Major Is Unlikely To Accept The Terms Of The Merlin License*

657. The independent record company witnesses, including those involved in Merlin's consideration of the license with Pandora, recognized that the majors would not agree to the same terms with Pandora or would likely receive substantially better terms. For example, Mr. Wheeler wrote an email to [redacted] *See* Hr'g Ex. PAN 5109. Mr. Wheeler explained his belief was that [redacted]

[redacted].] *See id.* at 1. Mr. Wheeler noted [redacted]

[redacted]

[redacted]] *Id.* At the hearing, he confirmed this belief and added that [redacted] .] Hr'g Tr. 7097:1-7098:2 (June 1, 2015) (Wheeler).

658. That the majors would receive better terms than Merlin in a license with Pandora is also consistent with Merlin's view that the more repertoire a rights owner negotiates on behalf of, the better terms they are likely to receive. As Mr. Lexton testified in a colloquy with Judge Strickler, [redacted] .] Hearing Tr. 6856:9-6857:13 (June 1, 2015) (Lexton).

d. *Pandora's Internal Documents Confirm That It Would Offer Better Terms To Larger Licensors*

659. In its internal documents describing direct licensing, Pandora acknowledged that it would be required to offer additional consideration and better terms to a major record company. An internal Pandora presentation titled [redacted]] Hr'g Ex. SX-1736 at 2. The presentation explains:

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660. The presentation specifically distinguishes between different levels of artists, independent record companies, and ultimately, the major record companies. *Id.* at 5.

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661. This spectrum of preferential terms based on size of repertoire or label spins is confirmed by comparing [

:]

- [
-
-
-

- [redacted]
- [redacted]
- [redacted]

e. *Major Record Company Repertoire Is Several Times More Prominent Than Merlin Repertoire On Pandora's Service*

662. Similarly, Pandora's key strategy presentation to its Board of Directors recognized the unique position of major record companies. As discussed *supra*, the presentation indicated that [redacted].]

663. This great differentiation in catalog size, in terms of Pandora spins, is meaningful to Pandora. [redacted].] *Id.* at 64.

664. This has two very significant implications for consideration of the Merlin license as a stand-alone benchmark in this proceeding. First, no witness in this proceeding, including Prof. Shapiro, has attempted to adjust the Merlin license for its failure to cover any major record

company. This complete absence of evidence, particularly in light of the untested, isolated, and unrepresentative nature of the license, renders it wholly inappropriate as a benchmark. Second, should the Judges nevertheless look to the Merlin license in determining the zone of reasonable rates, the "market rate" inferred by the Merlin license would be significantly upward of that identified by Prof. Shapiro to account for the considerable number of performances that would be licensed under substantially preferable terms in the hypothetical marketplace. At a minimum, this conclusively establishes that the Merlin license does not support the rates proposed by Pandora.

E. The Specific Structure And Elements Of Pandora's Rate Proposal Raise Additional Concerns

1. "Greater-Of" Rate Structure

665. Pandora's own economist, Prof. Shapiro, testified that a greater-of royalty structure "alleviates any concern that a pure percentage-of-revenue based royalty rate might fail to capture the 'intrinsic' value of a performance of sound recording." Hr'g Ex. PAN 5022 at 23 (Shapiro WDT). He further observed that:

> This royalty structure also directly addresses and alleviates any concern that a pure percentage-of-revenue based royalty rate might cause a 'disproportionality' to arise if some webcasters attempt to maximize market share rather than profits, or more generally if some webcasters choose to sacrifice revenues and/or profits during the rate-setting period in order to grow their installed base of users or their listening hours.

Id. at 23.

666. Finally, he noted that a greater-of rate structure allows record companies to "benefit from the security of per-play rates together with an upside in the event that the services improve their monetization." *Id.*. While reserving the possibility that his view with respect to "this manner of allocating risk" may change as the marketplace develops, Prof. Shapiro's view

was "that this structure is currently reasonable." *Id.*. Prof. Shapiro did not express a changed or revised view during the proceeding.

667. By virtue of its proposal, Pandora admits that the marketplace evidence supports the application of a greater-of rate structure to commercial webcasters that includes both a share of the commercial webcaster's revenue and a usage-based per-performance metric. Pandora Rate Proposal at 4 (Proposed Section 380.3(a)(1)(a)). This is consistent with both SoundExchange's rate proposal and the overwhelming marketplace evidence in the record demonstrating that direct licenses for sound recordings almost always utilize a greater-of rate structure. *See* Section VII.A, *supra*.

2. Pandora's Proposal Incorrectly Applies The "Greater-Of" Royalty Structure

668. Pandora's rate proposal makes the greater-of determination between the usage prong and revenue prong with respect to all performances, not with respect to what Pandora considers "eligible transmissions" made pursuant to the statutory license. Pandora Rate Proposal, at 5 (Proposed Section 380.3(a)(1)(b)) (Oct. 7, 2014). This is an incorrect way to apply a greater-of rate structure. If, as Pandora's proposes, (i) a "greater-of" determination is based on all performances and (ii) commercial webcasters do not pay royalties on the basis of all performances, the result could be that the commercial webcasters pays the *lesser of* the royalties if measured based on royalty-bearing performances. To do so would contradict the intent of Pandora's proposal on its face, and the overwhelming evidence in the record supporting the use of a rate structure which provides a greater-of royalty payment. *See* Section VII.A, *supra*. Based upon this evidence, the determination of what royalty prong applies under a greater-of rate structure should ensure that the greater *royalty* is paid. Pandora has presented no evidence, nor is

there any evidence in the record, supporting a determination of which royalty prong is "greater" based on all "performances" rather than based on the greater royalties.

669. Pandora's proposal incorrectly assesses usage-based royalties in making the determination of which royalty prong should apply. Under Pandora's proposal, if the greater-of determination favors the usage-based royalty based on all performances, a commercial webcaster could then exclude from payment performances of directly-licensed recordings or performances of sound recordings fixed before February 15, 1972 (so-called "Pre-72 Recordings"). Pandora Rae Proposal at 5 (Proposed Section 380.3(a)(1)(b)). If a commercial webcaster utilizes a significant percentage of directly-licensed sound recordings or Pre-72 Recordings *and* the Judges do not require payment for those performances, then inclusion of those performances in the greater-of determination will inaccurately assess a commercial webcaster's usage of sound recordings pursuant to the statutory license.

670. Pandora's proposal also incorrectly determines revenue-based royalties in determining which royalty prong should apply. If the greater-of determination favors the percentage-of-revenue royalty based on all performances, Pandora's proposal would allow a commercial webcaster to reduce the fee owed by a "Direct License Share," which is defined as "the result of dividing Licensee's Performances of directly-licensed recordings by the total number of Licensee's Performances of all sound recordings during the payment period." Pandora Rate Proposal at 5 (Proposed Section 380.3(a)(1)(b)). First, if there is a difference between the revenue earned by directly-licensed or Pre-72 performances and what Pandora defines as "Eligible Transmissions," then the greater-of determination under Pandora's proposal would inaccurately include revenue that Pandora does not regard as "Revenue from Eligible

Transmissions." The royalty base used to assess whether a revenue sharing prong is greater than a usage-based prong should be the same royalty base used to assess the royalty itself.

671. Because there is no evidence in the record to support making a greater-of royalty determination based on all performances, but then assess royalties based only on what Pandora defines as "Éligible Transmissions," the Judges should reject Pandora's proposal in this regard. Rather, consistent with the evidence in the record, the proper determination of which prong applies in a greater-of rate structure should be based on the royalties payable under each prong.

3. Usage-Based Royalty Prong

672. With respect to the usage-based royalty prong, Pandora proposes the following royalty rates:

YEAR	PER NON-SUBSCRIPTION PERFORMANCE	PER SUBSCRIPTION PERFORMANCE
2016	$0.00110	$0.00215
2017	$0.00112	$0.00218
2018	$0.00114	$0.00222
2019	$0.00116	$0.00226
2020	$0.00118	$0.00230

673. Pandora proposes an escalating per-performance rate, increasing year-over-year throughout the license period. Pandora Rate Proposal, at 4 (Proposed Section 380.3(a)(1)(a)(i)).

674. Pandora distinguishes between royalty rates applicable to non-subscription performances and subscription performances. Pandora Rate Proposal, at 4 (Proposed Section 380.3(a)(1)(a)(i)). Pandora's rate proposal does not define "non-subscription performance" or "subscription performance."

675. Pandora's proposed non-subscription performance rates for all commercial webcasters would represent a drastic downward departure from the rates set for commercial webcasters under the *Webcasting III Remand* decision, which for 2015 is $0.0023 per

performance. In fact, Pandora's proposal for non-subscription performances would represent an overnight 53% reduction in the commercial webcasting royalty rate. The commercial webcasting rate set by the Judges has not been as low as what Pandora proposes for 2016 since the year 2007. *Webcasting II*, 72 Fed. Reg. at 24096 (May 1, 2007).

676. Similarly, if Pandora's proposal for non-subscription performances was adopted for commercial webcasters who were previously operating under the broadcaster settlement negotiated by the National Association of Broadcasters ("broadcaster settlement") or the Webcasters Settlement Act agreement negotiated by Sirius XM ("commercial webcaster-WSA"), Pandora's proposal would represent overnight reductions in the royalty rate applicable to those performances of 56% and 54%, respectively.

677. Pandora's proposed subscription performance rate for all commercial webcasters in 2016 ($0.00215) would be a downward departure for the subscription performance rates applicable to any commercial webcaster operating under the statutory license in 2015. This would represent reductions of 6.5%, 10.4%, and 14% from the 2015 commercial webcaster *Webcasting III*, commercial webcaster-WSA, and broadcaster settlement rates, respectively. If Pandora's proposal is adopted, the royalty rate applicable to subscription performances would only return to the current rate applicable to statutory webcasting performances in 2020, the very last year of the next rate period.

4. There Is No Justification For The Bifurcated Rate Structure Proposed By Pandora

678. Pandora has proposed different rates for ad-supported performances and subscription performances. But there is no valid economic justification for this bifurcated rate structure.

679. Prof. Rubinfeld testified that it is "unreasonable to suggest that sellers in the market would willingly subsidize a service's business decision to rely on advertising rather than subscription revenue." Hr'g Ex. 29 ¶ 204 (Rubinfeld Corr. WRT). And evidence of real world negotiations confirms that, absent the statutory license, record companies would not agree to a two-tier rate structure for ad-supported and subscription performances. [

680. Although Pandora has proposed a bifurcated rate structure in this proceeding, its internal documents show that it recognizes that this rate structure lacks a sound economic basis. In an e-mail to Charlie Lexton, Chris Harrison, one of Pandora's negotiators noted:

] *Id.* David Frear of Sirius XM expressed the same view, noting that he "can't imagine why [a two-tier rate is] a valid way to treat the business." Hr'g Tr. 5448:16 – 5450:5 (May 22, 2015) (Frear).

5. Revenue-Sharing Royalty Prong

681. With respect to Pandora's proposed revenue sharing prong, Pandora's proposal is limited to 25% of "Revenue" from "Eligible Transmissions." Pandora Rate Proposal, at 4 (Proposed Section 380.3(a)(1)(a)(ii)).

682. Pandora proposes a new definition for the regulations of "Eligible Transmission" that includes reference to "a subscription or nonsubscription transmission made by Licensee." Pandora Rate Proposal, at 3 (Proposed Section 380.2). Pandora does not define "subscription" or

"nonsubscription" or address how to distinguish a transmission as "subscription" or "nonsubscription." Pandora's definition of "Eligible Transmissions" also does not refer to the statutory definition of "Performance." Pandora Rate Proposal, at 3 (Proposed Section 380.2).

683. Pandora proposes a definition of "Revenue" that is limited to money "derived by the Licensee from making Eligible Transmissions in the United States," and is further limited to only "Subscription revenue earned by Licensee directly from U.S. subscribers" or "advertising revenues, or other monies received from sponsors, if any, attributable to advertising on channels making Eligible Transmissions . . . less advertising agency and sales commissions." Pandora Rate Proposal, at 4 (Proposed Section 380.2). Pandora further excludes from "Revenue" any "revenue from activities other than making Eligible Transmissions," as well as sales and use taxes, shipping and handling, credit card, invoice, and fulfillment service fees. Pandora Rate Proposal, at 4 (Proposed Section 380.2).

684. Pandora's definition of "Revenue" does not define "subscription revenues" or "advertising revenues" or identify what distinguishes "subscription" from "advertising" revenue. *See* Pandora Rate Proposal, at 4 (Proposed Section 380.2). Pandora also does not define what revenues are "attributable to advertising on channels making Eligible Transmissions." Pandora Rate Proposal, at 3 (Proposed Section 380.2).

685. Pandora's definition of "Revenue" places no limit on the amount of "advertising agency and sales commissions" that can be deducted from "Revenue." Pandora Rate Proposal, at 4 (Proposed Section 380.2).

686. Also, Pandora's proposal would inaccurately include a double-deduction concerning rate structure: Both through its definition of "Revenue" and its rate proposal, Pandora's proposal limits the royalty base of revenue sharing to that revenue "derived by" or

"from" "Eligible Transmissions." Pandora Rate Proposal at 4 (Proposed Section 380.2); Pandora Rate Proposal at 4 (Proposed Section 380.3(a)(1)(a)). To allow a commercial webcaster to then further deduct a "Direct License Share" from that royalty base would inappropriately and accurately deduct revenue from Eligible Transmissions. There is no basis in the evidence, nor would it be appropriate, to both exclude revenue from directly-licensed performances from a revenue sharing royalty base *and* allow a further deduction for the same revenue.

F. The License Between Pandora And Naxos Does Not Support Pandora's Rate Proposal

1. The Meager Evidentiary Record Concerning The Naxos License Does Not Support Treating The Naxos License As Further Support For The Merlin License

687. Pandora presents almost no evidence whatsoever to support the use of its license with independent classical label, Naxos, in determining the zone of reasonable rates. Mr. Herring states in one paragraph [.] Hr'g Ex. PAN 5016 ¶ 51 (Herring Am. WRT). There is nothing more to his testimony. No discussion of the negotiations, expectations, performance, terms, or circumstances surrounding the license whatsoever. Prof. Shapiro similarly treats Naxos as an add-on, merely applying his effective rate calculations to Naxos. Hr'g Ex. PAN 5023 at 37 (Shapiro WRT). He too fails to discuss the negotiations, expectations, performance, terms, or circumstances surrounding the license except to acknowledge that the Naxos license [ ]. *Id.* at 42.

688. The Naxos license [

[redacted]

steering on Naxos, if any occurs, will not change the effective rate in the same way as the Merlin license, if at all.

689. Furthermore, as described in Section VIII.D.3.d, *supra*, the Naxos license is simply incomparable to the Merlin license in its core economics.

2. Naxos's Motivation For Its License With Pandora Was Evading Payment Of The Artist Share To SoundExchange

690. The only document in the evidentiary record reflecting the motivation for the Naxos deal establishes that the motivation for the license was not because of steering. *See* Hr. Ex. SX-274. [redacted]

691. Mr. Herring also testified at the hearing that [redacted]

[redacted]

692. This form of direct payment – where a label receives both the artist and label share of royalties – is [redacted].] Hr'g Ex. PAN 5014 § 12(a).

3. The Naxos License Is Not An Appropriate Benchmark

693. Nearly all of the reasons that apply to why the Merlin license is an unrepresentative benchmark apply with equal or greater force to the Naxos license.

694. Naxos, a single Merlin member, by definition, comprises an even smaller sliver of the market and the Naxos license therefore covers far fewer sound recordings than the Merlin license.

695. Naxos is a genre-specific record label that focuses on classical music sound recordings. Hr'g Tr. 3512:14-19 (May 13, 2015) (Herring).

696. Mr. Herring testified that the Naxos license covers [redacted].] Hr'g Tr. 3523:4-3527:9 (May 13, 2015) (Herring).

G. The Record Does Not Support Pandora's Steering Argument

697. Pandora relies on a benchmark agreement that contains [redacted]. Hr'g Ex. PAN 5014 § 4. But, as described in further detail below, an agreement with [redacted] is not a valid benchmark agreement. As a matter of simple arithmetic, a webcaster cannot commit to steer to every record label. Accordingly, a steering commitment cannot be a part of the statutory license. Nor is it possible to solve this problem by simply discarding the steering commitment. Doing so would separate the rate in the agreement

from the specific bargained-for consideration that the record company obtained in exchange for that rate.

698. Recognizing the serious problems inherent in relying on an agreement with [ ] Pandora falls back on a second, theoretical, argument: that the threat of steering alone would induce price competition among record companies. Prof. Shapiro claims that a webcaster's "ability or inability . . . to steer listeners toward or away from the music of a given record company is fundamental to the licensing negotiations that would take place in the absence of a compulsory license." Hr'g Ex. PAN 5022 at 9 (Shapiro WDT). In Prof. Shapiro's view, "a streaming service with considerable ability to steer will have much more bargaining power and be able to negotiate a lower royalty rate." Hr'g Ex. PAN 5023 at 20 (Shapiro WRT). According to Prof. Shapiro, this is because "the record company knows that raising its royalty rate to this streaming service can significantly reduce its share of music played by this service." *Id.* Prof. Shapiro claims that the "threat" of such steering is what gives the streaming service bargaining power. *Id.* And Prof. Shapiro contends that, as a result of this "threat," there would be little need for actual steering because the "threat" of steering alone would keep each record company from raising its rates to the streaming service. Hr'g Tr. 4561:21 – 4564:5 (May 19, 2015) (Shapiro).

699. Despite this theoretical account, which predicts that the threat of steering alone will result in lower prices to webcasters, the record is bereft of *any* benchmark agreement that reflects this dynamic. In other words, there is not a single agreement in the record in which a record company offered a lower price to a webcaster simply to avoid the webcaster's credible threat of steering. Rather, the benchmark agreements in the record that involve steering each involve a [ ]. Agreements that contain steering *commitments* do not reflect

the type of "threat"-based discounting described by Prof. Shapiro. Accordingly, the Judges should not embrace Pandora's theory in the absence of any concrete evidence that most willing sellers would actually discount their rates in response to a "threat" of steering.

700. In addition, as Prof. Shapiro admits, for steering to work it has to be credible. Hr'g Tr. 4564:7-11 (May 19, 2015) (Shapiro). But Prof. Shapiro has not shown that Pandora has a credible threat of steering that is sufficient to induce record labels to give it a discounted rate. In particular, Prof. Shapiro has not accounted for significant factors that disable Pandora's steering threat.

1. Agreements That Include Steering Commitments Are Not Useful Benchmarks

701. Agreements that contain steering commitments are not useful benchmarks because the bargained-for benefit of the steering commitment cannot be replicated in the statutory license.

702. A steering commitment has economic value to a record company. For instance, under the [[redacted]

18 [[redacted]]

703. [redacted]

704. [redacted] Hr'g Ex. SX-17 ¶ 179 (Rubinfeld Corr. WDT).

705. Prof. Shapiro also acknowledged that steering commitments have value. In response to Prof. Rubinfeld's statement that [redacted] Prof. Shapiro agreed with Prof. Rubinfeld that "some adjustment is appropriate." Hr'g Ex. PAN 5023 at 41 (Shapiro WRT).

706. The statutory license cannot offer steering commitments to every record label. For instance, [ ] But as a matter of mathematics, it is not possible to offer this benefit to every record label. Hence, Prof. Rubinfeld testified that "The statutory license does not—and cannot—contemplate 'playment.'" Hr'g Ex. SX-29 ¶ 70 (Rubinfeld Corr. WRT). As Prof. Talley explained:

> Such in-kind benefits, in fact, would not be readily available to all potential counterparties. Indeed Pandora could not credibly undertake to steer customers to labels of the majors too, because it would have to steer them away from something else Consequently even if steering "works," Pandora has only limited ability to promise steering services to counterparties.

Hr'g Ex. SX-19 at 28 (Talley WRT).

> [A]n affirmative obligation to steer just can't be implemented on a market-wide basis. It's just not possible for a service to say I'm going to steer listenership towards each label that I contract with.

Hr'g Tr. 6070:8-17 (May 27, 2015) (Talley).

707. Pandora contends that an agreement with a steering commitment can, nonetheless, be used as a benchmark agreement if the "[ ]." Hr'g Ex. PAN 5023 at 41 (Shapiro WRT). But this argument does not work in the context of the statutory license. The statutory license and the participants' rate proposals do not contain "price differences" among record labels. Accordingly, there is nothing in the license that would induce the "amount of steering" that was bargained for in the steering commitment. Relying on a benchmark agreement that includes a steering commitment would result in importing the discounted headline rates from the agreement but discarding the bargained-for commitments that resulted in that discount.

708. In sum, steering commitments provide value to record labels. With respect to the agreements in the record, [ ] But it is not possible for the statutory license to offer steering commitments to all record companies. As a result, using the discounted rates in an agreement with a steering commitment results in importing the discounted headline rates from the agreement but discarding the bargained-for commitments that resulted in that discount.

2. Pandora Lacks a Credible Steering Threat

a. *There Are No Agreements Based Solely on the "Threat" of Steering*

709. Prof. Shapiro's claim that the "threat" of steering alone would induce record companies to discount their rates is not supported by the evidence. There are no agreements in which a record company lowered its rates in response to such a threat.

710. The Pandora – Merlin agreement is not an example of an agreement in which a record company lowered its rates in response to a threat of steering. [ ] As Prof. Talley explained:

> the negotiated transaction that Professor Shapiro has proffered is, in fact, not one of these transactions that is either negotiated in the shadow of a threat to steer away or negotiated with an undertaking to steer away. It's in the opposite direction. This is a promise, in fact, a contractual obligation to steer towards Merlin . . . ."

Hr'g Tr. 6076:23 – 6077:6 (May 27, 2015) (Talley). [ ].

711. Moreover, under Prof. Shapiro's theory of steering-induced discounting, other record labels would be expected to discount their rates in the face of Pandora's threat to steer and in response to the Pandora – Merlin agreement. Indeed, the central premise of Prof. Shapiro's theory is that steering should spark price competition among record labels. Hr'g Ex. PAN 5023 at 40 (Shapiro WRT) ("steering is how record companies compete on price in the statutory market"). Yet the record is devoid of any evidence showing such competition.

712. [redacted]

713. The Pandora – Naxos agreement—the only direct license signed by Pandora in the year since the Pandora – Merlin license—[redacted]

714. [redacted].]

715. The Warner – iHeartMedia agreement [redacted]

716. [redacted].

717. In the absence of agreements in the record demonstrating that Pandora has the ability to steer, the Judges should not accept its claim that it could negotiate lower rates from record companies based solely on the threat of steering.

b. ***Pandora Has Not Demonstrated a Real-World Ability to Steer***

[19] By contrast, SoundExchange is required by statute to pay a portion of performance royalties directly to artists. 17 U.S.C. § 114(g)(2)(D) ("45 percent of the receipts shall be paid, on a per sound recording basis, to the recording artist or artists featured on such sound recording").

(i) Pandora's Experience With the Pandora – Merlin License Shows That it Lacks a Credible Threat of Steering

718. Prof. Shapiro admits that for steering to have an effect on prices, the threat of steering must be credible. Hr'g Tr. 4564:7-11 (May 19, 2015) (Shapiro). But Pandora's experience with the Merlin license demonstrates that it lacks the real-world ability to meaningfully steer.

719. [redacted]

720. [redacted]]

721. [redacted]]

722. Prof. Shapiro has not explained why, [redacted] the Judges should conclude that Pandora has a credible steering threat. In fact, Pandora's poor track record demonstrates that it does not have a credible steering threat.

(ii) Pandora Failed To Test Steering Under Real-World Conditions

723. Moreover, Pandora's steering experiments are not informative because they did not test steering under real-world conditions. During Pandora's steering experiments, its users were not aware that Pandora engaged in steering. Hr'g Tr. 4768:12-19 (May 19, 2015) (Shapiro). And Pandora has not presented evidence that its listeners have since become aware of Pandora's steering.

724. Prof. Shapiro admitted that Pandora's steering experiments did not test how people would react to learning "that Pandora was factoring in royalty rates and how they constructed the playlist." Hr'g Tr. 4775:4-8 (May 19, 2015). And Prof. Shapiro admitted that some consumers would not like it if they learned that Pandora engaged in steering. *Id.* at 4774:6-16 (Shapiro).

725. Pandora's efforts to steer are also directly contrary to the brand image it has presented its consumers. Prof. Shapiro conceded that "Pandora has publicly touted the purity of its music selections." Hr'g Tr. 4768:20-22 (May 19, 2015) (Shapiro). For example, in February 2006, Tim Westergren, Pandora's founder publicly promised Pandora's listeners:

> Pandora will never take paid placement to decide what's in a playlist. The recommendations we make are going to be based on the genome, they will never be based on somebody buying the space. You heard it from me here first. Never!

726. Hr'g Ex. SX-2369 at 1. And Mr. Westergren has recently acknowledged under oath that [redacted].] Hr'g Ex. SX-2369 at 3.

727. Further, Prof. Shapiro admitted that Pandora's competitors could "fan the flames" through comparative advertising. Hr'g Tr. 4775:20-25, 4776:21 – 4777:15 (May 19, 2015) (Shapiro). He agreed, for instance, that "Spotify or iTunes Radio could start a comparative advertising campaign to steal away customers from Pandora based on Pandora's intentional steering." *Id.* Prof. Shapiro also acknowledged that Apple could potentially advertise that "we give you the music you want, Pandora gives you the music they can afford." *Id.* at 4635:2-8. In fact, Prof. Shapiro noted that he has "worried about" the question whether Apple could take out such an advertisement and whether it would "magnify" a negative reaction to steering. *Id.*at 4635:2-4636:5.

728. Despite the fact that Prof. Shapiro has "worried" about the effect that widespread knowledge of steering would have on Pandora's listenership, he has not done any empirical analysis to quantify the effect or determine whether it would be significant. *Id.* Nor has Prof. Shapiro analyzed the effect on Pandora's brand image of reneging on previous commitments to "pure" music selection.

729. In sum, [redacted] and it has not tested the long-term effects of public steering on its brand image. As a result of these two deficiencies, Pandora lacks a credible threat of steering.

c. *Record Companies Have Significant Defenses To Any Threat of Steering*

730. Without the "safety net" provided by the statutory license—which guarantees Pandora access to music from every record company—Pandora could not credibly threaten to

steer against a record company. In a market without the statutory license, the record companies would have a number of defenses that would defuse any potential threat of steering. These defenses would be particularly powerful in the case of the major record companies, which are "must haves" for Pandora. Prof. Shapiro's theoretical account of steering has not grappled with these defenses and has not demonstrated that Pandora would be able to overcome them.

(i) A Record Label Could Refuse to License to Pandora

731. Prof. Shapiro conceded that a record company with market power may be able to disable a webcaster's threat of steering. Hr'g Tr. 4576:14 – 4577:5 (May 19, 2015) (Shapiro). At the hearing, the Judges asked Prof. Shapiro whether it was possible for a record company to take the following negotiating position in the absence of a statutory license: "Give us the rate we negotiated and no steering or we're pulling all our music from you. . . . You don't steer away, and you pay the same rate, and you play me at [the] same proportionate share as you always do." Hr'g Tr. 4576:3-13, 4576:22-25 (May 19, 2105) (Shapiro). Prof. Shapiro admitted that this would be a possibility: "I think that's exactly right. I happen to have studied exactly this dynamic intensively in the negotiations between programmers and cable television companies." Hr'g Tr. 4577:16-20 (May 19, 2015) (Shapiro). And Prof. Shapiro acknowledged that he did not know what the result of this "game of chicken" would be. *Id.* at 4577:22 – 4578:22.

732. Similarly, Prof. Talley noted: "[T]hink about this in the hypothetical market where there is no background statutory rate. [A] label might say, okay, if you're going to [steer against us], we may just walk away, right?" Hr'g Tr. 6074:18-21 (Talley) (May 27, 2015).

733. Ron Wilcox testified that [ ]

734. And Darius Van Arman testified [redacted]]

735. Prof. Katz acknowledged that one option available to a record company would be to deny the service a license and then rely on other distribution outlets or services. Hr'g Tr. 3015:16-21 (May 11, 2015) (Katz).

736. Mr. Harleston of UMG [redacted]] Hr'g Tr. 1429:3-6 (May 1, 2015) (Harleston).

737. The evidence in the record confirms Mr. Harleston's testimony that, in response to a steering threat, a record label could lean in to other services that offer better value propositions. As Pandora's internal business documents recognize, Pandora's [redacted]] These competitors include Spotify, Google, and Apple, which all offer both interactive and non-interactive features. Hr'g Tr. 4307:22-4308:12 (May 18, 2015) (Herring); *See* Section V.B, *supra*. In response to a threat to steer by Pandora, a record

company could take advantage of the broader value proposition offered by Pandora's competitors.

(ii) A Record Label Could Obtain Contractual Provisions That Disable Steering

738. Record companies would also be free to negotiate contractual protections from steering. For example, UMG has long recognized that *interactive* services have the ability to steer. Hr'g Ex. SX-25 ¶ 14 (Harrison WRT). But UMG has disabled this threat of steering by negotiating for contractual protections from steering.[20] Hr'g Ex. SX-25 ¶¶ 14-16 (Harrison WRT).

739. Similarly, Prof. Katz acknowledged that a record company could respond to a steering threat by seeking a lump sum payment instead of per-performance rates. Hr'g Tr. 3015:22- 3016:1, 3019:25 – 3020:6 (May 11, 2015) (Katz). A lump sum payment would make the threat of steering irrelevant. *Id.*

(iii) Because The Major Labels Are "Must Haves" For Pandora, They Would Not Discount In Response To A Steering Threat

740. The evidence shows that the major record companies are must-haves for Pandora. [redacted].] *Id.* Any any threat of steering by a webcaster would "be outflanked by a major's ability to threaten to withhold its entire catalog." Hr'g Ex. SX-19 at 34 (Talley WRT).

[20] Prof. Katz testified that he was not offering an opinion that these anti-steering provisions were anticompetitive or illegal. Hr'g Tr. 2900:7 – 2901:19 (May 11, 2015) (Katz). He explained that answering that question involves "a fact-specific inquiry" that he had not performed. *Id.* No economic expert in this proceeding has testified that the anti-steering clauses described by Mr. Harrison are anti-competitive and no expert has performed the complex economic analysis required to make such a determination. *See Leegin Creative Leather Prods v. PSKS, Inc.*, 551 U.S. 877 (2007) (rule of reason applies to vertical restraints).

741. Prof. Rubinfeld testified that the "[m]ajor labels' catalogs are 'must haves' in the non-interactive space."[21] Hr'g Ex. SX-29 at 38 (Rubinfeld Corr. WRT); Hr'g Tr. 1836:12-17, 1857:7-24 (May 5, 2015) (Rubinfeld) ("I think [the major labels] are must-haves in both spaces."). As Prof. Rubinfeld noted, "[t]he steering experiments conducted by Pandora demonstrate that Pandora would find it difficult to succeed without the catalogs of each major [label]." *Id.* Prof. Rubinfeld's testimony that the major labels' catalogs are "must-haves" in the non-interactive space is undisputed.

742. Prof. Katz acknowledged that the catalogs of the major labels may be must-haves for non-interactive services. *See* Hr'g Tr. 2989:10-2990:1 (May 11, 2015) (Katz) ("Q. Is it fair to say that you think today that for many simulcasters, Universal, Sony and Warner would be must-haves? A. Yes."; "Q. Is it fair to say that you also believe that the majors are must-haves for customized services such as Pandora? A. I would say I believe that's a possibility, yes.").

743. Prof. Shapiro testified that he was "offering no opinion whether the majors are must-have for Pandora." Hr'g Tr. 4582:7-10 (May 19, 2015) (Shapiro). Similarly, Michael Herring [ )]

744. Pandora's steering experiments confirm the must-have status of the major labels' catalogs for Pandora. [ ] *See* Hr'g Ex. SX-29 ¶¶ 140-154 (Rubinfeld Corr. WRT). Yet Pandora failed to test the test the impact on listening where there is

[21] Prof. Shapiro testified as an antitrust economist that "in and of itself" there is "nothing wrong" with companies that are "large," "powerful" or "even have a dominant position. Hr'g Tr. 4721:1-6 (May 19, 2015) (Shapiro).

a loss of 100% of a label's catalog. *See* Hr'g Ex. SX-19 at 34. Pandora's failure to run this experiment supports an inference that the major labels are, in fact, must-haves for Pandora.

745. The Services have suggested that the Judges should ignore the must have status of the major record companies and construct a hypothetical marketplace that is different from the market as it currently exists today. As discussed in SoundExchange's Conclusions of Law, there is no support for that position.

746. As Prof. Katz acknowledged, to construct a hypothetical market without "must-have" record companies, one would have to envision different record companies than those that presently exist today, and the market itself would look fundamentally different. *See* Hearing Tr. 3005:5-15 (May 11, 2015) (Katz) ("Q. And if instead what we did is we reduced the recordings and artists that Universal, Sony, and Warner controlled, from where they are today, to whatever the level is that would make them not must-haves, the market would also look different than it looks today, correct? A. Well, yes, I mean, almost by definition because you said you're changing the market, yes. Q. So the majors wouldn't be majors, correct? A. If you moved it away enough, correct.").

747. The Services have not proposed, much less demonstrated, any reliable method to create this alternative hypothetical universe. Prof. Katz was unable to say how much market power – and artists – one would need to take away from a major label such that it would no longer be a must have. *See* Hr'g Tr. 3000:14-17 (May 11, 2015) (Katz) (Q. You can't tell us how much we have to take away from Universal to make it not a must-have, correct? A. That's correct."). And Prof. Katz testified that while he thought about doing an analysis of what the market would look like where the majors "are no longer must-haves," he "didn't come up with a reliable way" to do so. *See* Hr'g Tr. 3004:16-3005:4 (May 11, 2015) (Katz).

IX. IHEART'S RATE PROPOSAL IS NOT SUPPORTED BY THE IHEART-WARNER AGREEMENT, BY IHEART'S AGREEMENTS WITH INDEPENDENT LABELS, OR BY SOUND ECONOMICS

748. iHeart proposes a rate of $0.0005 per performance—a dramatic departure from prior statutory rates and the actual rates as stated or reasonably derived from the benchmark agreements presented in this proceeding. In support of its rate proposal, iHeart principally relies on Profs. Fischel/Lichtman's "incremental analysis" of the iHeart-Warner agreement. As explained below, the record demonstrates that the incremental approach is divorced from economic theory or reality. Properly considered, the iHeart-Warner agreement cannot justify a rate of $0.0005 and instead suggests that SoundExchange's rate proposal of $.0025 is conservative.

749. Section A provides an overview of the iHeart-Warner agreement, including the core items of economic consideration that iHeart provided to Warner. This section also describes exactly how the shadow of the statutory license influenced the iHeart-Warner agreement because (1) the rates are anchored by and tied to what iHeart and its competitors currently pay through the statutory license; (2) the very existence of a statutory license gives iHeart unique leverage and options not available in an actual market in which Warner (or any other copyright owner) could withhold its content; and (3) that the agreement would (or could) be used as precedent in this proceeding may have distorted the course of negotiations and even internal valuations of the agreement. These shadows make the iHeart-Warner agreement (as well as iHeart's agreements with 27 independent labels) poor representations of what would happen absent a statutory license—further confirming that reliance on the interactive services agreements as benchmarks best avoids the impacts of the shadow.

750. Section B discusses Profs. Fischel/Lichtman's "incremental approach." That approach is wrong from an economic perspective and as applied to the iHeart-Warner agreement.

As explained fully below, that incremental analysis does not logically or as a matter of economics illuminate the rate that would be agreed to by a willing buyer and willing seller. This approach is not applied by any of the academically trained economists in this proceeding—not Prof. Shapiro, Prof. Katz, nor Prof. Rubinfeld. Even if it were methodologically appropriate, as applied, Profs. Fischel/Lichtman chose to rely on certain projections (and ignore others). They also selectively exclude consideration that iHeart provided to Warner, which bias their incremental rate downward. Clear from a review of the range of other projections and simple calculations to include the consideration that Profs. Fischel/Lichtman improperly excluded, even applying Profs. Fischel/Lichtman's incremental analysis, the iHeart-Warner agreement supports SoundExchange's rate proposal.

751. Section C discusses the correct approach—an analysis of the average effective royalty rate. The Services' reject out-of-hand any reliance on the performance of an agreement, choosing to focus on a few deliberately created and selected sets of projections (that they *assume* accurately reflect those parties' expectations). However, the case law, economic theory, and business experience teach us that performance cannot be ignored and should be considered along with any expectations analysis. Just as any market participant would factor performance of past agreements into their projections for the future, so too should the Judges consideration the performance to date of agreements when setting rates for the 2016-2020 rate term.

752. This section also explains the numerous items of consideration that must be considered to properly value the iHeart-Warner agreement. The agreement provides substantial consideration to Warner that is not available under the statutory license. Without any one of the core economic terms that Warner received, it would not have done the deal. Finally, properly analyzed, the iHeart-Warner agreement results in an average effective royalty rate that supports

SoundExchange's rate proposal. This is true whether you look at its actual performance, iHeart's expectations, or Warner's expectations of how the agreement would perform.

753. Section D discusses the iHeart agreements with 27 independent labels and why they cannot serve as a benchmark or confirm iHeart's $0.0005 rate proposal. These agreements fare worst on the comparability test and represent only a fraction of the market of sellers. Further, Profs. Fischel/Lichtman's analysis of those agreements suffers from the same fundamental flaws as their analysis of the iHeart-Warner agreement. It is further flawed because iHeart did not even model their expectations of those agreements, resulting in pure conjecture on the part of iHeart's experts.

A. The iHeart-Warner Agreement

1. Background and Core Terms of the iHeart-Warner Agreement

754. On September 12, 2013, iHeart and Warner announced that they had reached a direct license agreement for the right to perform Warner's sound recordings through iHeartRadio. Hr'g Ex. IHM 3348 at 2 (iHeart Press Release); Hr'g Ex. SX-33 (iHeart-Warner Agreement). The agreement ultimately reached does not resemble the agreement between iHeart and the 27 independent record labels that iHeart has offered as confirmatory evidence.[22] The iHeart-Warner agreement was addressed by both Profs. Fischel/Lichtman[23] for iHeart and Prof.

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[22] Notably, Warner was originally approached with terms identical to those contained in the agreements offered to the 27 independent labels. Hr'g Ex. IHM 3114 at 10 ([redacted] . Warner ultimately achieved a [redacted]] discussed in Section IX.D *infra*. Hr'g Tr. 5542:16-17; 5551:2-12 (May 22, 2015) (Fischel).

[23] Contrary to Profs. Fischel/Lichtman's assertions, the iHeart-Warner agreement was not the only (or even first) agreement "between a non-interactive webcaster of similar prominence as (footnote continued)

Rubinfeld for SoundExchange in their written direct testimony. Hr'g Ex. IHM 3034 at 17-29 (Fischel/Lichtman AWDT); Hr'g Ex. SX-17 at 45-47, 57-59 (Rubinfeld Corr. WDT).

755. The initial term of the iHeart-Warner agreement is [ ]. Hr'g Ex. SX-33 at 28, § 10(a). The agreement provides Warner [ ]. Hr'g Ex. SX-33 at 28, § 10(c); *see also* Hr'g Ex. SX-32 at 14 (Wilcox WRT).

756. In exchange for the right to perform Warner sound recordings under the agreement, iHeart agreed to provide Warner with numerous items of consideration having economic value,[24] including:

- For] under the agreement, iHeart pays Warner [. Hr'g Ex. SX-33 at 14, § 3(a).
- For [ ], iHeart pays Warner . Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii).
- For [ ], iHeart pays Warner

iHeartMedia and a record label of similar prominence as Warner." Hr'g Ex. IHM 3034 at 17 ¶ 32 (Fischel/Lichtman AWDT). The recorded music industry's agreements with Apple for iTunes Radio preceded the iHeart-Warner agreement.

[24] Mr. Wilcox testified to the value that each of these provisions has to Warner during his direct and rebuttal phase hearing testimony. *See generally* Hr'g Tr. 2348-2372 (May 7, 2015) (Wilcox); Hr'g Tr. 7384-7431 (June 3, 2015) (Wilcox). The specific value to Warner of each of these provisions is discussed *infra* in Section IX.C.2.

[redacted]]. Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii).

- For [redacted], iHeart pays Warner [redacted]. Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii).
- For [redacted], iHeart pays Warner [redacted]. Hr'g Ex. SX-33 at 15-16 § 3(b)(i)-(ii).
- [redacted]. Hr'g Ex. SX-33 at 2, § 1(e); 11, § 1(qq).
- iHeart must also pay Warner [redacted]. Hr'g Ex. SX-33 at 17, § 3(d).
- iHeart must also pay Warner an [redacted]. Hr'g Ex. SX-33 at 16, § 3(c).
- iHeart agreed to provide to Warner[redacted]. Hr'g Ex. SX-33 at 19-20, § 5(a). In addition to [redacted], iHeart agreed to provide Warner with a [redacted] Hr'g Ex. SX-33 at 19-20, § 5(a); 81, Exhibit F. [redacted] Hr'g Ex. SX-32 at 14 n.9 (Wilcox WRT); Hr'g Tr. 7403:4-21 (June 3, 2015) (Wilcox).
- iHeart also agreed to pay Warner [redacted]. Hr'g Ex. SX-33 at 10, § 1(pp); Hr'g Ex. SX-32 at 14 (Wilcox WRT).

- iHeart agreed to pay Warner [redacted]. Hr'g Tr. 7387:8-12 (June 3, 2015) (Wilcox).

757. Warner viewed the consideration it received as significantly greater than what it would have received under the statutory license. In Mr. Wilcox's words, they received a [redacted]. Hr'g Tr. 2370:13-17 (May 7, 2015) (Wilcox). Warner would not have made the agreement with iHeart without all of the foregoing terms. Mr. Wilcox testified that these terms [redacted]. Hr'g Tr. 7416:4-16 (June 3, 2015) (Wilcox).

758. Warner received additional valuable consideration under the agreement, including [redacted]. Hr'g Tr. 7384:10-16 (June 3, 2015) (Wilcox). These terms represent additional value to Warner that it would not receive under the statutory license.

759. In addition to receiving the right to perform Warner's sound recordings under the agreement, iHeart also received additional consideration. The provision authorizing iHeart to make simulcast performances also [redacted]. This was, as Profs. Fischel and Lichtman described it, an [redacted] of sorts that had some value to iHeart. Hr'g Ex. IHM 3034 at 20 (Fischel/Lichtman AWDT). iHeart also received [redacted]

[redacted]

[redacted]]. *Id.*; Hr'g Ex. SX-33 at 31, § 13(b). No iHeart fact witness testified regarding the value of these terms to iHeart.[25]

2. The Shadow of the Statutory License Anchored the Rates of the iHeart-Warner Agreement

760. The iHeart-Warner agreement was negotiated directly in the shadow of the statutory license, specifically, the NAB Settlement which establishes the rate that iHeart and other broadcasters pay. As described in part III.C, *supra*, the Services' proposed benchmarks drawn from the non-interactive market are heavily influenced by the shadow and therefore not representative of the willing buyer-willing seller market *absent* the statutory license. For this reason, the value of the iHeart-Warner agreement as a standalone willing-buyer/willing-seller benchmark is diminished. Profs. Fischel/Lichtman agree that at least the largest portion of the iHeart-Warner agreement "is directly affected by the existing statutory rate." Hr'g Ex. IHM 3034 at 25 ¶ 48 (Fischel/Lichtman AWDT). This stands in contrast to the interactive services benchmarks, in which, as iHeart's experts admit, the shadow "probably weighs less." Hr'g Tr. 4141:17-18 (May 15, 2015) (Lichtman).

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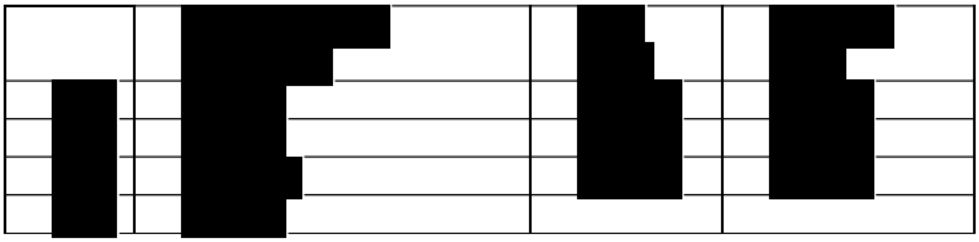
[25] Profs. Fischel/Lichtman discussed in their written direct testimony several of the provisions described in the preceding paragraphs and chose to assign monetary value to only two royalty rate provisions: the [redacted]. As a result, Profs. Fischel/Lichtman's analysis is biased toward a lower royalty rate (on an average and incremental basis). *See* Hr'g Ex. IHM 3034 ¶ 52 (Fischel/Lichtman AWDT). The net value of the other consideration provisions that Profs. Fischel/Lichtman chose not to value is [redacted] Hr'g Tr. 7385:1-2 (June 3, 2015) (Wilcox). As explained more fully below in Section IX.C.2., a benchmark analysis must account for the additional value to Warner.

761. The shadow of the Pureplay statutory rates paid by Pandora also directly influenced the rates established in the iHeart-Warner agreement. *See* Hr'g Tr. 7305:15-19 (June 2, 2015) (Cutler); *see also* Hr'g Ex. SX-1339. This is true because (1) from iHeart's perspective, it should not have to pay more than the Pureplay rates for a custom radio offering, identical to Pandora and (2) from Warner's perspective, it would rather encourage a directly licensed partner to compete with Pandora for listening time than permit Pandora to grow unfettered and pay only the Pureplay rates. This further limits the usefulness of the iHeart-Warner agreement as a willing-buyer/willing-seller benchmark. In fact, [ ]. Hr'g Ex. SX-32 at 7 (Wilcox WRT).



See also Hr'g Ex. SX-17 at 46 ¶ 184 (Rubinfeld Corr. WDT). Notably, the 27 direct licenses between iHeart and independent record labels [ ]. *See, e.g.,* Hr'g Ex. IHM 3365 at 5, 10 (iHeart-Concord Agreement).

762. Furthermore, iHeart previously licensed Warner's sound recordings through SoundExchange and continues to license other recorded music companies' repertoire—including the repertoire of Sony and Universal, the two other major recorded music companies—under the statutory license. Hr'g Ex. SX-17 ¶ 181 (Rubinfeld Corr. WDT). In the absence of a direct

license, iHeart could and would have simply opted to perform Warner's repertoire under the statutory license; Warner had (and has) no option to deny iHeart the right to perform its repertoire. Hr'g Ex. SX-17 at 47 ¶ 186(a) (Rubinfeld Corr. WDT). In contrast, interactive services cannot elect to proceed under the statutory license without changing the functionality of their consumer offering.

763. The statutory license further impacts the rates and terms agreed to between iHeart and Warner because [ ] only possible against the backdrop of the statutory license. Hr'g Tr. 2374:4-22 (May 7, 2015) (Wilcox). As a number of witnesses observed, [ ].[26] Hr'g Ex. SX-17 at 46 ¶ 183 (Rubinfeld Corr. WDT); Hr'g Tr. 7239:4-16 (June 2, 2015) (Cutler). Mr. Pittman—iHeart's lead negotiator—acknowledged that the iHeart-Warner agreement could not be replicated across the entire industry:

[ ]

Hr'g Tr. 4835:13-23 (May 20, 2015) (Pittman). The availability of the statutory license enabled iHeart to negotiate the iHeart-Warner agreement without compromising iHeart's ability to

[26] iHeart found that it is limited in its ability to boost any particular label. With Warner, it found that [ ]. Hr'g Ex. SX-1037.

perform the sound recordings of other major recorded music companies, including most notably the sound recordings of Sony and Universal.[27]

764. Finally, what Prof. Lichtman described as the "west shadow" or "the worry that the deals were designed to influence this hearing," greatly impacted the rates and terms of the iHeart-Warner agreement. Hr'g Tr. 4056:15-19 (May 15, 2015) (Lichtman). That is, iHeart negotiated the agreement with an eye toward using it as precedent in the proceeding. This shadow weighs just as heavily on Profs. Fischel/Lichtman's purported "incremental performances" and they give no explanation as to why their incremental analysis cures this influence of the shadow.

765. Steven Cutler, Executive Vice President of Business Development and Corporate Strategy for iHeartMedia, testified at the hearing, that iHeart knew and planned that its direct license agreements (incremental performances and all) would be evidence in this proceeding:

[redacted]

[27] Sony and Universal turned down iHeart's purported "win-win" offer because [redacted]. Hr'g Ex. SX-1139; Hr'g Ex. SX-25 at 12 ¶ 35 (Harrison WRT); Hr'g Tr. 509:24-510:2 (Apr. 28, 2015) (Harrison) ([redacted])

[redacted]

Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler). As Mr. Cutler's own internal emails show, [redacted]. Hr'g Ex. SX-1109. Furthermore, at the time the [redacted]. Hr'g Ex. IHM 3034 at 21 ¶ 40 (Fischel/Lichtman AWDT); *see* Hr'g Tr. 3260:7-25 (May 12, 2015) (Kendall); Hr'g Tr. 5496:8-18 (May 22, 2015) (Fischel).

B. The "Incremental Approach" Is the Wrong Way to Understand the iHeart-Warner Agreement

1. Overview of iHeart's Rate Proposal

766. iHeart proposes a per-performance rate for all webcast performances (including ephemeral recordings) of $0.0005 throughout the 2016-2020 rate period. *See* Proposed Rates and Terms of iHeartMedia, Inc. (Oct. 7, 2014). iHeart's proposal would reduce by *80%* the per-performance rate that iHeart and other broadcasters that operate pursuant to the NAB Settlement currently pay for exercising rights under the statutory license.

767. Given how radically the iHeart proposal would reduce rates under the statutory license, Prof. Fischel conceded at the hearing that he was "concerned whether the proposal that [he and Prof. Lichtman] were advancing would be credible." Hr'g Tr. 5314:14-15 (May 21, 2015) (Fischel). Prof. Fischel was right to be concerned.

768. iHeart contends that 29 direct agreements submitted for the Judges' consideration—all but one of them an iHeart agreement (the other being Pandora-Merlin)—support its rate proposal and the Fischel-Lichtman "incremental analysis." In fact, none of these agreements—or any other agreement submitted by any other party—has $0.0005 as the stated per-performance rate or within any range of stated rates. There is not a single document in evidence showing that any parties—least of all Warner and iHeart—ever had a "meeting of the minds" as to a rate of $0.0005 per performance. Hr'g Tr. 5489:19-25 (May 22, 2015) (Fischel). There is not a single communication between iHeart and Warner citing a rate of $0.0005 under the iHeart-Warner agreement. Hr'g Tr. 5490:1-4 (May 22, 2015) (Fischel). No internal iHeart document shows such a rate for the iHeart-Warner agreement. Hr'g Tr. 5490:5-7 (May 22, 2015) (Fischel). There is no evidence at all in the record showing that a willing copyright owner would agree to license the performance of its sound recordings at a rate of $0.0005. Hr'g Ex. SX-29 ¶ 23 (Rubinfeld Corr. WRT).

769. iHeart's $0.0005 rate proposal relies entirely on the "incremental" approach that Profs. Fischel and Lichtman advance. None of the other economic experts who testified advanced such an approach in their written testimony. While Prof. Fischel and Prof. Lichtman are distinguished scholars, they are not trained economists. Neither has a doctorate degree in economics. Neither lists any formal education in economics on his CV. Hr'g Ex. IHM 3034 at 76 (Fischel/Lichtman AWDT, Fischel Education); 105 (Lichtman Education).

2. Prof. Fischel/Lichtman's Incremental Approach Is Methodologically Unsound

a. *Overview of the Incremental Approach*

770. Profs. Fischel/Lichtman's incremental analysis hypothesizes that direct licenses for the right to webcast sound recordings can be divided into separate agreements covering two different "bundles" of rights. The first is a "bundle" for the purported right to perform sound recordings up to the number of performances Profs. Fischel/Lichtman say the parties expected to occur under the statutory license in the absence of a direct license.[28] Profs. Fischel/Lichtman contend that the revenue for this bundle consists exclusively of the number of such performances multiplied by the otherwise applicable statutory rate. The second is a "bundle" for the purported right to make all the additional performances over and above those in the first bundle that Profs. Fischel/Lichtman say the parties expected to occur because of the direct license. Profs. Fischel/Lichtman contend that the revenue for this second bundle of rights consists exclusively of the specific dollars that the parties expected to be paid by the licensee to the licensor—in accordance with specific provisions within the same agreement providing for the payment of specific dollar amounts—over and above the revenues in the first bundle.

771. Profs. Fischel/Lichtman assert that the *only* relevant information regarding what willing buyers and willing sellers would agree to absent a statutory license is found in the number of performances and revenue—as Profs. Fischel/Lichtman have circumscribed both—in the second bundle. Specifically, Profs. Fischel/Lichtman claim that dividing the purported "incremental" revenue by the "incremental" number of performances yields the precise per-

[28] Importantly, Profs. Fischel/Lichtman analyze *only* expectations and projections without making any attempt to reconcile those iHeart projections with the actual performance of the agreement. As explained in Section IX.C.2. *infra*, this is wrong from a legal, economic, and business perspective.

performance rate that the parties would have agreed for 100% of the performances contemplated under their agreement in a world without the statutory license. Hr'g Ex. IHM 3034 ¶¶ 46-49 (Fischel/Lichtman AWDT); Hr'g Tr. 5518:2-5 (May 22, 2015) (Fischel).

772. Prof. Fischel testified that calculating the per-performance rate under his and Prof. Lichtman's incremental approach is a matter of the most basic and simple mathematics, namely, determining the "incremental" revenue in the second bundle, and then dividing that by the "incremental" number of performances in the second bundle:

[redacted]

Hr'g Tr. 5361:13-25 (May 21, 2015) (Fischel). The simplicity of this math which is derived from looking only to a single projection, however, neglects the entirety of the terms in the iHeart-Warner agreement. These terms impose additional obligations on iHeart and provide substantial additional consideration to Warner, and therefore, must be factored into any benchmark analysis. *See* Section IX.C.2., *infra.*

b. *The Incremental Approach Is Methodologically Flawed*

773. Profs. Fischel/Lichtman's "bundling" method of determining the rate that a willing buyer and seller would agree to absent the statutory license is methodologically flawed. Hr'g Ex. SX-29 at 9 ¶ 23 (Rubinfeld Corr. WRT). There is no valid method of determining the number of performances that were influenced by the statutory license and those that were not. *Id.* On the contrary, the parties negotiated a single agreement, which licensed iHeart to make all

performances over the initial [redacted] term, not just those in excess of what Profs. Fischel/Lichtman assume otherwise would have occurred as the result of Warner's purported "share" of iHeart performances. By breaking the single actual bundle of performances under the agreement into two hypothetical bundles, Profs. Fischel/Lichtman's approach artificially and erroneously divides consideration in a manner that these parties did not negotiate, and that parties in any reasonably analogous economic transaction would not negotiate. Moreover, Profs. Fischel/Lichtman's formula is highly sensitive to changes in the incremental revenues (numerator) and any change to the incremental performances (denominator). Hr'g Tr. 5533:22-5534:2 (May 22, 2015) (Fischel). All else equal, the larger the projected performances, the smaller the incremental rate. Hr'g Tr. 5519:1-14 (May 22, 2015) (Fischel).

774. Simple analogies demonstrate why Profs. Fischel/Lichtman's approach is methodologically unsound. For example, in a "buy one, get one free" (or "BOGO") transaction, the price of the second product is not zero; that product could not be obtained without paying the full price for the first. Accordingly, the appropriate price for each of the two products is the average between the two. Hr'g Ex. SX-29 at 10 ¶ 24 (Rubinfeld Corr. WRT).

775. Prof. Fischel tried to counter that example at the hearing by claiming that, in this case, the price of the first bundle is established by government regulation (the statutory license), whereas the second bundle is priced as the result of negotiation. Questioning from the Judges made clear the fallacy in Prof. Fischel's attempted distinction. If a vendor sells ice cream cones at a regulated price for one cone of $1, but decides s/he can sell two cones for $1.05, it would be absurd to contend that the free-market price for ice cream absent government regulation would be 5 cents. The most that one can discern from the vendor's price is that s/he was willing under

those circumstances to sell two ice cream cones for an average price of 52.5 cents. Hr'g Tr. 5367:13-5368:17 (May 21, 2015) (Fischel).

776. The incremental approach cannot be applied to all agreements between copyright owners and streaming services. For example, Profs. Fischel/Lichtman do not attempt to apply their incremental analysis to the Apple iTunes Radio agreements. Those agreements, of course, meet the same qualifications that Profs. Fischel/Lichtman describe for the "best currently available evidence on the rates and terms that a willing buyer and willing seller would negotiate" because they "document actual rates and terms that were in fact negotiated by buyers and sellers for rights we understand are very similar to those at issue in this proceeding." Hr'g Ex. IHM 3034 ¶ 18 (Fischel/Lichtman AWDT). Profs. Fischel/Lichtman could not have applied their incremental analysis to the Apple iTunes Radio agreements because the agreements negotiated with each of the three major recorded music companies and the independents are paid in accordance with natural market shares rather than an artificially uplifted percentage of performances.

777. It is further telling that the incremental approach was not adopted by other experts. Prof. Shapiro does not use the incremental approach in valuing the Pandora-Merlin deal. Indeed, he cites Profs. Fischel/Lichtman's calculation of the *average* expected per-performance rate but not the incremental rate. Hr'g Ex. PAN 5023 at 37 (Shapiro WRT).

c. *Profs. Fischel/Lichtman's Analysis of the Pandora-Merlin Agreement Confirms that the Incremental Approach Is Methodologically Flawed*

778. Moreover, Prof. Shapiro and Profs. Fischel/Lichtman conduct different analyses of the Pandora-Merlin agreement and arrive at dramatically different effective rates—divergent by nearly [ ]. Hr'g Ex. SX-29 at 22 ¶ 79 (Rubinfeld Corr. WRT). Profs. Fischel/Lichtman estimate the incremental rate for the Pandora-Merlin

agreement to be a range between [ ]. Hr'g Ex. IHM 3034 at 40-41 (Fischel/Lichtman AWDT). The mere fact that they claim a rights owner would pay for webcast performance when no rights owner has done so confirms the bias in their approach.

3. Profs. Fischel/Lichtman Apply Their Incremental Approach to a Single iHeart Projection—the iHeart [ ] Case

779. In their written testimony applying their incremental approach to the iHeart-Warner agreement, Profs. Fischel/Lichtman relied exclusively on specific projections—a "case" that analyzes certain assumptions— [ ]. Hr'g Ex. IHM 3034 at 21 ¶ 40 (Fischel/Lichtman AWDT). This case is labeled, "[ ]." Profs. Fischel/Lichtman assert that they chose this case because [ ]. Hr'g Tr. 5322:12-16 (May 21, 2015) (Fischel). Of course, iHeart shared an entire "*set of projections*" not just one with their Board of Directors. Hr'g Ex. IHM 3338 (Cutler WDT) (emphasis added); *see also* Hr'g Tr. 7263:25-7264:3 (June 2, 2015) (Cutler). In the [ ]. Hr'g Ex. IHM 3346 at 9-11. iHeart shared these different projections for a reason: it wanted its Board to be aware of *different* possible scenarios that it could result and the corresponding different expectations regarding how the agreement would perform. These scenarios informed iHeart's expectations of the agreement and it was wrong for Profs. Fischel/Lichtman to ignore them completely. Although Mr. Cutler testified that he viewed the [ ] case as its best estimate, he did not say—indeed no iHeart fact witness

testified—that the other scenarios were extreme cases or unrealistic scenarios.[29] Nonetheless, Profs. Fischel/Lichtman did nothing to test which of these scenarios actually was the most realistic. Hr'g Tr. 5496:19-5497:1 (May 22, 2015) (Fischel).

780. Starting with the [ ] case, Profs. Fischel/Lichtman apply their incremental approach by first calculating the total number of performances of all sound recordings (not only Warner's) that they say iHeart expected to make over the initial [ ] term of the iHeart-Warner agreement. Because the [ ] case lists total listening hours in average *monthly* numbers, Profs. Fischel/Lichtman first annualized these figures. They then converted the total listening hours to total performances, using iHeart's projected average number of performances per hour; [ ].[30] Hr'g Ex. SX-221. Utilizing this approach, Profs. Fischel/Lichtman arrive at a total number of [ ] projected performances over the initial [ ] of the iHeart-Warner agreement. Hr'g Ex. IHM 3034 ¶ 41 (Fischel/Lichtman AWDT).

781. Profs. Fischel/Lichtman then used this total number to determine the two "bundles" of performances of Warner sound recordings they hypothesized. With respect to the first bundle, Profs. Fischel/Lichtman assumed a world in which there is no agreement, and [ ]. As for the second bundle, Profs. Fischel/Lichtman assumed that iHeart

[29] And as it turns out—these projections, at least on the low end, were not extreme at all. The [ ] proved to be more optimistic than actual performance. Hr'g Tr. 7264:22-7265:1 (June 2, 2015) (Cutler).

[30] Even iHeart's projected number of performances per hour [ ].

would [ ]. Hr'g Ex. IHM 3034 ¶ 42 (Fischel/Lichtman AWDT).

782. Profs. Fischel/Lichtman then applied their "incremental" methodology, determining that the second bundle includes [ ] performances of Warner sound recordings that occur only as the result of the iHeart-Warner agreement. Neither iHeart in its models nor Warner in its models did an analogous determination of incremental performances.

783. To determine incremental revenue, Profs. Fischel/Lichtman accepted wholesale the cells in the [ ] case that show iHeart would pay Warner [ ]. Hr'g Ex. IHM 3034 ¶ 51 (Fischel/Lichtman AWDT). Dividing [ ] by [ ] performances results in Profs. Fischel/Lichtman's $0.0005 average incremental payment per performance. *Id.*.

784. The incremental approach is highly sensitive to changes in the number of purported "incremental" performances and in the amount of purported "incremental" revenues—both "important driver[s] of the ultimate incremental calculation." Hr'g Tr. 5533:22-5534:2 (May 22, 2015) (Fischel). For example, if Profs. Fischel/Lichtman changed nothing else, but accepted [ ]. Hr'g Ex. SX-367 at 5; Hr'g Tr. 5503:7-8 (May 22, 2015) (Fischel). We discuss these sensitivities—and their relevance to the credibility of the incremental approach—in greater detail below.

4. Profs. Fischel/Lichtman's Incremental Approach Has No Basis in the iHeart-Warner Agreement, Nor in the Parties' Negotiations

785. As Mr. Wilcox explained in his testimony, Profs. Fischel/Lichtman's "analysis is based on incorrect and misleading assumptions and conclusions regarding the Warner-iHeart

agreement, the parties' negotiations, and Warner's modeling." Hr'g Ex. SX-32 at 3 ¶ 2 (Wilcox WRT).

786. Nothing in the iHeart-Warner agreement, the First Amendment to that agreement, nor any other agreement between the parties divides the rights granted to iHeart into two bundles nor the revenues earned by Warner into two bundles. That is simply not how the agreement is structured. [ ]. Hr'g Ex. SX-33 at 14, § 3(a). [ ]. Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii). The fact that the agreement created an economic incentive for iHeart to play more Warner sound recordings does not mean that the agreement created a separate license for incremental performances of Warner sound recordings.

787. Prof. Fischel acknowledged, he found no communications between iHeart and Warner citing the incremental rate of $0.0005 per incremental performance. Hr'g Tr. 5490:1-4 (May 22, 2015) (Fischel). Nor does iHeart have internal documents that reference that rate. *Id.* at 5490:5-7. Mr. Wilcox testified that "Warner and iHeart never discussed a license using the 'bundles' construct used in the Fischel-Lichtman analysis; Warner did not model the agreement under that construct; and, most importantly, the agreement does not embody any such construct." Hr'g Ex. SX-32 at 4-5 (Wilcox WRT).

788. Even iHeart's CEO, Mr. Pittman did not view the agreements reflecting "incremental" rates and "incremental" performances. To the contrary, Mr. Pittman made his view of the economics of the deal quite clear:

[redacted]

789. Hr'g Tr. 4805:18-4806:2 (May 20, 2015) (Pittman) (emphasis added). Like Warner, iHeart viewed the deal as the whole of all performances and all consideration. Furthermore, Profs. Fischel/Lichtman selectively exclude economic consideration clear from the face of the iHeart-Warner agreement and highly valued by Warner. As explained in Section IX.C.2., *infra,* the provisions that Profs. Fischel/Lichtman assign a net value or zero must be taken into account as consideration that Warner received. In fact, the terms that Profs. Fischel/Lichtman dismiss are the very definition of "incremental" consideration: they would not be contractual commitments absent the direct license. Numerous terms—[redacted]—are "incremental" to the statutory license.

790. As mentioned above, the incremental approach is a highly sensitive calculation. Had Profs. Fischel/Lichtman included any of these improperly excluded "incremental" terms of the agreement—the incremental analysis would result in a significantly higher rate. For example, [redacted]. Further, [redacted]. Finally, [redacted]

[redacted]. Each of these calculations confirms that Profs. Fischel/Lichtman's incremental analysis, if not methodologically unsound, was incorrectly applied in a manner that biased Prof. Fischel/Lichtman's results toward a lower rate.

5. Applying Prof. Fischel/Lichtman's Incremental Analysis to Two Other Projections Prove the Bias in Their Analysis

791. Profs. Fischel/Lichtman had access to and reviewed all of the iHeart models and cases. Hr'g Tr. 5365:9-10 (May 21, 2015) (Fischel). At the hearing, Prof. Fischel stated that they did, in fact, analyze all the various scenarios and found some that [redacted]. Hr'g Tr. 5365:11-12 (May 21, 2015) (Fischel). Nonetheless, they relied upon and only presented the results of a single scenario—the [redacted] Case—because that was the case that the Board of Directors relied upon in approving the deal, in Prof. Fischel's words: ([redacted]) Hr'g Tr. 5322:12-16 (May 21, 2015) (Fischel). Indeed, they [redacted] it in part because it [redacted] Hr'g Tr. 5365:9-24 (May 21, 2015) (Fischel); *see also* Hr'g Ex. IHM 3034 at 21 ¶¶ 40, n.42 (Fischel/Lichtman AWDT). Yet, Profs. Fischel/Lichtman never did anything to confirm whether or not that case actually was the most realistic or most closely hewed to actual performance in the year between execution of the iHeart-Warner agreement and when Profs. Fischel/Lichtman submitted their written direct testimony. Hr'g Tr. 5496:19-5497:1 (May 22, 2015) (Fischel).

792. They likewise focus on a single projection from the multitude of Warner models and projections to the exclusion [ ]. Analyzing any of these other cases result in incremental rates that confirm the reasonableness of SoundExchange's rate proposal.

b. ***Applying Prof. Fischel/Lichtman's Approach to iHeart's [ ] Case Results in Substantially Higher Incremental Rates***

793. Another case that was shared with iHeart's Board of Directors—the [ ] Case—proved to be a more accurate best estimate of the deals performance. Hr'g Tr. 5494:1-7 (May 22, 2015) (Fischel); Hr'g Tr. 7263:25-7264:3 (June 2, 2015) (Cutler). This case includes a description that iHeart would take [ ]. Hr'g Tr. 5522:2-8 (May 22, 2015) (Fischel); Hr'g Tr. 4839:23-4840:21 (May 20, 2015) (Pittman) (describing cost mitigation measures including [ ]). Given iHeart's cost mitigation measures, their growth has, in fact, [ ] as confirmed by Mr. Cutler. Hr'g Tr. 7264:22-7265:1 (June 2, 2015) (Cutler) ([ ]). Profs. Fischel/Lichtman did their incremental analysis on the [ ] case, but did not report it to the Judges. Hr'g Tr. 5523:5-20 (May 22, 2015) (Fischel). Nonetheless, had Profs. Fischel/Lichtman reported these results (of their simple mathematical calculation) to the Judges it would have shown an incremental rate of $0.0021 per performance.

RESTRICTED TABLE

Source: SX-221-005

This calculation shows that even applying Profs. Fischel/Lichtman's analysis, iHeart's expectations included scenarios in which it would pay an incremental rat of $0.0021 (or significantly higher if properly adjusted for the additional consideration that Profs. Fischel/Lichtman omit).

c. *Applying Prof. Fischel/Lichtman's Approach to the Projections [redacted] Results in Substantially Higher "Incremental" Rates*

794. Prof. Fischel walked the Judges through the calculation that he says he did based on a single case within a single model that Mr. Wilcox attached as an exhibit to his written rebuttal testimony. Prof. Fischel said that, applying the incremental approach to this model produced an effective per-performance rate on incremental performances of $0.0008. Hr'g Tr. 5381:11-13 (May 21, 2015) (Fischel). Prof. Fischel testified that he relied on that case because Mr. Wilcox identified it in his testimony. Hr'g Tr. 5536:2-7 (May 22, 2015) (Fischel). But, to be consistent with his own approach, Prof. Fischel should have looked to the set of projections that [redacted].[31] Prof. Fischel/Lichtman relied on the specific assumptions and projections that iHeart's management team shared with its Board of Directors and the comparable case is the [redacted]. *See* Hr'g Ex. SX-367-005; (Hr'g Tr. 7552:5-7553:8 (June 3, 2015) (Wilcox) (explaining that [redacted]),. Had Prof. Fischel had conducted his incremental analysis using the [redacted] which Mr. Wilcox testified was the case reflected in the [redacted] then the Fischel/Lichtman formula would have resulted in an incremental rate of ***$0.0045*** per performance. Again, applying the simple math that Prof. Fischel described, this is the calculation:

[31] In fact, as Mr. Wilcox explained, that model [redacted] Hr'g Tr. 7421:14-20 (June 3, 2015) (Wilcox).

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Source: Hr'g Ex. SX-92 at 15.

C. Calculating the Average Effective Rate Is the Right Way to Understand the iHeart-Warner Agreement

795. Setting aside Profs. Fischel/Lichtman's incremental approach, the proper way to analyze any benchmark agreement is on an average effective royalty basis. The economists

disagree as to whether performance or expectations should inform this calculation. Under either calculation—and confirmed by looking at both kinds of calculations—the iHeart-Warner agreement results in effective average per-performance rates that support SoundExchange's rate proposal.

1. Analyzing the Past Performance of Agreements to Determine the Rates to Which What Willing Buyers and Willing Sellers Would Agree Is Consistent with Law, Economics, and Business Practice

a. *The Law Supports Looking to Performance*

796. As explained more fully in SoundExchange's Proposed Conclusions of Law, courts have rejected purely looking at the parties' ex ante projections, and have looked to actual performance data. *See SoundExchange's Proposed Conclusions of Law* at § IV.A. This is because performance provides meaningful information that courts, like parties to a hypothetical transaction, would take into account in setting the terms of that hypothetical agreement. *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009). Accordingly, the Judges should consider all available evidence here.

797. As a matter of information before the Judges, it is also noteworthy that for all of the agreements put forward as benchmarks by the Services, their analysis is based on a *single* party's expectations, which may not be shared with the other side to the agreement. Performance information guides whether those one-sided expectations are reasonable or not, and relying solely on one side's internal projections is particularly precarious. As Prof. Rubinfeld explained, "reliance on one party's subjective expectations as to how the deal would perform is inappropriate," given that "internal projections do not reflect a mutual understanding of the value of the agreement; indeed, even if shared, the other side could have conflicting projections on the deal's worth. In particular, no party has an incentive to correct the other side's overly-optimistic projections." Hr'g Ex. SX-29 ¶¶ 26, 31 (Rubinfeld Corr. WRT).

798. Furthermore, to the extent that parties anticipated that the agreement and its projections could and would be used as evidence in this proceeding, they cannot be reliable evidence. Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler) ([redacted]); *see also* Hr'g Tr. 4134:8-25 (May 15, 2015) (Lichtman); Hr'g Ex. SX-17 at 50 n.23 (Rubinfeld Corr. WDT) ("information with respect to expectations may be unclear or if clear may be tainted by strategic negotiation considerations.").

b. *Economic Principles Suggest Reasonable Actors Would Look to Performance*

799. Reasonable economic actors would be informed by their past agreements and performance data when negotiating an agreement today. *See* Hr'g Ex. SX-29 ¶ 27 (Rubinfeld Corr. WRT) ("The performance data reflect actual experiences in the marketplace. The most recent performance data is likely to be the best predictor of what will happen in the immediate future.").

800. As Prof. Katz agreed—reasonable business people would learn from past performance:

> Q You would expect reasonable business people to try to learn from the past, correct?
>
> A Yes.
>
> Q They would probably look at the terms that they negotiated and try to figure out if they turned out to be good terms or not, correct?
>
> A That would be a sensible thing to do.
>
> Q So they would look at the terms that they negotiated and how those terms actually worked out afterwards, correct?
>
> A That's the only one thing they could do.

> Q You would expect them to do that if they were acting reasonably, correct?
>
> A It would depend on the circumstances, but certainly that's something I could see reasonable people doing, yes.

Hr'g Tr. 3044:5-20 (May 11, 2015) (Katz).

801. A performance-based analysis is particularly appropriate for agreements that include [ ], such as the iHeart-Warner agreement and the Apple agreements. Absent actual performance of the agreement it is impossible to know what the effective per-performance rates are and one is left only with an allocation of risk and no way of determining the likelihood that any risk would come to fruition. In contrast to such subjective uncertainty, the actual performance of the agreement in this circumstance places an objective economic per-play value on the streams under the agreement.

802. Finally, projections are stale the moment they are created. The Judges have the task of setting the rate based on hypothetical transactions for that term. Few if any of the benchmark agreements have terms that extend into the rate period and none has a term that extends to 2020. Accordingly, those projections are dated and would—indeed must—be updated with information that the parties would consider in setting rates and terms today (not 2 years ago).

c. *Business Actors Look to Performance*

803. Reliance on stale projections is particularly ill-suited here because, in the real world in which parties negotiate a rate to be applied prospectively, they look to past performance in order to model expected future performance. Mr. Cutler confirmed this point, which is not disputed:

[ ]

[redacted]

Hr'g Tr. 7257:115-7258:9 (June 2, 2015) (Cutler). Mr. Cutler further acknowledged that, if he were establishing a [redacted] case *today* incorporating information learned from performance to date under the iHeart-Warner agreement, the iHeart [redacted]:

[redacted]

Hr'g Tr. 7265:18-24 (June 2, 2015) (Cutler).

804. Likewise, Mr. Harrison made clear that factors such as substitution between services can only be known base on that services' performance and is something they take account of in negotiations with that service going forward.

[redacted]

[redacted]

Hr'g Tr. 977:4-14 (April 30, 2015) (Harrison).

805. Given the statutory requirement that the Judges consider what willing buyers and willing sellers would agree to in a market unconstrained by the statutory license, the Judges should follow the practice of the market participants and rely on actual performance data.

2. Analyzing the Benchmark Rate Requires Consideration of All Economic Value Warner Received in the iHeart-Warner Agreement

806. Despite acknowledging that "it is the net value of all" of the various non-royalty rate provisions "taken together that is relevant from an economic perspective," Profs. Fischel/Lichtman make little to no attempt to discern the actual value of these provision to iHeart. Hr'g Ex. IHM 3034 ¶ 39 (Fischel/Lichtman AWDT). They assume, without citing any confirmatory evidence from Warner, that the non-royalty rate term provisions have a net value of zero between those benefiting Warner and those benefiting Heart.[32] Hr'g Tr. 5340:1-4 (May 21, 2015) (Fischel); Hr'g Ex. IHM 3034 at 20-21 (Fischel/Lichtman AWDT). As the record shows—this is factually inaccurate. The net value of the non-royalty rate provisions is [redacted] Hr'g Tr. 7385:1-2 (June 3, 2015) (Wilcox).

807. Another reason Profs. Fischel/Lichtman cite to justify their decision to exclude consideration that would favor the licensors is that they do not see (all) of these items of

[32] To the extent Profs. Fischel/Lichtman do not value these provisions because doing so would be inexact or difficult—it is wrong to exclude them entirely. Simply because a term may be more difficult to value precisely in dollars does not negate its value. Because the statutory license does not provide these additional forms of consideration, any benchmark analysis must account for their value to the copyright owner.

consideration reflected in the parties' spreadsheets or projections.[33] Hr'g Tr. 5339:20-25 (May 21, 2015) (Fischel) ([ ] Profs. Fischel/Lichtman thus appear to believe that spreadsheets or projections are the only place that a party to the transaction would record value:

[ ]

Hr'g Tr. 5342:8-21 (May 21, 2015) (Fischel). Prof. Fischel reasoning is inconsistent with what parties do in practice. In both iHeart and Warner's [ ]. Hr'g Ex. SX-367; Hr'g Ex. IHM 3346. Of course, we do not know for certain what iHeart *told* its Board in writing because all of the text is redacted as privileged. *See* Hr'g Ex. IHM 3346 (redacting seven pages of the Board memorandum, everything except the projections). Surely at some point in the redacted seven pages of text management set forth its analysis and understanding of the cost and value of the various terms in the iHeart-Warner agreement.

[33] Profs. Fischel/Lichtman apply different criteria to the [ ], which appears as a line item in the model attached to Mr. Wilcox's testimony. With regard to that item of consideration, Profs. Fischel/Lichtman ignore it entirely despite it appearing in numerous Warner projections and financial analyses. Hr'g Tr. 5378:18-25 (May 21, 2015) (Fischel) (discussing Hr'g Ex. SX-92 at 15); Hr'g Ex. SX-367 at 5.

808. To be sure, Warner, like other major recorded music companies conducts modeling of some terms of its agreements. This makes sense because some terms of the agreement are dependent on performance. However, those items of consideration that are obvious on the face of the agreement—for example, [ ]—do not need to modeled or projected. It follows that they may very well not appear in a model or projection, but are instead reflected in presentations or memoranda discussing the economics of the agreements. Those terms still have value.

809. Profs. Fischel/Lichtman improperly ignore each of these core terms:

b. *Profs. Fischel/Lichtman Improperly Disregard Core Economic Terms that Provide Upside Value to Warner*

810. [ ]. Hr'g Ex. SX-33 at 2, § 1(e); 11, § 1(qq). [ ] Hr'g Ex. SX-32 at 4 n.2 (Wilcox WRT); *see also* Hr'g Ex. SX-89 at 1 ([ ]); Hr'g Ex. SX-90 ([ ]).

811. [ ] One major economic benefit to Warner as a result of the direct license with iHeart was a [ ]. As Mr. Wilcox explained this is a crucial

economic term to establish market precedent going forward as advertising moves to the digital world.

Hr'g Tr. 7405:16-7406:3 (June 3, 2015) (Wilcox).

c. ***Profs. Fischel/Lichtman Improperly Disregard Core Economic Terms that Provide Substantial Protection from Downside Risk to Warner***

812. [ ] was downside protection but it also meant that [ ]. Hr'g Ex. SX-33 at 17, § 3(d).

813. [ ] iHeart must also pay Warner an [ ]. Hr'g Ex. SX-33 at 16, § 3(c). As. Mr. Wilcox described, this term was a form of insurance and it gave Warner [ ] Hr'g Tr. 7410:24-25; 7411:12-13 (June 3, 2015) (Wilcox).

814. [ ] As Mr. Wilcox explained what this had tremendous value to Warner:

Hr'g Tr. 7412:20-7413:18 (June 3, 2015) (Wilcox).

d. ***Profs. Fischel/Lichtman Discount [ ], Which Warner Values at [ ] Over the Initial Term of the Agreement***

815. iHeart agreed to provide to Warner [ ]. Hr'g Ex. SX-33 at 19-20, § 5(a).

iHeart used these advertising programs as currency—it was [ ].[34] Hr'g Ex. SX-207. Even when Warner took the negotiating position that it could

[34] iHeart [ ]. Hr'g Ex. SX-34 at 4 (describing [ ] Hr'g Tr. 7399:18-7400:17 (June 3, 2015) (Wilcox).

not value the in-kind consideration on a dollar-for-dollar basis, iHeart maintained [

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Hr'g Ex. SX-1372. Furthermore, iHeart told Warner that [

]. Hr'g Tr. 7388:20-7389:6 (June 3, 2015) (Wilcox). The contract which both parties agreed to and signed prescribes a fair market value of [ ]. Hr'g Ex. SX-33 at 19-20, § 5(a). Mr. Cutler testified to precisely what fair market value referenced in this contract:

[

]

Hr'g Tr. 7314:21-7315:8 (June 2, 2015) (Cutler).

817. Warner recognized the value of these advertising provisions in its internal financial analyses. In Warner's [

[redacted]

[redacted]]. Hr'g Ex. SX-367 at 5. Other internal documents similarly reflect the fact that [redacted]. *See, e.g.*, Hr'g Exs. IHM 3114 at 5, 10; IHM 3121 at 4; IHM 3225 at 2.

818. When asked directly, iHeart represented that [redacted]. Hr'g Ex. SX-93 at 1. That value is substantiated by Mr. Cutler's testimony that the fair market value stems from [redacted]. Hr'g Tr. 7317:3-7 (June 2, 2015) (Cutler). Mr. Poleman [redacted]

[redacted]

Hr'g Tr. 5194:23-5195:10 (May 21, 2015) (Poleman).

819. The value to Warner is monetary. [redacted]. As Mr. Wilcox testified:

[redacted]

[redacted]

Hr'g Tr. 7392:7-19 (June 3, 2015) (Wilcox); *see also* Hr'g Ex. SX-22 at 12-13 (Wilcox WDT) ("Clear Channel's commitments also save WMG the expense of comparable advertising.").

820. Mr. Pittman described his view of the financial impact that terrestrial promotion has on record labels. In his view, the airplay devoted to music is worth *billions* of dollars in free advertising to the record labels from terrestrial broadcasters per year. Hr'g Ex. IHM 3222 at 4 (Pittman WDT). As a result, according to Mr. Pittman, record companies spend a very small portion of their budget on advertising. *Id.*; Hr'g Tr. 4800:17-4801:7 (May 20, 2015) (Pittman). Mr. Pittman used the same [redacted]. Mr. Pittman stated that he believes that is a [redacted]

[redacted]

Hr'g Tr. 4885:18-4886:7 (May 20, 2015) (Pittman).

821. Furthermore, [redacted]. Hr'g Ex. SX-2324. Mr. Poleman testified that

[redacted] Hr'g Tr. 5194:20-22 (May 21, 2015) (Poleman). That these advertising opportunities are limited makes the contractual commitment an opportunity cost for iHeart if it would otherwise prefer to sell the commercial inventory to advertisers or offer it to a different label. In the case that [redacted].[35] Hr'g Tr. 5189:16-5190:21 (May 21, 2015) (Poleman).

822. Finally, both sides' experts recognize that [redacted] have value for Warner. Hr'g Tr. 5340:20-5341:3 (May 21, 2015) (Fischel) ([redacted]); Hr'g Ex. SX-29 ¶¶ 48-51 (Rubinfeld Corr. WRT). Profs. Fischel/Lichtman, however, discount the value because they say that iHeart was providing it to Warner prior to the direct agreement and that, therefore, its value is a form of insurance. This is not accurate. The value is stated as a fair market value in the agreement—[redacted]. This consideration is not contingent on any event happening or any "risk" that would make it similar to an insurance policy. No matter the events that transpire—whether iHeart [redacted]—Warner will receive the actual fair market value of the advertising provisions.

823. Further, to the extent that Profs. Fischel/Lichtman are correct (which they are not) to consider the value to be like an insurance policy, it would still have a very high monetary

[35] The deal created a contractual commitment where otherwise iHeart had sole control over all of the circumstances of its promotional programs, including whether to offer them at all. In the words of Mr. Pittman, [redacted]. Hr'g Ex. SX-1139.

value. iHeart told Warner that [ ]. Hr'g Tr. 7389:7-12 (June 3, 2015) (Wilcox). Warner accepted iHeart's representations that it was [Hr'g Ex. SX-367 at 3. No one from iHeart testified that iHeart [ ]. Accordingly, Warner's [ ]. In sharp contrast to the "insurance policy" [ ]. Hr'g Tr. 7389:7-12 (June 3, 2015) (Wilcox).

e. ***Profs. Fischel/Lichtman Assign No Value to], Which Warner Values at Over the Initial Term of the Agreement***

824. The value of [goes above and beyond [and alters the typical structure of these promotional programs. As the contract makes clear—[ ]. Hr'g Ex. SX-33 at 19-20, § 5(a); *Id.* at 81, Exhibit F, §§ 1-2. [ ]. Hr'g Tr. 7401:9-12 (June 3, 2015) (Wilcox). [ ] Hr'g Ex. SX-33 at 82, Exhibit F, § 7.

825. Regarding the quantity of impressions, as Mr. Poleman testified, it [ ] Hr'g Tr. 5152:9-14 (May 21, 2015) (Poleman). [ ]. The intensity of the program was an important

point to Warner because it [redacted] Hr'g Tr. 7401:21-24 (June 3, 2015) (Wilcox). Regarding [redacted], Mr. Poleman also made clear that [redacted]. Hr'g Tr. 5156:16-23, 5157:10-15 (May 21, 2015) (Poleman). [redacted].

826. [redacted] Hr'g Ex. SX-32 at 14 n.9 (Wilcox WRT); Hr'g Tr. 7403:4-21 (June 3, 2015) (Wilcox). No iHeart fact witness denied this calculation or provided any factual basis for discounting the [redacted] at all. iHeart does not even claim, nor could it, that Warner was receiving this consideration prior to the execution of the agreement. [redacted]. Hr'g Tr. 7405:2-8 (June 3, 2015) (Wilcox).

f. *Profs. Fischel/Lichtman Make No Adjustment for [redacted]*

827. iHeart also agreed to pay Warner [redacted]. Hr'g Ex. SX-33 at 10, § 1(pp); Hr'g Ex. SX-32 at 14 (Wilcox WRT). This was an [redacted] Hr'g Tr. 7408:25-7409:3 (June 3, 2015) (Wilcox). When the Judges asked Mr. Wilcox whether Warner had assigned a number value to it, Mr. Wilcox answer, consistent with many of these provisions that they could not be certain

[redacted]

[redacted]]. Hr'g Tr. 7409:4-25 (June 3, 2015) (Wilcox).

g. *Profs. Fischel/Lichtman Ignore [redacted]*

828. Profs. Fischel/Lichtman simply omit from their calculation [redacted]

[redacted]]. As Mr. Wilcox explained:

[redacted]

Hr'g Tr. 7385:8-19 (June 3, 2015) (Wilcox). Contemporaneous emails make clear that it was [redacted]]. Hr'g Ex. IHM 3320. Later, [redacted]]. Hr'g Tr. 7387:8-12 (June 3, 2015) (Wilcox). However, Warner considered the payment to be in connection with the webcasting agreement and included in its financial analyses and projections. Hr'g Ex. SX-367 at 5; Hr'g Ex. SX-92 at 15; Hr'g Ex. SX-587.

829. [redacted]]. Hr'g Tr. 7304:3-13 (June 2, 2015) (Cutler); Hr'g Tr. 5505:11-16 (May 22, 2015) (Fischel). [redacted]]

830. iHeart's argument for excluding the [redacted]], but that an integration clause of the contract makes the

payment exclusively and only consideration for the rights contained therein. *See* Hr'g Tr. 7494:1-22 (June 3, 2015) (Wilcox). iHeart takes inconsistent positions: on the one hand, with respect to [ ]; on the other hand, with respect to [ ].

831. To Warner, the [ ]. Hr'g Tr. 7494:8-13 (June 3, 2015) (Wilcox). Warner is [ ]. Hr'g Tr. 7556:2-17 (June 3, 2015) (Wilcox). Warner would not have executed the webcasting agreement (all else equal) had this consideration not been an exchange:

[ ]

Hr'g Tr. 7388:6-12 (June 3, 2015) (Wilcox).

832. As a general matter, Warner received substantial value from the agreement that is not expressed through the royalty rate provisions—[ ], to list a few. Warner would have sought other consideration had any of these terms been different. As a result, each item of

consideration should be taken into account as consideration Warner received through the direct license that it would not have received under the statutory license.

3. Average Effective Rate Calculation Based On Performance of the iHeart-Warner Agreement Supports SoundExchange's Rate Proposal

a. *Prof. Rubinfeld's Analysis of iHeart-Warner Performance*

833. Prof. Rubinfeld used the performances and royalties paid during the first eight months of the iHeart-Warner agreement, October 2013 to May 2014 (the data that was available at the time of his analysis), to calculate the average royalty rate paid per performance. Hr'g Ex. SX-17 at 57-59 ¶¶ 229-236 (Rubinfeld Corr. WDT); SX-64 (Rubinfeld App. 1b, backup calculations); SX-133 (updated calculations to include June to September 2014).

834. Prof. Rubinfeld separately calculated the average per-performance rate under the agreement for [ ] and [ ] performances from October 2013 to May 2014. During the eight-month period there were [ ] performances of Warner content on iHeart Radio. Hr'g Ex. SX-64.

835. For [ ]. Hr'g Ex. SX-64. For [ ], Prof. Rubinfeld takes the conservative approach of [ ]. *Id*. This amount is equal to [ ] for the eight-month period. *Id*. Prof. Rubinfeld also [ ]. Hr'g Ex. SX-64.

836. The average per-performance rates are first calculated by dividing the amount paid in royalties by the number of performances. For [ ] . Hr'g Ex. SX-66. For [ ].

837. Prof. Rubinfeld then adjusted these numbers by a factor of 1.1 [ ]. Hr'g Ex. SX-17 at 58 ¶ 234 (Rubinfeld Corr. WDT); Hr'g Ex. SX-66.

838. Prof. Rubinfeld then computes the overall blended average effective rate for the iHeart-Warner agreement by [ ]. Hr'g Ex. SX-17 at 58 ¶ 232 (Rubinfeld Corr. WDT); Hr'g Ex. SX-66. The blended average adjusted per-performance rate is [$0.003090] for the eight-month period from October 2013 to May 2014. *Id*.

839. For the percentage of revenue, Prof. Rubinfeld [ ]. Hr'g Ex. SX-66. To be conservative in translating the performance of the iHeart-Warner agreement into a possible proposed benchmark, Prof. Rubinfeld caps the percentage of revenue at 55%.

840. To project the proposed benchmark rates to be derived from the iHeart-Warner agreement, Prof. Rubinfeld adjusts to account for changes over time on an annual basis. Hr'g

Ex. SX-17 at 58 ¶ 235 (Rubinfeld Corr. WDT); Hr'g Ex. SX-64 (Rubinfeld App. 1b, backup calculations).

841. The resulting effective rates are as follows:

	Per-play Rate	**Percentage of Revenue**
2016	[redacted]	[redacted]
2017		
2018		
2019		
2020		

Hr'g Ex. SX-17 at 59 ¶ 236 (Rubinfeld Corr. WDT); Hr'g Ex. SX-64 (Rubinfeld App. 1b, backup calculations); Hr'g Ex. SX-66.

842. The Services take the position that Prof. Rubinfeld's calculations must be wrong because his average effective royalty rate from the iHeart-Warner agreement results in a per-performance rate above the statutory rates, which Profs. Fischel/Lichtman say would have been "irrational" for iHeart. Hr'g Ex. IHM 3054 ¶¶ 97-98. This cannot be right. Both iHeart and Warner were accepting risks in entering the agreement as to how it would perform on an average effective royalty basis, [redacted]. This allocation of risk is a negotiated point and iHeart certainly accepted the possibility that it would be paying average effective rates above the statutory license. Furthermore, as Mr. Wilcox testified, iHeart was motivated to have an agreement with a major [redacted]. Hr'g Tr. 2353:17-25 (May 7, 2015) (Wilcox). iHeart may also have gotten value from the very existence of the agreement that made a higher rate justifiable because they may have believed that this agreement would help them to lower industry rates going forward. Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler).

843. Much less irrational, Prof. Rubinfeld's performance-based calculations are conservative for several reasons:

- First, although recognizing the value to Warner, Prof. Rubinfeld makes no adjustment upward for [ ]. Hr'g Ex. SX-17 at 57 ¶ 229 (Rubinfeld Corr. WDT).
- Second, Prof. Rubinfeld's assessment is likewise conservative because he does not account for the additional value [ ]. As explained below, a conservative approach would be to assign [ ].
- Third, Prof. Rubinfeld allocates [ ] despite there being no present legal obligation for iHeart to pay for terrestrial radio performances.[36] Hr'g Ex. SX-17 at 58 ¶ 231 (Rubinfeld Corr. WDT). Notably, Profs. Fischel/Lichtman [ ]. Hr'g Ex. IHM 3034 at 20 (Fischel/Lichtman AWDT).
- Fourth, Prof. Rubinfeld uses the conservative . Hr'g Ex. SX-17 at 59 n.135 (Rubinfeld Corr. WDT).

Because Prof. Rubinfeld's adjustment approach was conservative and the rates derived from the performance of the iHeart-Warner agreement are still well above SoundExchange's rate proposal, it follows that SoundExchange's rate proposal is on the low end of the range of reasonable rates.

	iHeart-Warner Per-play Rate	**SoundExchange's Proposed Per-Play Rates**	**iHeart-Warner Capped Percentage of Revenue**	**SoundExchange's Proposed Percentage of Revenue**
2016		$0.0025		55%
2017		$0.0026		55%
2018		$0.0027		55%
2019		$0.0028		55%
2020		$0.0029		55%

[36] In Prof. Rubinfeld's rebuttal report, he calculates the average royalty rate per performance based on actual performance but excluding [ ] and including [ ] as Profs. Fischel/Lichtman did. The resulting rate is [ ] per performance. Hr'g Ex. SX-133.

b. *Warner's Analysis of iHeart-Warner Performance*

844. Independent of this proceeding, Warner has tracked the performance of the iHeart-Warner agreement. As of March 2014, [ ]

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Hr'g Ex. SX-296 at 16.

845. On the [ ] alone, Warner calculated an effective per-performance rate of [ ]

RESTRICTED TABLE

[redacted]

Hr'g Ex. SX-296 at 15.[37] As Prof. Shapiro testified repeatedly, the internal business documents, not created for litigation, are the "best stuff" for understanding how business people make decisions. Hr'g Tr. 2717:10-25 (May 8, 2015) (Shapiro). Warner's internal documents show that it [redacted]. SX-296 at 15.

[37] Of course, the only purpose of allocating [redacted] *See, e.g.*, Hr'g Ex. SX-342 ([redacted].)

4. Average Effective Rate Calculation Based On Properly Adjusted iHeart [ ] Projections Supports SoundExchange's Rate Proposal

846. Properly considered, iHeart's projections of the royalties it would pay under the iHeart-Warner agreement also support SoundExchange's rate proposal. Profs. Fischel/Lichtman calculated an expected average per-performance rate of [ ] form iHeart's [ ] projections. Hr'g Ex. IHM 3034 at 23 ¶ 43 (Fischel/Lichtman AWDT). That number is represented by Line 8, the Projected Total Royalty Rate per Performance in Fischel/Lichtman's Exhibit B:

RESTRICTED TABLE

[redacted]

Hr'g Ex. IHM 3034 at 172, Exhibit B (Fischel/Lichtman AWDT). Profs. Fischel/Lichtman's calculation, however, results in an erroneously low average rate.

847. First, the iHeart projections wrongly rely upon [ ]. Hr'g Ex. SX-221 (Warner Model.xlsb). [

[redacted]

[redacted]]. Hr'g Ex. SX-33 at 15-16 § 3(b)(i)-(ii).

848. Profs. Fischel/Lichtman state that this discrepancy is meant to adjust for [redacted] Hr'g Ex. IHM 3034 at 18 ¶ 35 (Fischel/Lichtman AWDT). Merely looking at the model shows that this was not iHeart's intention:

RESTRICTED GRAPHIC

[redacted]

849. More likely, it appears this is an error that was simply hardcoded into the spreadsheet that iHeart had been using to analyze its agreements with the independent labels, which do rely on [redacted]. Hr'g Ex. SX-221 at n.2; *see, e.g.*, Hr'g Ex. SX-3365 at 5 ¶ 1(ee) (iHeart-Concord Agreement). The model erroneously applies [redacted]. Hr'g Ex. SX-29 at 12 ¶ 37 (Rubinfeld Corr. WRT). This is simply an error.

[38] [redacted] Hr'g Ex. SX-33 at 2 ¶ 1(h).

850. Second, Profs. Fischel/Lichtman erroneously group payment for "digital-only" streams with simulcast streams [ ]. Hr'g Ex. SX-29 at 13 ¶ 38 (Rubinfeld Corr. WRT). This is incorrect—[ ]. Hr'g Ex. SX-33 at § 1(h), 3(b); *see also* Hr'g Ex. SX-129.

851. Simply adjusting for these two errors increases the average expected royalty rate to [ ]. Hr'g Tr. 6282:1-9 (May 28, 2015) (Rubinfeld).

852. As described above in Section IX.C.2, any analysis of the iHeart-Warner agreement must take into account the substantial value Warner received through the non-royalty rate provisions.

853. Among the most glaring omissions by Profs. Fischel/Lichtman are [ ]. These omissions greatly underestimate the true consideration Warner received under the agreement. First, [ ] This increases Profs. Fischel/Lichtman's expected average per-performance rate to [ ]. Hr'g Tr. 6284:20-25 (May 28, 2015) (Rubinfeld). Second, adding [$22]. Hr'g Ex. SX-32 at 14, n.9 (Wilcox WRT); Hr'g Tr. 7403:4-21 (June 3, 2015) (Wilcox). Correcting Prof. Fischel/Lichtman's average projected royalty rate to account for either of the foregoing two elements results in an average effective per-performance rate of [ ]. Including both

[redacted] to the expected rate analysis results in an average per-performance rate of [redacted]. Third, [redacted] to any projected average royalty rate.

5. Average Effective Rate Calculation Based On iHeart [redacted] Projections Supports SoundExchange's Rate Proposal

854. Setting aside the economic terms that Profs. Fischel/Lichtman did not value, they also give insufficient justification for relying on only the [redacted] iHeart case as opposed to the other cases that iHeart modeled. (*See* Section IX.B.5, *supra*). iHeart took the [redacted] case into account and took on the risk that it would actually be the reality. In Mr. Cutler's words: [redacted] Hr'g Tr. 7265:10-14 (June 2, 2015) (Cutler). Had Profs. Fischel/Lichtman analyzed one of the iHeart cases that proved to more accurately reflect actual performance of the deal, the average projected per-performance rate would be [redacted]. Hr'g Ex. SX-131 at 5 (Prof. Rubinfeld's calculations of average per-performance rate under scenarios of iHeart projections not analyzed by Profs. Fischel/Lichtman).

RESTRICTED TABLE

Hr'g Ex. SX-131 at 5. Notably, another iHeart case that Profs. Fischel/Lichtman reviewed [ ] closely reflects actual performance of the agreement to date and results in an average expected per-performance royalty of [ ]. *Id.* at 4. Further adjusting these rates to account for the consideration that Profs. Fischel/Lichtman ignore, *see* Section IX.C.2, *supra*, would result in even higher average effective royalty rates.

6. Average Effective Rate Calculation Based on Warner Projections Supports SoundExchange's Rate Proposal

855. During the hearing, Prof. Fischel presented a new analysis of a particular projection that he asserted was Warner's best estimate of the iHeart-Warner agreement.[39] Hr'g Tr. 5372-5381 (May 21, 2015) (Fischel). Prof. Fischel claims that applying his incremental framework to this model results in an incremental performance rate of $0.0008. *Id.* at 5381:13. He did not calculate a Warner expected average per-performance rate using this document.

856. Using the exact same case that Prof. Fischel identified from Mr. Wilcox's exhibits, one can calculate the average projected rates. First, (corresponding to Profs. Fischel/Lichtman's Exhibit A), one annualizes the average monthly total listening hours and then multiplies them by the assumed performances per listening hour. Summing these numbers gives a total projected number of performances for iHeartRadio. *See* Hr'g Ex. SX-92 at 15.

RESTRICTED TABLE

[redacted]

[39] As Mr. Wilcox explained, Prof. Fischel's characterization of the model misunderstands and misrepresents his testimony. The spreadsheet [redacted] Hr'g Tr. 7421:14-20 (June 3, 2015) (Wilcox).

[redacted]

Source: SX-92-015

857. From the total number of performances [redacted], using Profs. Fischel/Lichtman's Exhibit B format, one can calculate the Projected Warner Share of Performances both absent and under the agreement. The numbers of projected royalties come directly from the exhibit to Mr. Wilcox's testimony. Because Warner includes the [redacted], that amount is included in this calculation. Line 8 reflects the expected average per-performance rate calculated using the [redacted] from Mr. Wilcox's exhibit, SX-92-015. The average expected per-performance royalty [redacted]. Notably, even [redacted] the average rate is [redacted] per performance.

RESTRICTED TABLE

[redacted]

Source: SX-92-015

858. Likewise, looking at the [ ], results in an average effective royalty aligned with that Prof. Rubinfeld calculated—here [ ] per performance.

RESTRICTED TABLE

Source: Hr'g Ex. SX-92 at 15.

859.

D. The iHeart-Independent Agreements Are Not Representative Benchmarks and Profs. Fischel/Lichtman's Analysis of Them Is Fundamentally Flawed

860. In addition to analyzing the iHeart-Warner agreement and the Pandora-Merlin agreement using their incremental approach, Profs. Fischel Lichtman cite to 27 agreements between iHeart and independent record labels as supportive evidence. These agreements cannot be benchmarks because they represent a tiny fraction of all copyright owners and webcasting performances.

861. The agreements between iHeart and 27 independents fail the comparability analysis.

- *Willing buyer and seller test:* iHeart has the option of electing the statutory license for these performances and, as a result, the independent labels could not deny it a license.
- *Same parties test:* As explained more fully below, the [redacted] and, as a result, the agreements cannot be representative of the largest share of the market which is occupied by the three major labels.
- *Statutory license test:* More than the iHeart-Warner deal, they are anchored by the statutory rates [redacted]. As a result, they fail the statutory license test.
- *Same rights test:* The Independent agreements more closely match the rights granted by the statutory license than the interactive agreements but they still involve consideration—such as [redacted] that is not covered by the statute.

862. Further, the iHeart-Independent agreements are not representative of the rates and terms that a non-interactive webcaster would negotiate with a major recorded music company. Prof. Fischel admits that [redacted] Hr'g Tr. 5542:17-18 (May

22, 2015) (Fischel). Indeed, by his calculations a [ ]. Hr'g Tr. 5542:5-8 (May 22, 2015) (Fischel). In contrast to the iHeart-Warner deal, the terms of the Independent deals are:[40]

- [
-
- ;
- ; and
-]

Hr'g Tr. 5551:2-12 (May 22, 2015) (Fischel). As Prof. Shapiro observed, the rates of the iHeart-Warner deal [ ]. Hr'g Tr. 4736-4738 (May 19, 2015) (Shapiro).

863. Finally, these licensors together are less representative of a market rate because they "represent a sliver of the universe of rights holders for sound recordings." *SDARS II* at 23,061. iHeart's data confirm that none of the labels accounted for more than [ ].

864. Nonetheless, Profs. Fischel/Lichtman analyze these deals ostensibly in the same way as the iHeart-Warner deal. They purport that these deals represent an average per play rate of [ ], and an "incremental" amount of $.0002. Yet, this analysis is flawed and based on scant evidence. Prof. Fischel [ ]. Hr'g Tr. 5543:3-11 (May 22, 2015) (Fischel). Accordingly, Profs. Fischel/Lichtman's presumption that iHeart [

[40] Particular to Concord [ ]. Hr'g Tr. 6505:11-13 (May 28, 2015) (Barros).

[redacted].

Hr'g Tr. 5544:1-15 (May 22, 2015) (Fischel).

865. Instead, Profs. Fischel/Lichtman relied on actual performance as a starting point. Hr'g Tr. 5545:7-12 (May 22, 2015) (Fischel). They then backed out of actual performance, expectations of the parties at the time of contract—at the [redacted]. Hr'g Tr. 5545:13-18 (May 22, 2015) (Fischel). This "expectation" however is not supported by any internal iHeart documents and is certainly not supported by actual performance. [redacted] Hr'g Tr. 5545:21:5546:2 (May 22, 2015) (Fischel). The following spreadsheet relied upon by Fischel for his analysis shows the number of iHeart licenses who were not being [redacted].

RESTRICTED GRAPHIC

[redacted]

866. Nonetheless, Profs. Fischel/Lichtman hypothesized that iHeart expected a [redacted] and believe that—without any evidence that the Independent concurred in or

shared that expectation—this expectation should form the basis of their incremental analysis.[41] Profs. Fischel/Lichtman also extrapolate the data that they have [ ] despite the fact that the document they rely upon was created before a number of the contracts were even executed. Hr'g Tr. 5548:4-7 (May 22, 2015) (Fischel); Hr'g Ex. SX-2347.

867. Furthermore, as with the iHeart-Warner agreement, Profs. Fischel/Lichtman omit consideration that the Indies received but that could not be replicated under the statutory license. For example, Mr. Barros testified that [ ]. Hr'g Tr. 6506:12-14 (May 28, 2015) (Barros) ([ ]). Likewise, for Concord [ ]. Hr'g Tr. 6509:21-24 (May 28, 2015) (Barros). Concord would not have entered into a direct license with iHeart without these forms of consideration. Yet, Profs. Fischel/Lichtman make no attempt to adjust upward to account for this additional consideration.

X. NAB'S PROPOSED "ZONE OF REASONABLENESS" HAS NO MARKET BASIS AND IS INAPPROPRIATE FOR THIS PROCEEDING

868. NAB does not propose a particular statutory rate. Rather, through its expert Prof. Katz, NAB proposes a "zone of reasonableness for the royalty rate that will be set in the current proceeding as it applies to simulcasters." Hr'g Ex. NAB 4000 ¶ 80 (Katz WDT).

[41] One could hypothesize any range of "boosts" that iHeart did or did not achieve and arrive at a dramatically different expected incremental rate. This is particularly true because the Indies' [ ].

869. The lower bound of NAB's proposed "zone of reasonableness" is "near zero," based on Prof. Katz's estimation of what a willing buyer and willing seller would agree to for performance rights in the terrestrial radio market. Hr'g Ex. NAB 4000 ¶¶ 81-84, 95 (Katz WDT).

870. The upper bound of NAB's proposed "zone of reasonableness" is "no higher than 13 percent" of revenues, based on the statutory rate set in *SDARS II*. Hr'g Ex. NAB 4000 ¶¶ 93, 95 (Katz WDT).

871. NAB's "zone of reasonableness" should be disregarded, for the following reasons.

872. As explained in part A., the use of terrestrial radio as a reference point is improper. Current U.S. copyright law does not recognize a performance right in sound recordings for terrestrial radio. Consequently, no market exists for performance rights in sound recordings on terrestrial radio. Prof. Katz's assumptions regarding what rate a willing buyer and willing seller would agree to pay for such terrestrial performances are not supported by the evidence.

873. As explained in part B, reliance on the *SDARS II* proceeding is also improper. *SDARS II* was a regulatory proceeding, not a marketplace agreement. What is more, it was a regulatory proceeding applying a different statutory standard than the one at issue here—*SDARS II* did not seek to replicate the rate that a willing buyer and willing seller would agree to pay. Even if the standard were the same (and it is not), the rates still could not simply be transposed from that proceeding to this one. *SDARS II* involved a monopsony buyer, Sirius XM, with a completely different cost structure than the webcasters at issue in Prof. Katz's proposal. And Prof. Katz failed to recognize that the upper bound of his zone of reasonableness was derived from stale evidence.

874. As explained in subpart C, the Judges should reject NAB's implicit suggestion to segment the statutory rate to provide a discount for simulcast. The statutory rate should be a single rate structure that allows for the full functionality permitted under the statute. No party actually proposed a rate structure that included a different rate for simulcasters versus other webcasters, and no licensee witness performed a comparison of the rate structured proffered by NAB with other licensee rate structures.

875. As explained in subpart C.1., the evidence does not support the rationale underlying the proposed "discounted" rate for simulcasters – namely, that simulcast and terrestrial radio are equally promotional, and have the same functionality. Instead, the evidence demonstrated that the promotional effects and functionality of simulcast differs from terrestrial radio to a significant degree, calling into question the underpinnings of NAB's "zone of reasonableness."

876. As explained in subpart C.2., these differences are likely to increase over the ensuing rate period. Whether and to what extent simulcast is similar to terrestrial radio is evolving, and will continue to evolve. Services have proposed definitions that would permit even further deviation from terrestrial in simulcast, while still allowing them to characterize their service as a "Broadcast Retransmission." A discounted rate would be decidedly inappropriate for the degree of customization and variation from a broadcast transmission proposed in these definitions, because they propose a definition that Prof. Katz did not assume as part of his "zone of reasonableness" analysis.

877. As discussed in subpart C.3, the alternative is equally undesirable. A definition that constrained functionality to "identical" content only would stifle evolution and innovation and encourage gamesmanship by creating incentives to operate services in a particular manner.

878. Finally, as explained in part subC.4, a discounted rate is simply unnecessary and would give simulcasters an unfair advantage. The license at issue here is for the full functionality permitted under the statute. If a particular music user decides to do less with the statutory rights, that is a business decision. The user can always negotiate a direct license for less than what the statute permits. Broadcasters already receive a significant discount to their business operations because they pay no royalties whatsoever for the use of sound recordings on terrestrial stations. And broadcasters have given no compelling reason to create a subsidy for their simulcast business.

A. Terrestrial Radio Is Not A Proper Reference Point In Setting A Willing Buyer/Willing Seller Rate

879. As discussed in greater detail in SoundExchange's Proposed Conclusions of Law, no market exists for performance rights in sound recordings on terrestrial radio. Under current law, no such right exists. Broadcasters do not license recordings for use on terrestrial radio stations, and they do not pay for the right to play music on terrestrial radio. Broadcaster's cost-free use of sound recordings results from an anomaly in existing copyright law – not a willing buyer/willing seller exchange. Hr'g Ex. SX-29 ¶ 103 (Rubinfeld Corr. WRT); Hr'g Tr. 1371:25-1372:13 (May 1, 2015) (Harleston); Hr'g Tr. 7057:10-19 (June 1, 2015) (Burruss).

880. Prof. Katz does not offer any marketplace evidence reflecting the "near zero" rate. Hr'g Tr. 5735:15-5737:23 (May 26, 2015) (Katz).

881. And indeed, Prof. Katz agrees that there is no "market or payments" for performance rights in sound recordings on terrestrial radio. But he bases his "near zero" floor on record company behavior, specifically promotion efforts directed toward terrestrial radio. The "near zero" floor assumes that, in some instances, record companies would pay terrestrial radio

to play their sound recordings. Hr'g Ex. NAB 4000 ¶¶ 81-84 (Katz WDT); Hr'g Tr. 5668:20-5669:25 (May 26, 2015) (Katz).

882. This assumption is not supported by the evidence. Fact witnesses testified that it was both "unfortunate" and "unfair" that terrestrial radio does not pay a royalty for the sound recording performance right. Hr'g Tr. 1371:25-1372:13 (May 1, 2015) (Harleston); Hr'g Tr. 7057:10-19 (June 1, 2015) (Burruss).

883. Specifically, Jeff Harleston of Universal Music Group was asked about the benefit to Universal Music Group from the plays on terrestrial radio of the Robin Thicke song, "Blurred Lines." Mr. Harleston testified that, "[u]nfortunately, the copyright law does not provide for a performance right in terrestrial sound recordings," and that, "[t]he benefit to Universal from the terrestrial airplay was, unfortunately, only promotional because the copyright law does not provide for terrestrial radio to play it – to pay a performance royalty." Hr'g Tr. 1371:25-1372:13 (May 1, 2015) (Harleston).

884. Similarly, Jim Burruss, Senior Vice President of Promotion Operations for Columbia Records, testified that he believed it was "unfair" that artists and labels were not compensated for airplay on terrestrial radio, stating that he "would like to see our artists and our labels get paid for what's right." Hr'g Tr. 7057:10-19 (June 1, 2015) (Burruss).

885. To the extent Prof. Katz and NAB simply assume that "simulcast" is the same as terrestrial radio – in terms of its content, functionality, or its promotional/substitutional effect – that is not supported by the evidence, as further explained below.

B. The Rate Set In *SDARS II* Is Not an Appropriate Benchmark

886. As discussed in greater detail in SoundExchange's Proposed Conclusions of Law, the rate set in *SDARS II* is not an appropriate benchmark because, as Prof. Katz acknowledged, it is not a voluntarily negotiated rate, and was set by the Judges in a regulatory proceeding. Hr'g

Tr. 5759:20-25 (May, 26, 2015) (Katz); *see also SDARS II Final Order*, 78 Fed. Reg. 23,054 (Apr. 17, 2013).

887. Further, as testified to by Sirius XM CFO David Frear, "satellite radio and [w]ebcasting operate under two totally different royalty administrations." Hr'g Tr. 5472:16-19 (May 22, 2015) (Frear). Put simply, the rate set in *SDARS II* was not meant to reflect a similar standard to that at issue here: what a willing buyer/willing seller would agree to pay. The statutory factors in play in the *SDARS II* determination differ significantly. The *SDARS* standard is "policy-driven, whereas the standard for setting rates for nonsubscription services set forth in section 114(f)(2)(B) is strictly fair market value—willing buyer/willing seller." *Web I Final Order*, 67 Fed. Reg. 45240, 45244 (July 8, 2002).

888. Prof. Katz acknowledged that he was not offering an opinion on whether the applicable statutory language in the *SDARS II* proceeding and the "willing buyer/willing seller" standard were equivalent, from an economic perspective. Hr'g Tr. 5760:14-5761:3 (May 26, 2015) (Katz).

889. Even if the standard were comparable (and it is not), the satellite radio market and the webcasting market are too dissimilar to simply transpose a rate from one into another. As Mr. Frear testified at the hearing, the satellite and webcasting industries are "two totally different businesses" that have "fundamentally different" costs of operation. Hr'g Tr. 5471:1-23 (May 22, 2015) (Frear).

890. Even though Prof. Katz expressly recognized that "services' costs (including costs other than licensing costs) are relevant to those firms' demand for—and bargaining positions with respect to the prices of—licenses," his reliance on a satellite benchmark does not account for the fact that the cost structure of a satellite service like Sirius XM is dramatically different

from the cost structure of webcasters like those at issue here. Hr'g Ex. NAB 4015 ¶¶ 70-71 (Katz WRT).

891. In *SDARS II*, Sirius XM relied on the testimony of Mel Karmazin, its Chief Executive Officer since 2004, which "describe[d] the ways in which Sirius XM's cost constraints – including having invented and continually invested in maintaining, upgrading and innovating its technological infrastructure and developing its unique and often exclusive content – vary widely from those of its new Internet-based competitors, which are not saddled with similar costs." *Sirius XM's Introductory Memorandum to the Written Direct Statement* at 7, *In re Determination of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services*, No. 2011-1 CRB PSS/Satellite II (Nov. 29, 2011).

892. The Judges noted this difference in *SDARS II*, stating that "substantial financial outlays are unique to Sirius XM, which has developed a proprietary music distribution system, rather than use the existing internet framework," as webcasters have done. *SDARS II Final Order*, 78 Fed. Reg. at 23,069.

893. And at the hearing Mr. Frear confirmed that "the costs of the satellite radio business are significantly greater than the cost[s] of operating [Sirius XM's] [w]ebcasting business." Hr'g Tr. 5471:12-23 (May 22, 2015) (Frear).

894. Prof. Katz's analysis also overlooks that Sirius XM is a monopsony buyer, as it is the sole provider of satellite radio services. There is no "sole provider" of streaming services in the webcasting market, *SDARS II Final Order*, 78 Fed. Reg. at 23,065; rather, the market consists of several services of varying sizes that compete with one another. Hr'g Tr. 5472:4-15 (May 22, 2015) (Frear). Sirius XM would thus be in a position to "negotiate[] very different

rates," than those which would emerge in the webcasting market. *SDARS II Final Order*, 78 Fed. Reg. at 23,065.

895. Finally, and most fundamentally, Mr. Frear testified that "there's a difference in a consumer's willingness to pay for satellite radio and a consumer's willingness to pay for [w]ebcasting." Hr'g Tr. 5471:24-5472:3 (May 22, 2015) (Frear). Absent adjustment to account for how consumers value satellite radio as compared to simulcasts—an adjustment Prof. Katz does not even attempt to make—this difference renders satellite radio a fundamentally uninformative benchmark in this proceeding. Given the "law of derived demand," the differing willingness to pay for the two types of services at the consumer level would translate to a differing willingness to pay upstream—and distinct willing buyer/willing seller rates. Hr'g Tr. 5044:8-19 (May 20, 2015) (Shapiro); Hr'g Tr. 6058:15-16 (May 27, 2015) (Talley); *SDARS I Final Order*, 73 Fed. Reg. 4080, 4093 (Jan. 24, 2008) (observing that in input markets "demand for these inputs is driven by or derived from the ultimate consumer markets in which these inputs are put to use").

896. The 13% figure upon which Prof. Katz relies to set the upper bound of his zone of reasonableness is problematic for yet another reason: it is based on incredibly stale market evidence. In *SDARS II*, after concluding that both parties' proposed benchmarks were flawed, the Judges used the 13% benchmark rate from *SDARS I* as one of several "guide posts" for its application of the 801(b) factors. *SDARS II Final Order*, 78 Fed. Reg. at 23066, 23068 ("The Judges also are informed . . . by the 13% benchmark rate that served as a benchmark in *SDARS I*."). The 13% benchmark rate in *SDARS I* was, in turn, derived from an interactive service benchmark based on agreements negotiated more than seven years ago, when the streaming market looked entirely different than it does today. *SDARS I Final* Order, 73 Fed. Reg. at 4093.

These outdated agreement are a manifestly unreasonable basis for setting rates in this proceeding. Hr'g Tr. 5771:23-5772:3 (May 26, 2015) (Katz) ("If you're asking me would I be comfortable if the present judges said, oh, let's just look at agreements from 2008 and ignore the rest of the record and anything that's happening in the intervening period, I would not be comfortable with that.").

C. The Judges Should Reject NAB's Implicit Suggestion That Simulcasters Should Receive A "Discounted" Statutory License Rate

897. No party explicitly proposed a rate structure that would provide for different rates for "simulcasters," versus other webcasters. By offering a rate that would apply only to simulcasters, Prof. Katz's "zone of reasonableness" implicitly suggests that the rate for simulcasters should be different from the rate that would apply to other webcasters. But, as counsel for NAB confirmed, neither Prof. Katz nor any other witness for the Services compared the rate proposed for simulcasters to the rate proposed for full DMCA functionality. Hr'g Tr. 5693:18-5695:23 (May 26, 2015) (Mr. Joseph confirms); Hr'g Ex. SX-29 ¶ 205-06 (Rubinfeld Corr. WRT).

898. Statutory rate segmentation would be unnecessary and inappropriate. As Dr. Rubinfeld testified, the CRB should "set a statutory rate that is based on the value of the full functionality permitted by the statutory license." Hr'g Ex. SX-29 ¶ 205-06 (Rubinfeld Corr. WRT).

1. Key Differences Between "Simulcast" And Terrestrial Radio Undermine Prof. Katz's Assumption That The Two Have Identical Promotional Effects, Functionality, And Content

899. Prof. Katz bases his implicit suggestion for a discounted simulcast rate on certain assumptions regarding terrestrial radio and simulcast. Specifically, he assumes that terrestrial radio and simulcast are identical, in that they share the same promotional and substitutional

effects, functionality, and content. Hr'g Ex. NAB 4000 ¶¶ 81-84 (Katz WDT). Whether the content is identical begs the question of how simulcast is defined, which is discussed in the next part. This section addresses Prof. Katz's assumptions about simulcast's similarity to terrestrial radio in terms of promotional/substitutional effect and functionality.

900. The evidence developed at trial does not support these assumptions. Instead, the evidence revealed key differences between simulcast and terrestrial that support a finding that simulcast listeners can employ broader functionality than is available with terrestrial radio, and that simulcast is likely not as promotional as terrestrial radio. This evidence undermines Prof. Katz and other NAB witnesses' justifications for a "lower" rate.

(a) Simulcast Lacks Terrestrial Radio's Geographic Limitations, Offering Greater Choice And Consequently Less Promotional Effect

901. Terrestrial radio typically offers access to a limited selection of genre stations within a particular market. But simulcast streams are generally available outside of a station's geographic territory, so a listener's options are not limited by geography. *See* Hr'g Ex. NAB 4005 ¶ 22 (Downs WDT); Hr'g Ex. NAB 4002 ¶ 12 (Dimick WDT) (Lincoln Financial Media Company's stations are generally available in the continental United States).

902. The wide variety of streaming stations from all over the world are collected on aggregator sites like TuneIn and iHeartRadio. As John Dimick explained, TuneIn is "like . . . a one-stop shop. It's sort of where everybody goes to find out what's being streamed." Hr'g Tr. 5801:6-23 (May 26, 2015) (Dimick); *see also* Hr'g Ex. NAB 4009 ¶ 9 (Dimick WRT).

903. The absence of geographic limitations allows a simulcast listener to access streams from all over the world, providing a much different a different user experience from geographically-limited terrestrial radio. As Mr. Kooker testified:

> I think when you look at, in particular, the aggregation of simulcasts like you find in services like TuneIn or in the iHeart website [or] app, what you – what you have the ability to do is you have access to hundreds of terrestrial stations all at once, you have the ability to search for an artist or song, and you will instantly get results for that artists or song if they're playing somewhere in the massive network that's being aggregated and have the ability to play that song essentially on-demand.
>
> So, again, very unlike terrestrial radio where you would be listening to it in one single market and you would only be listening to what is actually programmed to play at that moment in time.

Hr'g Tr. 6556:13-7 (May 29, 2015) (Kooker).

904. NAB expert Dr. Stephen Peterson admitted that, unlike terrestrial radio, simulcast streams are not geographically limited. Hr'g Tr. 3909:4-16 (May 14, 2015) (Peterson). He conceded that this difference raises the possibility that simulcast streams "could divert sales" because they "open[] up another opportunity" to listen to music. Hr'g Tr. 3910:2-13 (May 14, 2015) (Peterson). Dr. Peterson admitted that to answer this question, the effect of simulcast "would have to be studied," and acknowledged that he had not performed any empirical analysis or study to determine whether simulcast and terrestrial radio result in different promotional effects. *Id.* at 3910:14-3911:2. In fact, Dr. Peterson admitted that he was not aware of any empirical analysis or study offered by any of the services on this issue. *Id.* at 3911:3-10.

905. Ron Wilcox, Business Affairs for Warner Music Group, testified that, in his view, the broader availability of simulcast stations from outside of your area renders simulcast and terrestrial "just totally different animals" in terms of promotional effect:

> [W]hen you're in the terrestrial mode with an AM/FM dial in front of you, and you're interested in a given type of music, you have limited choices. You may have – there may be only one station in your area that has that genre. There may be a couple. That's probably the most.

> And that goes to the issue of promotion in that situation of playing music can be – could be promotional, particularly if we're not receiving any money from it.
>
> When you go into simulcast – and I'm – I listen to things in simulcast fashion – you have a plethora, almost an infinite number of choices of radio stations of every type and genre, subgenre, et cetera, all over the world that you can dial in to be streamed on your computer.
>
> So it's very – there's much greater choice. And once you get into that sort of more narrow choice of music that you're going to listen to, there's less chance it'll inspire a purchase or consumption in an elective fashion.

Hr'g Tr. 2522:9-2523:9 (May 7, 2015) (Wilcox).

(b) Simulcast Has More Robust Search Functionality Than Terrestrial Radio

906. Several witnesses testified about the ability to conduct searches of iHeartRadio and TuneIn for a particular artist, genre or geographical area. This functionality is not available on terrestrial radio. Hr'g Ex. SX-29 ¶ 209 (Rubinfeld Corr. WRT); Hr'g Tr. 7076:7-12 (June 1, 2015) (Burruss).

907. Dennis Kooker of Sony Music conducted an experiment using the search functionality on iHeartRadio to search simulcasting stations for Meghan Trainor. Hr'g Ex. SX-27 at 5 (Kooker WRT); Hr'g Tr. 6556:12-6558:9 (May 29, 2015) (Kooker). The search immediately identified where Meghan Trainor songs were currently playing at stations across the country, and played them from that station's stream. Hr'g Ex. SX-27 at 5 (Kooker WRT). By contrast, the likelihood of searching out and finding the same Meghan Trainor songs on terrestrial at that time was "very, very low." Hr'g Tr. 6558: 3-9 (May 29, 2015) (Kooker). Based on the frequency of play on those terrestrial stations, Mr. Kooker estimated that a listener would have had to listen to terrestrial "for hours (at least)" to ensure she heard those songs. Hr'g Ex. SX-27 at 7 (Kooker WRT). As Mr. Kooker testified:

> The ability to search *all* (or a selected portion) of iHeartRadio's simulcast stations in a musical genre or a geographic region and immediately identify and access specific artists and/or songs being played, or alternatively, search for a specific artist and immediately access that artist's music from various simulcast stations, make iHeart's simulcast service fundamentally different from terrestrial radio.

Id. at 6.

908. Jim Burruss, Senior Vice President of Promotion Operations for Columbia Records, also confirmed that "simulcast" and terrestrial are not the same experience because of the search functionality that allows users to "find that song again somewhere else":

> Q: You have no reason to believe that someone listening to their local radio station over the station's simulcast signal doesn't get the same promotional benefit as listening over the air, right?
>
> A: I think when you listen to a terrestrial radio station, you're engaged. This is your piece to be listening to this music that's being programmed, and I believe that you're an active listener and I believe you have a great opportunity to turn around and act upon that. I believe that your love and passion for it will force you to go out and buy it, to be able to participate in it, to buy concert tickets, to envelop that.
>
> I don't believe you have the same experience with simulcast. Because I think you can just turn around and find that song again somewhere else and click on it and hear it again and not engage that way.

Hr'g Tr. 7082:3-22 (June 1, 2015) (Burruss).

909. Dr. Blackburn also testified that this increased search functionality on services like iHeartRadio, allowing the search of so many simulcast streams across the country, would decrease the likelihood of a user going out and purchasing the music. Hr'g Tr. 1594:17-1596:20 (May 4, 2015) (Blackburn).

910. Witnesses confirmed that the search function on iHeartRadio and TuneIn does not let the user identify a song and play it from the beginning. Rather, a user joins the song in

progress, but can refresh the search to attempt to locate the song again from the beginning. Hr'g Tr. 1596:21-1597:23 (May 4, 2015) (Blackburn); Hr'g Tr. 6559:18-6561:12 (May 29, 2015) (Kooker).

911. Dr. Rubinfeld testified that differences in functionality between "simulcast" and terrestrial radio make "simulcasters" more competitive with webcasters than with terrestrial radio broadcasters. Simulcasters "do not occupy a distinct submarket." And the increased functionality available in a digital service brings simulcasting services into competition more with on-demand services. Hr'g Ex. SX-29 ¶ 209 (Rubinfeld Corr. WRT).

912. Fact witnesses confirmed Dr. Rubinfeld's view. In an internal document, one of the reasons iHeartMedia offered for using particular technology was to [redacted] *Id.*]

913. Licensee services challenged whether increased search functionality replicated the experience on a more customized radio station, or whether it approached so-called "on-demand" functionality. But was not the point, as Mr. Kooker testified. Hr'g Tr. 6645:5-15 (May 29, 2015) (Kooker). The point is not that search functionality renders simulcast an on-demand or customized radio service. It is that these differences from terrestrial radio undermine the key assumptions Prof. Katz and the NAB witnesses relied upon to support their proposed discounted rate—namely, that terrestrial and simulcast shared the identical promotional effect and functionality.

(c) Simulcast Allows For More Customization

914. NAB witness John Dimick echoed the similarity point relied upon by Prof. Katz. He initially testified that the streams of his company's stations are "exactly the same as what we put out over the air," and that "[t]here's no way to customize" or provide "feedback" for their simulcast streams. Hr'g Tr. 5798:9-5801:5 (May 26, 2015) (Dimick).

915. But on cross-examination, Mr. Dimick acknowledged that, in fact, TuneIn provides additional functionality and customization. On sign-in, TuneIn shows a user songs that have just started playing across the country. And those songs are personalized to the user's taste "over a period of time by telling TuneIn these are the songs that I like." Hr'g Tr. 5840:15-5851:7 (May 26, 2015) (Dimick).

(d) Unlike Terrestrial Radio, Simulcast Incorporates Technology Allowing Users To Pause, Rewind, And Record

916. Mr. Dimick further testified that TuneIn simply provided access to his station's simulcast products, without permitting users greater functionality such as the ability to "pause" a live radio stream. Hr'g Tr. 5798:9-5801:5 (May 26, 2015) (Dimick); Hr'g Ex. NAB 4009 ¶¶ 5-9 (Dimick WRT).

917. Dimick also acknowledged that, in fact, TuneIn does allow users to pause a live radio stream, as well as rewind and record songs from the stream. Hr'g Tr. 5840:15-5851:7 (May 26, 2015) (Dimick).

918. Again, the customization and pause/record/rewind functionality does not transform a simulcast into a so-called "on-demand" service. It distinguishes simulcast from terrestrial radio, which does not allow for that functionality. These differences make it more likely that users will access their favorite music on simulcast than on terrestrial radio. Contrary to the assertions of Prof. Katz and the NAB witnesses, this makes it more likely that the two

types of offerings do not share identical promotional effects, and that simulcast is more likely to be substitutional than terrestrial radio.

(e) Both Broadcasters And Record Label Witnesses Confirmed That Simulcast And Terrestrial Have Different Promotional Effects

919. Ben Downs's testimony suggests that there are differences in the promotional value of terrestrial broadcasts and simulcast streams. Mr. Downs testified that advertisers value his stations' terrestrial broadcasting operation and "like to promote their products" on his terrestrial service. Hr'g Tr. 5241:25-5242:5 (May 21, 2015) (Downs). Yet Mr. Downs admitted that advertisers "don't see the same value in [his stations'] simulcast streams" and "aren't willing to pay anything" for these streams. *Id.* at 5242:6-12. Mr. Downs conceded that advertisers did not value his stations' simulcast streams despite the fact that his simulcast streams were essentially similar to his terrestrial broadcasts. *Id.* at 5242:13-5243:13.

920. The record label promotions witnesses who testified confirmed that record companies do not see terrestrial and simulcast as sharing the same promotional benefits. Mr. Burruss confirmed that his focus is on terrestrial radio as a promotions executive, and that simulcast does not come up in the discussion of how to promote and market an artist. Nor does Columbia measure listenership on simulcast in the same way it measures terrestrial listenership, or devote any of its resources to promotion on simulcast services. Hr'g Tr. 7045:2-12, 7048:16-7050:15 (June 1, 2015) (Burruss).

921. Similarly, Charlie Walk testified that although his record label promotes to terrestrial radio, "[s]imulcast is not a word that comes up in our promotion calls or meetings or conversations regarding the promotion of our acts." Hr'g Ex. IHM 3242 at 20 (Walk Dep. at 75:2-5). Mr. Walk saw promotional value in terrestrial radio, but when asked whether he thought the promotional impact of simulcast "would be the same," he testified that he did not

know. *Id.* at 33 (Walk Dep. at 129:6-9). Mr. Walk's testimony shows that, like advertisers, record labels do not treat simulcast streams the same as terrestrial broadcasts.

2. The Parties' Proposed Definitions Would Allow Greater Customization And Variation In The Content Of Simulcasts Over The Next Rate Period

922. These variants in functionality for simulcast reflect the state of play today. All indications suggest that such functionality will continue to evolve over the five years at issue in this rate period. Hr'g Ex. SX-29 ¶ 207 (Rubinfeld Corr. WRT). The same is true for the question of what constitutes a "simulcast" in the first place, in particular whether the content of a stream must be the same as a terrestrial broadcast in order to constitute a "simulcast."

923. Prof. Katz assumes that simulcasts "have the same content as the terrestrial, over-the-air broadcasts that they replicate." Hr'g Ex. NAB 4000 ¶ 83 (Katz WDT). But that begs the question of what constitutes a simulcast. Prof. Katz did not offer a definition and he "did not engage in a line-drawing exercise" to determine how different a stream of a terrestrial broadcast could be while still constituting a "simulcast" subject to his "zone of reasonableness" analysis. Hr'g Tr. 5738:8-5744:3 (May 26, 2015) (Katz).

924. As a technical matter, a stream of a terrestrial broadcast need not have the same content as the terrestrial broadcast itself. Jeffrey Littlejohn, iHeartRadio's Executive Vice President of Engineering and Systems Integration, was responsible for helping to develop [redacted] Hr'g Tr. 3638:16-3629:6 (May 13, 2013) (Littlejohn); Hr'g Ex. IHM 3210 ¶ 2 (Littlejohn WDT).

925. Mr. Littlejohn confirmed that, in his understanding as an engineer, [redacted]] Hr'g Tr. 3661:24-3662:25 (May 13, 2013) (Littlejohn). But the party's proposed definitions provide otherwise.

926. The parties' proposed definitions for "Broadcast Retransmission" would allow significant variation from the terrestrial broadcast stream, while still permitting the parties to characterize the stream as a "Broadcast Retransmission" for rate purposes. *Proposed Rates and Terms of iHeartMedia, Inc.* ¶2 (Oct. 7, 2014); *NAB's Proposed Rates and Terms* at 2 (Oct. 7, 2014).

927. iHeart's proposed amendment to the definition of "Broadcast Retransmission" would allow up to 49.9% of the content to be swapped out of the terrestrial stream [ ] while still allowing iHeartMedia to treat the stream as a "Broadcast Retransmission" for rate purposes:

> For the further avoidance of doubt, a Broadcast Retransmission does not cease to be a Broadcast Retransmission because the Broadcaster has replaced programming in its retransmission of the radio broadcast, so long as a majority of the programming in any given hour of the radio broadcast has not been replaced.

Proposed Rates and Terms of iHeartMedia, Inc. ¶ 2 (Oct. 7, 2014).

928. NAB's proposed definition of "Broadcast Retransmissions" would amend the current regulation to allow additional substitutional programming, including "occasional substitution of other programming that does not change the character of the content of the transmission." *NAB's Proposed Rates and Terms* at 2 (Oct. 7, 2014).

929. The significant variation permitted under these definitions would allow for even greater customization in a simulcast stream than exists today. Up to 49.9% of a terrestrial stream could include different content when streamed to a user. An internet stream is a one-to-one

transmission, so nothing technically prevents simulcasters from customizing each individual stream with up to 49.9% different content from the terrestrial broadcast.[42] That level of customization and variation from the terrestrial broadcast is contrary to the assumptions underlying Prof. Katz's "zone of reasonableness" analysis, which assumed that the content on simulcast streams would "replicate" the terrestrial broadcast. Hr'g Ex. NAB 4000 ¶ 83 (Katz WDT).

3. Statutory Segmentation Would Discourage Innovation And Encourage Gamesmanship

930. If a statutory license offered a discounted rate for less-than-total DMCA functionality, that would discourage innovation. Music users would be incentivized to limit their uses of music to that specified functionality, rather than developing and innovating their services to meet consumer demand. Hr'g Ex. SX-29 ¶ 211 (Rubinfeld Corr. WRT).

931. Prof. Katz conceded that a segmented statutory rate would create such incentives and disincentives, potentially deterring innovation:

> Q:If a lower rate applied to simulcasters than to non-simulcasters, that might create certain incentives and disincentives for simulcasters, correct?
>
> A: In theory, yes.
>
> Q: If innovating the simulcast service would result in having to pay a higher rate, an economically rational simulcaster would take that higher rate into account before deciding whether to innovate, correct?

[42] *See, e.g., Am. Broad. Companies, Inc. v. Aereo, Inc.*, 134 S. Ct. 2498, 2503 (2014) (defining "streaming" as "the process of providing a steady flow of audio or video data so that an Internet user is able to access it as it is transmitted").

> A: If such an innovation existed, if you were rational, you would take that into account, yes.

Hr'g Tr. 5745:24-5746:11 (May 26, 2015) (Katz).

932. A rate segmented based on functionality would invite gamesmanship in an effort to obtain particular royalty treatment. [redacted]

[redacted]

If simulcasters were subject to a distinct rate, other webcasters would inevitably attempt similar tactics to reduce their royalty obligations." Hr'g Ex. SX-29 ¶ 211 (Rubinfeld Corr. WRT).

4. Statutory Rate Segmentation Would Be Unnecessary, Impracticable, And Unfair

933. The license at issue here covers the full functionality under the statute. If a music service desires less than the full functionality permitted by the statute and considers the statutory rate too high for that use, a direct license for less than the full functionality can be negotiated. "[I]f there is market demand for segmentation, the market will use the bargaining process to effectively achieve segmentation that is in the interest of both services and labels." Hr'g Ex. SX-29 ¶ 205-06 (Rubinfeld Corr. WRT).

934. NAB offered no evidence that demand elasticities are different among distinct segments of services, or that different types of users would listen to a simulcast over a different webcasting service. Dr. Rubinfeld testified that such evidence would be "essential if the CRB were to set different rates for different commercial segments." Hr'g Ex. SX-29 ¶ 208 (Rubinfeld Corr. WRT).

935. Statutory segmentation as opposed to market segmentation would be undesirable because it is not possible to draw clear lines effectively in light of a rapidly evolving market. As Dr. Rubinfeld explained, "Functionality is not a reasonable metric by which to segment the

webcasting market for a five-year statutory license term because functionality – and consumer preferences – are constantly evolving." Hr'g Ex. SX-29 ¶ 207 (Rubinfeld Corr. WRT).

936. A segmented statutory rate would create a subsidy for a struggling business model. Broadcasters repeatedly testified at the hearing that they struggled to develop their simulcasting business, in terms of attracting both listeners and advertisers. As but one example, John Dimick of Lincoln Financial Media testified:

> Many of our advertisers are unwilling to pay anything extra for inclusion of their advertisements on our streams. Many even take the position that streaming should be thrown in for free. Although I believe advertisers understand that there are some listeners for the stream, a major problem with converting that understanding into advertising dollars has been the lack of a demonstrated audience or a consistent ratings boost based on the streaming listenership.

Hr'g Ex. NAB 4002 ¶ 18 (Dimick WDT).

937. Broadcasters presented no marketplace evidence that would support the conclusion that a rational record company would agree to give a service a discount on the ground that the operator believes no one wants to listen to it and no one wants to advertise on it. There is no reason the statutory rate should subsidize such services either. *Web III Remand*, 79 Fed. Reg. at 23119; *accord Web II Remand*, 72 Fed. Reg. at 24088 n.8 ("It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners. Furthermore, it would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act.").

938. Such a subsidy would be particularly unsuitable here, because broadcasters already receive a significant competitive advantage from the lack of a performance right for sound recordings on their broadcast stations.

XI. THE APPLE ITUNES RADIO AGREEMENTS, BEATS "THE SENTENCE," RHAPSODY "UNRADIO," NOKIA "MIXRADIO," AND SPOTIFY "SHUFFLE" SUPPORT SOUNDEXCHANGE'S RATE PROPOSAL

A. Apple's Agreements With Warner And Sony Regarding The iTunes Radio Service

939. Although Apple's agreements with Warner and Sony for the iTunes Radio service are more affected by the shadow of the statutory rate than the interactive agreements, *see supra* Section III.B, when properly analyzed – from either a performance or projections-based approach – these agreements support SoundExchange's rate proposal.

1. Background And Overview Of Terms Of Agreements

940. In June 2013, Apple entered into [ ] with Warner and Sony for its iTunes radio service. Hr'g Exs. SX-2070; SX-2071. iTunes Radio is a free (ad-supported) non-interactive, personalized streaming radio service, similar to Pandora and iHeartRadio. *See* Hr'g Ex. SX-1652 at 10 ([ ]); Hr'g Ex. SX-128 ¶ 7 (Rubinfeld Corr. WRT App. 2). Warner and Sony's agreements with Apple describe iTunes Radio [ ]. *See* Hr'g Exs. SX-2070 at 19; SX-2071 at 13. Prof. Shapiro also treats iTunes Radio as a DMCA-compliant service in his analysis. *See* Hr'g Tr. 4909:7-12 (May 20, 2015) (Shapiro) ("I'm treating the iTunes Radio service as statutorily compliant, as best I understand it."). iTunes Radio also offers a subscription, ad-free service to Match subscribers as part of their annual $24.99 subscription fee. *See* Hr'g Ex. SX-1652 at 10.

941. The Services have suggested that iTunes Radio allows for "caching" of content. As the agreements make clear, however, [ ] Hr'g Ex. SX-2070 at 2 ¶ (f); *see also* SX-2071 at 2 ¶ (f). In other words, the [ ].

942. The Services also have raised questions regarding the iTunes Radio service [ ]. As the agreements make clear, however, iTunes Radio [ ] Hr'g Ex. SX-2070 at 19 ¶ 6; *see also* Hr'g Ex. SX-2071 at 13 ¶ 6(i). In other words, iTunes Radio provides [ ].

943. The iTunes Radio agreements with Warner and Sony have the following key royalty provisions. In the first year of the agreement, Apple pays the label [ ]. *See* Hr'g Exs. SX-2070 at §§ 1(b)-(c) & 5(b)(ii)(D); SX-2071 at §§ 1(d) & 5(a)-(b). In the second year, the [ ]. *See* Hr'g Ex. SX-2070 at §§ 1(b) & 5(b)(ii)(D); *see also* Hr'g Ex. SX-2071 at §§ 1(d) & 5(a)(ii)(D). Apple also agrees to pay as [ ]. *See* Hr'g Ex. SX-2070 at § 5(a) (Warner, under [ ] section); Hr'g Ex. SX-2071 at § 5(c) (Sony, under [ ] section). Apple also [

[redacted]. *See* Hr'g Exs. SX-2070 at § 5(b)(ii)(B); SX-2071 at§ 5(a)(ii)(B).

944. Apple's agreements with Warner and Sony also permit up to [redacted]. *See* Hr'g Exs. SX-2070 at § 1(x); SX-2071 at § 1(y).

2. Apple Has The Equal Ability To Steer As Pandora Or iHeart And Has Substantial Bargaining Power

945. Although the Services' critique of the interactive streaming services space as not reflecting "effective" or "workable" competition is misplaced, *see* Section VII.D, *supra*, it clearly would have no application to the Apple iTunes Radio agreements.

946. First, like Pandora or iHeartRadio, iTunes Radio is a non-interactive radio service, and has the equal ability to steer listeners to music offered by different labels, including independents – to the extent such ability exists for *any* non-interactive service, which SoundExchange disputes. Hr'g Ex. SX-128 ¶ 7 (Rubinfeld Corr. WRT App. 2). Prof. Shapiro stated in his written direct testimony, before the Apple agreements became part of this proceeding, that the mere *capability* of steering that is sufficient to create a benchmark created by effective or workable competition. *See* Hr'g Ex. PAN 5022 at 9 (Shapiro WDT) (the "ability or inability of a webcaster to steer listeners toward or away from the music of a given record company is fundamental to the licensing negotiations that would take place in the absence of a compulsory license" and the "net result in a workably competitive market may well be relatively little actual steering, yet lower prices to aggregators with the capability to steer."[43]).

[43] In supplemental written testimony, Prof. Shapiro states that there was "no indication that Apple, during the negotiations with the majors, even raised the possibility that it could steer (footnote continued)

947. Moreover, it is hard to envision a more powerful company sitting on the other side of the negotiating table than Apple, one of the most powerful companies in the world. Hr'g Ex. SX-128 ¶ 7 (Rubinfeld Corr. WRT App. 2). Given Apple's history and unique position in the digital music marketplace, Apple would have possessed significant bargaining power in its negotiations with the record labels. *Id*.

948. Apple also wielded substantial bargaining power in its negotiations with the independent record labels. Based on the available independent label agreements with Apple, the independents [ ]. *See* Hr'g Ex. SX-128 ¶ 29 (Rubinfeld Corr. WRT App. 2).

3. The Apple Agreements With Warner And Sony Were Not Contemplated To Be Used As Benchmarks In This Proceeding, Making Them Appropriate Benchmarks

949. The Services have speculated that Apple's agreements with Warner or Sony were the result of some conspiracy between Apple and the labels to influence these proceedings. This farfetched theory is both irrelevant, and in any event, contradicted by the actual facts.

950. At the outset, as Prof. Shapiro testified, all parties negotiate non-interactive streaming agreements with an eye towards how they may be used in this proceeding and may influence the ratemaking process. *See* Hr'g Tr. 4760:2-8 (May 19, 2015) (Shapiro) ("it's my understanding and assumption in general that everybody in the industry is looking -- is

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toward one record company or threatened to steer away from a record company, based on differences in royalty rates." Hr'g Ex. PAN 5365 (Shapiro Supp. WRT at 8). This contradicts Prof. Shapiro's prior testimony that the mere *capability alone* is sufficient, but if anything, it also demonstrates that Pandora and iHeart's limited steering exercises are replicable across the industry, and that major services like Apple may have no interest in creating services driven by steering as opposed to the breadth and quality of the music available to users.

concerned about impact on precedent, as I said before, because it's likely that deals will -- direct deals will show up here in the next round of the CRB proceedings."). Thus, the Services' speculation that this may also be the case with the iTunes Radio agreements does not diminish the agreements as a benchmark – or at least not any more than the Pandora-Merlin or iHeart benchmarks would themselves be diminished.

951. But moreover, of all the non-interactive service agreements offered in these proceedings, the Apple agreements with Warner and Sony may be least vulnerable to this concern.

952. First, both agreements [ ]. Hr'g Ex. SX-2070 § 16; *see also* Hr'g Ex. SX-2071 § 15.

953. Contrary to the Services' speculative theory that Apple was trying to help the labels influence this proceeding, Apple did not participate in this proceeding, and it [ ]. *See, e.g.,* Hr'g Ex. SX-17 ¶¶ 17, 163 (Rubinfeld Corr. WDT). Apple also vigorously *opposed* the Services' subpoena seeking third-party discovery from Apple.

954. In sum, the speculation that Apple was conspiring with Warner and Sony to influence these proceedings through the Apple agreements has no basis in fact, and is at any rate, irrelevant.

4. The [ ] In The iTunes Radio Agreements [ ]

955. The Services also hypothesize that the [ ]

[redacted]. Again, this theory is based on pure speculation, is contradicted by the agreements themselves between Apple and the labels, and is belied by the parties' internal business documents, which unequivocally [redacted].

956. First, as noted above, the [redacted]. *See* Hr'g Exs. SX-2070 at § 5(a) (Warner, under [redacted] section); SX-2071 at § 5(c) (Sony, under [redacted] section).

957. Second, all of the internal projection documents in evidence in this proceeding for Apple, Sony, and Warner treat [redacted].

958. First, Apple's pre-execution internal overview of the iTunes Radio agreements – [redacted] Hr'g Ex. NAB 4201 at 12-13 ([redacted]); Hr'g Tr. 4972:2-8 (May 20, 2015) (Shapiro) ([redacted]).

959. If this was, as the Services speculate, some secret agreement by which Apple [redacted]

[redacted]

960. Second, both Sony and Warner in their internal projection documents relied upon by the Services [redacted].

961. In the Sony document, Sony expressly [redacted]. Hr'g Ex. SX-2145 at 4; *see also* Hr'g Tr. 4993:15-21 (May 20, 2015) (Shapiro) ([redacted]).

962. Similarly, Warner in an [redacted]. Hr'g Ex. IHM 3549; *see also* Hr'g Tr. 3181:9-15 (May 12, 2015) (Katz) ([redacted]).

963. The Services have suggested that [redacted].

964. As noted, iTunes Radio offers a subscription, ad-free service to Match subscribers as part of their annual $24.99 subscription fee. *See* Hr'g Ex. SX-1652 at 10. This was a pre-existing cloud locker service at the time of launch of the iTunes Radio service. *See, e.g.,* Hr'g

Ex. SX-2070 § 1(q) ([ ]).

965. Under the terms [ ]. *See, e.g.,* Hr'g Ex. SX-2181 at 7, § 3.b ([ ]); Hr'g Ex. SX-2182 at 8, § 2.j ([ ]); Hr'g Tr. 3192:16-19 (May 12, 2015) (Katz) ([ ]).

966. When Sony and Warner entered into the iTunes Radio agreements, [ ].

967. Thus, the [ ]

Hr'g Ex. SX-2073 (emphasis added).

968. Similarly, [ ] Hr'g Ex. SX-2072. Apple was required to [ ] *Id.*

969. Nothing in either of these [ ].

970. The Services nonetheless speculate that the [ ]. *See, e.g.*, Hr'g Tr. 3195:2-5 (May 12, 2015) (Katz) ([ ]

[redacted]). This is contradicted by the fact that [redacted]

971. As Prof. Katz acknowledged, if the [redacted]. *Id.* at 3195:17-23 ([redacted]).

972. These payments for [redacted] Hr'g Ex. SX-2071 at 1 (emphasis added). If the [redacted].

973. Similarly, the Warner agreement states that [redacted] Hr'g Ex. SX-2070 at § 1.x (emphasis added); *see also* Hr'g Ex. SX-2171 at § 1.y ([redacted]

[redacted]

974. In sum, the Services' theory that the lump-sum payments are actually reallocated payments from the Match/Cloud agreements is based on nothing more than speculation, and is contradicted by the undisputed evidence in the record.

5. The Services' Claim That Apple Would Agree To Higher Rates Because Of Additional Sources Of Revenue Under The Agreement Ignores That The Labels Would Receive Even Greater Sources Of Revenue, Providing A Stronger Incentive For Them To Agree To Lower Rates

975. The Services have suggested that the rates in the Apple agreements with Warner and Sony are higher than they otherwise would be because Apple would obtain additional incremental sources of revenue under the agreement – specifically, download revenue.

976. The Services' argument, however, ultimately gets them nowhere, because the additional sources of revenue Apple would receive would also flow – in even greater amounts – to the record labels.

977. As Apple's [redacted]. *See* Hr'g Ex. NAB 4201 at 12-13; *see also* Hr'g Tr. 3127:25-3128:17 (May 12, 2015) (Katz) ([redacted]).

978. The [redacted]. And as Prof. Katz acknowledged, Robert Wheeler, Apple's iTunes Controller, whom Apple designated in response to the Services' subpoena, testified at his deposition that Apple [redacted]:

[redacted]

See Hr'g Tr. 3130:1-23 (May 12, 2015) (Katz).

979. With respect to the identified [redacted], (*see* Hr'g Ex. NAB 4201 at 12) which Prof. Katz agreed was [redacted]. *See* Hr'g Tr. 3142:14-19 (May 12, 2015) (Katz) ([redacted]).

980. Thus, the only significant source of additional revenue beyond the advertising revenue associated with the service – [redacted]. Hr'g Ex. NAB 4201 at 12-13. Because record labels receive approximately [redacted] of each iTunes store download, that means that the record labels would expect to receive more than double these amounts from those incremental downloads. *See* Hr'g Tr. 3139:2-11 (May 12, 2015) (Katz) ([redacted]

[redacted]

981. As Prof. Katz acknowledged, record labels would consider such incremental download revenue in negotiating a price with Apple and would have an incentive to agree to a *lower* price than they otherwise would have given such revenue.

[redacted]

See Hr'g Tr. 3140:9-21 (May 12, 2015) (Katz).

982. Prof. Shapiro similarly acknowledged that "[a]ny incremental download sales, above and beyond those that a statutory webcaster would promote, are mutually beneficial to the label and Apple," and for that reason, there was no need to do any upwards or downwards adjustment on the rates for the agreement based on download revenue. Hr'g Ex. PAN 5365 at 14 n.55 (Shapiro Supp. WRT).

6. Performance And Projections-Based Analyses Of The iTunes Radio Agreements Support SoundExchange's Rate Proposal

983. When analyzed from either a performance or projections-based approach, the rates in Apple's agreements with Warner and Sony support SoundExchange's rate proposal.

(b) **It Was Appropriate And Economically Sound For Prof. Rubinfeld To Examine The Performance of The Agreements In**

Calculating An Effective Per Play Rate

984. As discussed in SoundExchange's conclusions of law and above, Section IX.C.1, *supra*, it was both legally and economically appropriate for Prof. Rubinfeld to examine the actual performance of the iTunes Radio agreements in calculating an effective per-play rate for those agreements.

985. As noted above, wherever there is a [ ], there will be uncertainty and risk on both sides as to what the ultimate effective per-play rate will be. In the specific context of the Apple iTunes agreements, both sides, sophisticated parties, assumed the risk that the ultimate effective per-play rate could be higher, or lower, including higher or lower than the existing statutory rates, and ultimately what that rate ended up being. *See supra* at Section IX.C.1. Thus, the Services' argument that Apple would not rationally agree to rates higher than the existing statutory rate is a red herring. By agreeing to an [ ], Apple in fact did agree to the risk that the effective per-play rates could exceed the statutory license.

986. And indeed, [ ], and the uncertainty and risk that can accompany them based on performance projections, can play a central role in negotiations where the parties are unable to agree on changing other forms of consideration, such as, for example, increasing a per-play rate. *See supra; see also, e.g.,* Hr'g Tr. 3037:9-14 (May 11, 2015) (Katz) ([ ]).

987. Focusing on performance data, as opposed to the parties' internal projections, corrects for that uncertainty and risk and provides an objective value to performances made under the terms of the agreement.

988. As discussed further below, in the context of the Apple iTunes Radio agreements with Warner and Sony, Prof. Shapiro focuses exclusively on information regarding the parties' internal projections and takes a mid-point between them to calculate a projected rate. But as Prof. Shapiro acknowledged, simply taking parties' projected effective per-play rates does not tell you what their ultimate willingness to pay or willingness to sell values are and the range between them, i.e., the parties' bottom lines.

[redacted]

See Hr'g Tr. 5036:6-24 (May 20, 2015) (Shapiro)

(b) **Prof. Rubinfeld's Calculated Effective Per-Play Rates For The iTunes Radio Agreements Are Reasonable And Consistent With Apple's Own Calculated Effective Per-Play Rates**

989. Prof. Rubinfeld calculates effective per-play rates for the Warner and Sony iTunes Radio agreements by taking the [redacted]. *See* Hr'g Ex. SX-128 ¶¶ 26, 38 (Rubinfeld Corr. WRT App. 2). This is a conservative approach, as it does not take into potential [redacted]. *Id.*

990. Under this approach, Prof. Rubinfeld calculates an [ ]. Hr'g Ex. SX-2064A.

991. Prof. Rubinfeld also adjusted these figures to account for differences in [ ]. The Apple iTunes Radio performance data [ ]. *See* Hr'g Ex. SX-128 ¶¶ 28, 40 & ns.22, 31 (Rubinfeld Corr. WRT App. 2). As noted, *supra*, Prof. Rubinfeld estimated [ ]. *See id.*

992. Prof. Rubinfeld also adjusted his calculated rates for Apple to account for the fact that independent labels [ ]. *See* Hr'g Ex. SX-128 ¶¶ 29, 41 (Rubinfeld Corr. WRT App. 2).

993. Accounting for both of these adjustments results in an adjusted effective per-play rate for [ ]. *See* Hr'g Ex. SX-128 ¶¶ 30, 42 (Rubinfeld Corr. WRT App. 2).

994. Prof. Katz criticizes Prof. Rubinfeld's [ ]. *See* Hr'g Ex. NAB 4015 ¶ 233.

995. This is an improper comparison, however, for several reasons. First, [

”] Hr’g Ex. NAB 4201 at 3. Given that such [

].

996. As Prof. Shapiro states in his testimony, [

] Hr’g Ex. PAN 5365 at 14 n.55 (Shapiro Supp. WRT). For the same reason that there is no need to adjust an effective per-play rate based on incremental download revenue that is beneficial to both Apple and the labels, there is no need to adjust an effective per-play rate based on [ ].

997. Second, Prof. Katz’s 1.7 adjustment assumes that Apple [

[redacted].

998. Consistent with Prof. Rubinfeld's [redacted] Hr'g Ex. PAN 5022 at D-7 & n.10 (Shapiro WDT).

999. Finally, even if one were to accept Prof. Katz's 1.7 adjustment, [redacted]. Hr'g Ex. NAB 4015 at 142 & Table 11.

(c) The Parties' Internal Projections Are Far Closer To SoundExchange's Rate Proposal Than The Services

1000. For the reasons discussed above, focusing on the parties' internal projections is potentially problematic and does not give one an accurate estimate of parties' willingness to pay or willingness to sell values. But if one were to analyze the parties' internal projections here, they are far closer to SoundExchange's rate proposal than to those of the Services.

(i) Sony Projections

1001. Sony projected an [redacted]. *See* Hr'g Ex. SX-2145 at 4, 7 (under column [redacted]); Hr'g Ex. PAN 5365 at 15 (Shapiro Supp. WRT) (noting that Sony [redacted]

[redacted]); Hr'g Tr. 3161:13-3162:10 (May 12, 2015) (Katz) ([redacted]).

1002. Underlying these projections, Sony [redacted]. *See* Hr'g Ex. SX-2145 at 4, 7. Sony estimated [redacted]. *Id*. Sony also [redacted]. *See Id*.

(i) **Warner Projections**

1003. Warner's internal projection models [redacted]. *See* Hr'g Ex. IHM 3549 at 1; *see also* Hr'g Ex. NAB 4015 ¶ 226 (Prof. Katz relying on these internal projections) Conservatively [redacted]. *See* Hr'g Ex. IHM 3549 at 1. As Prof. Katz testifies, [redacted]. *See* Hr'g Ex. NAB 4015 ¶ 226; Hr'g Tr. 3200:20-25 (May 12, 2015) ([redacted]).

1004. Warner's internal projections [redacted] Hr'g Ex. IHM 3549 at 1.

(ii) **Apple Projections**

1005. In its internal projections, Apple was [redacted].

1006. Apple estimated, across all labels, an [redacted]. *See* Hr'g Ex. NAB

4201 at 12-14 ([ ]). Apple [ ].

1007. Apple's [ ].

See Hr'g Tr. 4986:5-13 (May 20, 2015) (Shapiro).

1008. Notwithstanding that Apple provided [ ]. Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT).[44]

[44] Prof. Shapiro then takes the mid-point between Sony's projections and Apple's projections, and [ ]. Hr'g Ex. PAN 5365 at 16 & Table 1 (Shapiro Supp. WRT).

1009. Besides the questionable nature of this mid-point approach, as discussed above, Prof. Shapiro makes a number of other errors in his analysis of Apple's projected per-play rate across all performances.

1010. First, he assumes [redacted] (Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT)) [redacted]. *See* Hr'g Tr. 5025:1-4 (May 20, 2015) (Shapiro).

1011. Second, Prof. Shapiro [redacted] (Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT)) but for the reasons discussed above, under Prof. Shapiro's own reasoning [redacted].

1012. Third, Prof. Shapiro assumes that performances to [redacted]. Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT). But as discussed above, [redacted]

[redacted]

1013. Correcting for these three errors, and using a [redacted]. *See* Hr'g Tr. 5032:19-23 (May 20, 2015) (Shapiro) ([redacted]).

1014. If one were to take the simple average of Sony, Warner, and these corrected estimated projections for Apple for the first year of the agreement, that would yield a rate of [redacted].

B. The "Section III.E" Services Corroborate The Interactive Services' Benchmarks

1015. Statutory services compete directly with interactive services to capture consumers and listening time. *See* Section V.B, *supra.* The converse is also true. Interactive services compete directly with statutory services and, in recent years, have developed consumer offerings that put statutory and non-statutory services more and more in direct competition. Beats' "The Sentence," Spotify's "Shuffle," Rhapsody's "Unradio" and Nokia's "MixRadio" are all consumer offerings available for free or for a discounted subscription price and with functionality that mimics that available under the statutory license—programmed-like playlists without full on-demand access. Record companies concede to deeply discounted rates for these product offerings because their agreements with these services [redacted].

Despite these deep discounts, even the stated rates that these services pay strongly corroborate SoundExchange's rate proposal.

1016. Furthermore, like Apple iTunes Radio, these service offerings provide programmed playlists without on-demand functionality to the listener. Accordingly, the *absence* of any steering provisions as it relates to these service offerings is telling.

1. Beats' "The Sentence" Has Near-Statutory Functionality And Rates That Corroborate SoundExchange's Rate Proposal

1017. Prof. Rubinfeld analyzed [ ] "free-to-the-user service" of Beats' The Sentence, designated in the contracts as the [ ]. Hr'g. Ex. SX-29 at 47 (Rubinfeld Corr. WRT); Hr'g Tr. at 2092:22-25 (May 6, 2015) (Rubinfeld). Beats represents a useful corroborative benchmark because, as explained below, it has nearly identical functionality to the statutory services. It also is a recent service—launched in 2014 negotiated by a sophisticated actor, including AT&T as it related to the bundled service. Further, the rates are less impacted by the statutory license because the subscription service offering is interactive and cannot qualify for the statutory license. Hr'g Ex. SX-29 ¶¶ 185-186 (Rubinfeld Corr. WRT).

1018. The functionality of Beats' "The Sentence" free-to-the-consumer offering is nearly identical to, and in some ways more restrictive, than the functionality permitted under the statutory license: [45] [ ]

[45] Beats also offers an initial 14-day free trial period to anyone who downloads the app for the first time. After the free trial expires, the individual has access to the free-to-the-consumer version of The Sentence without any of the additional functionality available only as a part of the subscription service. The Services' witnesses analyzed the free trial of the subscription service – with all of the functionality allowed to subscribers. Hr'g Ex. PAN 5364 ¶ 13 (Fleming-Wood Supp. WRT) (describing features available during the 14-day free trial of Beats' subscription); Hr'g Ex. IHM 3640 ¶¶ 11-15 (Littlejohn Supp. WRT) (same); Hr'g Tr. at 3641:4-25 (May 13, 2015) (Littlejohn) (Q: So you tested a free trial of the Beats service. A: That's correct.).

[redacted]

]. Hr'g Ex. SX-36 at 12 [(

)]; *see also* Hr'g Ex. SX-29 ¶ 180 (Rubinfeld Corr. WRT).[46]

1019. The functionality is defined in the contracts, as Mr. Harrison described during the hearing as [

]. Hr'g Tr. 1027:9-19 (Apr. 30, 2015) (Harrison):

[46] Each of the record labels' contracts with Beats regarding The Sentence is substantially similar in this regard. *See* Hr'g Ex. SX-114 [

)] at SNDEX0059579-80 (Exhibit C); Hr'g Ex. SX-109 [

)] at SNDEX0059117-18 (Exhibit D); Hr'g Ex. SX-80 [at SNDEX0025518; Hr'g Ex. SX-100 [

at SNDEX0057760 (§ 1 (z)).

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Hr'g Ex. SX-36 at 12.

1020. Indeed, as Prof. Rubinfeld notes, [ ]. *Id.*; *see, e.g.*, Hr'g Ex. SX-109 at SNDEX0059089 [((defining [ ]

1021. In some respects, the limits imposed on The Sentence are *more restrictive* than the statutory requirements. For example, The Sentence [”]. Hr’g Ex. SX-36 at 12 [( )].

1022. In one respect, The Sentences’ functionality exceeds the statutory requirements—compliance with the performance complement. Yet, this is not uncommon. Waivers of the performance complement are commonplace for statutory services—including all the services underlying the Services’ proffered benchmarks. Simulcasters operating pursuant to the NAB WSA Settlement do not comply with the performance complement. *See, e.g,* Hr’g Ex. NAB 4001 ¶ 28 (Newberry WDT); Hr’g Ex. NAB 4101 (waiver agreements with major record companies and American Association of Independent Music); Hr’g Tr. at 3653:18-3654:1 (May 13, 2015) (Littlejohn) (explaining that performance complement does not apply to simulcasts). iHeartRadio [ ] Hr’g Ex. SX-34 at 1, 1(a) [( )] [ ]. Hr’g Ex. PAN 5014 at 1(c)(v), 2(c).

1023. Prof. Rubinfeld analyzes the rates that apply to The Sentence [ ] offering across a range of agreements with different record labels. These rates closely approximate the rates that a willing buyer and willing seller might agree to for a non-subscription, non-interactive service − albeit lower because they are directly tied to a subscription product through [ ]. The [ ]. For example:

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[redacted]

Hr'g Ex. SX-36 at 9 (Beats-UMG Agreement). The per-performance rates for the [redacted].

1024. The rates that apply to at the minimum level of conversion are as follows:

[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]

1025. The range of rates from [redacted] is consistent with SoundExchange's rate proposal of $0.0025 starting in 2016.

2. Spotify's Free Tier Provides a Useful Corroborative Benchmark for Ad-Supported Models

1026. Prof. Rubinfeld also looked to the stated rates paid by Spotify for its Mobile Shuffle Service ([redacted]) to corroborate SoundExchange's rate proposal. *See* Hr'g Ex. SX-109 ([redacted]) at AGMT-000103; Hr'g Ex. SX-80 ([redacted]) at SNDEX0055405, -423; Hr'g Ex. SX-

87 ([ ]) at SNDEX0056492; Hr'g Ex. SX-100 (["]) at SNDEX0056191.

1027. Spotify's Free Tier on mobile devices offers functionality that is much closer to the functionality offered by Pandora and iHeartRadio than to the functionality offered by an on-demand service. For instance, as Pandora's own documents acknowledge, Spotify's Free Tier on mobile devices does not allow "on demand" listening—i.e., the user cannot pick a specific song to listen to. Hr'g Ex. SX-263 at 23[ ]; Hr'g Ex. SX-266 at 17 [ ] Similarly, Spotify's Free Tier on mobile devices limits users to six skips an hour. Hr'g Ex. SX-266 at 17.

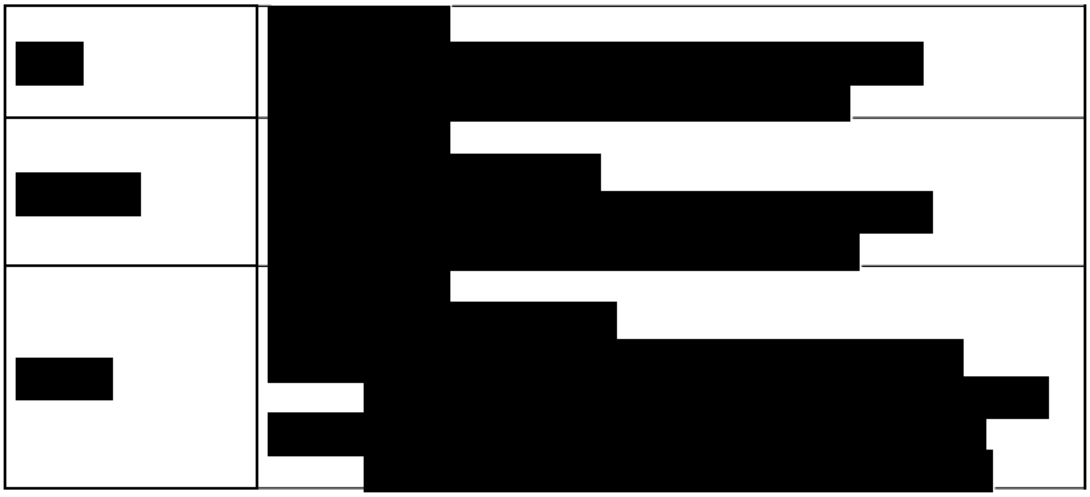
1028. Spotify's Free Tier also includes a customized "radio" feature that is similar to Pandora's and iHeartMedia's offerings. [ ]

1029. These rates are indicative of what a willing buyer and willing seller would agree to for an ad-supported service, thereby escaping the Services' experts criticisms of using subscription service rates as the benchmark. The rates that Spotify pays for its ad-supported offering are particularly illustrative because Pandora's internal documents identify [ ] Hr'g Ex. SX-269 at 11.

3. Rhapsody "unRadio" Demonstrates Rates to Which a Willing Buyer and Willing Seller Would Agree for a Programmed Subscription Service

1030. Although unRadio offers some limited on demand functionality, it is primarily a customized radio service like Pandora. *See* Hr'g Ex. SX-29 at 51. [ ]. Hr'g Ex. SX-263 at 23. And to

the extent Pandora's arguments regarding steering have any force, they should be equally applicable to a service like unRadio. [ ]. Hr'g Ex. SX-29 at 51 (Rubinfeld Corr. WRT). Rhapsody pays the following rates:



Hr'g Ex. SX-29 ¶ 197 (Rubinfeld Corr. WRT).

4. Nokia's MixRadio Programmed Service Also Corroborates SoundExchange's Rate Proposal

1031. As Prof. Rubinfeld explains in his written testimony, the primary difference between Nokia's MixRadio product and statutory services is the ability to play cached radio stations while offline. Hr'g Ex. SX-29 ¶ 199 (Rubinfeld Corr. WRT). The paid service at $3.99 to consumers also offers unlimited skipping. *Id.* Much like Pandora and iHeart, the MixRadio service [ ] *See, e.g.*, Hr'g Ex. SX-80 at SNDEX0056747 [ ]; Hr'g Ex. SX-87 at SNDEX0019170 [ ]

[redacted].]

1032. While MixRadio does permit some off-line listening, functionality that is not available under the statutory license, this feature is limited[47] – users must subscribe to the premium service to gain access to "premium benefits like unlimited track-skipping, unlimited offline mixes, [and] high-quality audio."[48] And, most importantly, MixRadio does not allow on-demand listening.[49]

1033. As Prof. Rubinfeld testifies, [redacted] the rate of $.0025 in Prof.

[47] *See, e.g.*, Hr'g Ex. SX-80 at SNDEX0056747 [redacted] Hr'g Ex. SX-100 at SNDEX0019868 [redacted]

[48] *See* Hr'g Ex. SX-29 ¶ 199 (Rubinfeld Corr. WRT); Hr'g Ex. SX-80 at SNDEX0056748-49 [redacted]

[49] *See, e.g.*, Hr'g Ex. SX-80 at SNDEX0056747 [redacted] Hr'g Ex. SX-100 at SNDEX0019868 [redacted] Hr'g Ex. SX-87 at SNDEX0019171 [redacted]

Rubinfeld's rate proposal for 2016. Hr'g Ex. SX-29 ¶¶ 200-201 (Rubinfeld Corr. WRT). The MixRadio per-play rate is [ ] as the rate proposed by Pandora, and [ ] the .0005 rate proposed by iHeart and NAB. Notwithstanding the limited additional functionality granted by the MixRadio licenses, the per-play rates contained in Nokia's agreements starkly suggest that the Services' proposals are widely out of proportion with market rates. MixRadio is thus an "informative analog" to the Services' non-interactive benchmarks.

XII. NAB'S AND SIRIUS XM'S ATTACKS ON THEIR WSA SETTLEMENTS ARE UNFOUNDED

1034. Both NAB and Sirius XM have levied a series of attacks on the Webcaster Settlement Act ("WSA") agreements they voluntarily negotiated with SoundExchange in 2009—agreements the Judges relied upon, in part, in *Web III* to set the statutory rates for 2011-2015. Hr'g Ex. NAB 4001 ¶¶ 16-30 (Newberry WDT); Hr'g Ex. SXM 6000 ¶¶ 33-51 (Frear WDT); *Webcasting III Remand* at 23111. While no party offered these WSA agreements as benchmarks in this proceeding, Prof. Rubinfeld testified that they are probative, arm's-length deals that the Judges properly considered in *Web III*. Hr'g Ex. SX-29 ¶ 217 (Rubinfeld Corr. WRT). In addition, Mr. Huppe, who was directly involved in both negotiations as then-General Counsel of SoundExchange, explained that NAB and Sirius XM have both mischaracterized the circumstances surrounding the agreements. Hr'g Ex. SX-26, ¶¶ 2-3, 30 (Huppe WRT); Hr'g Tr. 7563:25-7564:19 (June 3, 2015) (Huppe).

A. NAB's Claim That The Rates It Agreed to in Its WSA Settlement Were "Not Reasonable" Is Unfounded

1035. Steven Newberry, the lead negotiator for NAB, discounted the significance of NAB's 2009 agreement with SoundExchange and claimed that the agreement "did not adopt reasonable fees." Hr'g Ex. NAB 4001 at 6 (Newberry WDT). To support this position, Mr.

Newberry pointed to: (i) NAB's belief that the Judges would adopt unfavorable rates in *Web III*; (ii) NAB's purported lack of leverage in the negotiations; (iii) the impact of the Great Recession on NAB's appetite for litigation; and (iv) NAB's failure to "fully comprehend" the implications of designating the agreement as precedential. *Id.* ¶¶ 16-30. Based on an interview with Mr. Newberry, Prof. Katz similarly asserted that the NAB WSA agreement was an invalid benchmark because: (i) NAB had pessimistic expectations about the outcome of *Web III*; (ii) SoundExchange purportedly "possessed monopoly power"; and (iii) SoundExchange had the ability to selectively designate WSA agreements as precedential. Hr'g Ex. NAB 4000 ¶¶ 64-78 (Katz WDT).

1036. None of these attacks withstand scrutiny. The evidence instead showed that the Judges' reliance on the NAB Settlement in *Web III* was reasonable and appropriate.

1. Uncertainty About *Web III* Drove WSA Negotiations

1037. The NAB WSA agreement was a seven-year deal negotiated in early 2009. Hr'g Tr. 7564:23-7565:16 (June 2, 2015) (Huppe). The first two years covered by the agreement—2009 and 2010—overlapped with the *Web II* period, and the remainder of the term overlapped with the *Web III* period. Hr'g Tr. 7565:11-16, 7567:12-22 (June 3, 2015) (Huppe). The only statutory rates that were in place at the time of the negotiations were the rates for 2009 and 2010; the statutory rates for 2011-2015 were unknown. Hr'g Tr. 7567:12-22 (June 3, 2015) (Huppe).

1038. Mr. Newberry and Prof. Katz both discounted NAB's WSA agreement because it was affected by the rates set by the Judges in *Web II*. Hr'g Ex. NAB 4001 ¶ 20 (Newberry WDT); Hr'g Tr. 5708:6-19 (May 26, 2015) (Katz). Since the *Web II* rates overlapped with two years covered by the NAB settlement, the discussions for these years were naturally influenced by the rates currently available under the statutory license. Hr'g Ex. SX-26 ¶ 8 (Huppe WRT). "In fact, it would make little sense for either party to entirely ignore what NAB members would

otherwise pay . . . in 2009 or 2010." *Id.* However, the parties ultimately agreed to *lower* rates for 2009 and 2010 than the *Web II* rates. Hr'g Ex. SX-26 ¶ 9 (Huppe WRT). Given that the statutory rates for 2011-2015 had not yet been established, *Web II* did not cast any shadow over the remaining years of the settlement. Although Mr. Newberry and Prof. Katz suggested that *Web II* made the outcome of *Web III* a forgone conclusion,[50] in fact both NAB and SoundExchange were negotiating from a position of uncertainty about what rates would be set in *Web III*. Hr'g Ex. SX-26 ¶ 6 (Huppe WRT).

1039. At the time of the negotiation, the *Web III* proceeding was in its very early stages—no party had yet submitted a rate proposal or any evidence. SX-26 ¶ 6 (Huppe WRT); Hr'g Tr. 7565:20-7566:1 (June 3, 2015) (Huppe). As Mr. Huppe explained, "[n]o one was able at that time to predict what would happen in the *Webcasting III* proceeding, much less what rates the Judges would decide upon." Hr'g Ex. SX-26 ¶ 7 (Huppe WRT); Hr'g Tr. 7566:2-16 (June 3, 2015) (Huppe). Mr. Newberry echoed this sentiment. Hr'g Tr. 5082:21-22 (May 20, 2015) (Newberry) ("I can't (sic) predict what the Judges would do.").

1040. The uncertainty was amplified given that *Web III* was to be only the second webcasting proceeding before the Copyright Royalty Board and the streaming market was a "rapidly changing space" at the time. Hr'g Tr. 7566:10-11 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 7 (Huppe WRT).

[50] At the hearing, Mr. Newberry testified that NAB "did not expect to have a reasonably different outcome" in *Web III* as compared to *Web II* because "if you say the same thing in front of the same judge repeatedly, you're probably going to get approximately the same answer each time." Hr'g Tr. 5116:4-5117:9 (May 20, 2015) (Newberry). If NAB had some expectation of getting "approximately the same answer" in *Web III*, presumably a push forward of *Web II*'s $0.0019 rate was a possible outcome. Mr. Newberry offered no testimony as to why NAB would have expected a material rate increase in *Web III*.

1041. In other words, both SoundExchange and NAB bore the risk that the Judges would adopt rates in *Web III* that varied from their preferred rates. Hr'g Ex. SX-26 ¶ 7 (Huppe WRT). And the rates that the Judges ultimately adopted in *Web III* were in fact lower than SoundExchange's initial rate proposal in that proceeding. Hr'g Ex. SX-26 ¶ 7 (Huppe WRT); Hr'g Ex. SX-120. In sum, during the negotiations "no party—SoundExchange, NAB, or Sirius XM—could act as if the Judges had already set the rates for the 2011-2015 period." Hr'g Ex. SX-26 ¶ 7 (Huppe WRT).

1042. For SoundExchange, eliminating this uncertainty and "getting some clarity around what the rates are" was "the main motivator for the settlement discussions" with NAB. Hr'g Tr. 7566:17-7567:3 (June 3, 2015) (Huppe). While the passage of the Webcaster Settlement Act of 2008 naturally spurred the negotiations, the "primary mover" was a desire by both parties to find a solution to *Web III*. Hr'g Tr. 7565:1-5 (June 3, 2015).

2. NAB's "Monopolist" Claim Is Groundless and Inconsistent with the Facts

(a) Section 114 Specifically Contemplates Collective Action

1043. Although SoundExchange negotiated collectively on behalf of record companies and artists in its negotiation with NAB in 2009, this does not mean that SoundExchange exercised "monopoly" power or that the negotiation did not result in fair market rates. Hr'g Ex. SX-29 ¶ 220 (Rubinfeld Corr. WRT). As an initial matter, given that SoundExchange represented a multitude of interests, it was not acting as a classic monopolist. *Id.* Nor did NAB present any evidence to support Prof. Katz's speculation that SoundExchange acted as a cartel, or any evidence whatsoever that SoundExchange's Congressionally-sanctioned negotiating authority restricted competition in any way. Hr'g Tr. 5710:19-5712:1 (May 26, 2015) (Katz).

1044. Moreover, the section 114 statutory license specifically contemplates collective action by both licensees and licensors. The rate-setting proceeding, the antitrust exemption, and the very concept of a blanket license assumes that the record companies and webcasters alike will act through collective bodies. *See generally* 17 U.S.C. § 114. Congress purposefully created a mechanism by which representatives of the record industry and the webcasting industry could reach collective negotiated solutions. *Id.* § 114(e). To ensure that this collective action could not give rise to competitive abuses, Congress also created a rate court backstop in the event parties could not reach an agreement. *See, e.g.*, 155 Cong. Rec. S6740 (June 17, 2009) ("The Copyright Royalty Board process is intended as a backstop when parties cannot reach agreements.").

1045. Congress further facilitated settlement negotiations and expanded SoundExchange's negotiating authority when it passed the Webcaster Settlement Acts of 2008 and 2009. Webcaster Settlement Act of 2008, Pub. L. 110-435, 122 Stat. 4974 (Oct. 15, 2008); Webcaster Settlement Act of 2009, Pub. L. 111-36, 123 Stat. 1926 (June 30, 2009); 17 U.S.C. §114(f)(5). With this legislation, Congress granted SoundExchange the authority to negotiate settlements that could supplant the statutory rates set by *Web II* and encouraged SoundExchange to reach negotiated compromises with the services. *See, e.g.* 154 Cong. Rec. H10279 (Sept. 27, 2008) ("In supporting this legislation and approach, I believe it is particularly important that SoundExchange reach out and expand the number of webcasting representatives with whom they have been meeting."). The opportunity created by the Webcaster Settlement Acts came with tight deadlines—deadlines that necessitated collective action by both the record industry and the services. Webcaster Settlement Act of 2008, Pub. L. 110-435, 122 Stat. 4974 (Oct. 15, 2008) (creating a four-month negotiating window); Webcaster Settlement Act of 2009, Pub. L. 111-36,

123 Stat. 1926 (June 30, 2009) (creating a 30-day negotiating window); Hr'g Ex. NAB 4001 ¶ 19 (Newberry WDT).

1046. In sum, Congress expressly granted SoundExchange authority to negotiate on the record industry's behalf under the auspices of the WSA, and this authority arose in the context of a statutory scheme in which willing buyer/willing seller rates set by the Copyright Royalty Judges are always available as a backstop. As Prof. Rubinfeld testified, the collective negotiation between SoundExchange, on behalf of the record industry, and NAB, on behalf of the broadcast industry, in and of itself raises no competitive concerns. Hr'g Ex. SX-29 ¶¶ 219-222, 224, 226-227 (Rubinfeld Corr. WDT).

(b) NAB Had Other Options

1047. Moreover, while the WSA gave services additional opportunities to negotiate with SoundExchange, the WSA did not compel any party to do so. Webcaster Settlement Act of 2008, Pub. L. 110-435, 122 Stat. 4974 (Oct. 15, 2008); Webcaster Settlement Act of 2009, Pub. L. 111-36, 123 Stat. 1926 (June 30, 2009); 17 U.S.C. § 114(f)(5). Similarly, the WSA in no way displaced the other means by which services could obtain sound recording licenses; Congress simply created an additional licensing mechanism. *Id.*; Hr'g Ex. SX-26 ¶ 14 (Huppe WRT); Hr'g Tr. 7574:16-7575:7 (June 3, 2015) (Huppe). Notwithstanding Mr. Newberry's vague insinuations to the contrary, the parties had more, not less options, as a result of the WSA. Hr'g Ex. NAB 4001 ¶ 3 (Newberry WDT). In fact, the negotiating opportunity created by the WSA was beneficial to the services, as it made private negotiations eminently more feasible. Hr'g Tr. 5086: 10-16 (May 20, 2015) (Newberry) (noting difficulty of coordinating negotiations between 15,000 broadcasters and four major labels); Hr'g Tr. 5440:25-5441:7 (May 22, 2015) (Frear) (recognizing challenges involved in negotiating with thousands of labels to obtain direct licenses covering all the music played by Sirius XM); Hr'g Tr. 7577:1-4 (June 3, 2015) (Huppe) ("It is

obviously more convenient for a service or licensee to negotiate with one entity for all the rights.").

1048. Accordingly, the NAB did not face a "take-it-or-leave-it" offer from a "monopoly seller that held all of the cards," as Mr. Newberry suggested. Hr'g Ex. SX-26 ¶ 13 (Huppe WRT) (quoting Newberry WDT, Hr'g Ex. NAB 4001 ¶ 3). NAB did not have to negotiate with SoundExchange at all; it had several other options. Hr'g Ex. SX-26, ¶¶ 13-14 (Huppe WRT); Hr'g Tr. 7574:16-7575:7 (June 3, 2015) (Huppe).

1049. First, NAB could have actively participated in the *Web III* proceedings and advocated for its preferred rate, just as they are in these proceedings. Hr'g Ex. SX-26 ¶ 14 (Huppe WRT); Hr'g Ex. SX-29 ¶ 227 (Rubinfeld Corr. WRT); Hr'g Tr. 5120:1-6 (May 20, 2015) (Newberry); Hr'g Tr. 5779:16-5780:2 (May 26, 2015) (Katz). According to Mr. Huppe, SoundExchange "had every reason to believe, if [they] didn't reach a settlement, [NAB] would continue to litigate," particularly given that (i) NAB had historically participated in these proceedings; (ii) NAB was vigorously appealing *Web II* at the time; and (iii) NAB had already filed a petition to participate in *Web III*. Hr'g Tr. 7575:8-22 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 14 (Huppe WRT); Hr'g Ex. SX-123. Mr. Newberry admitted that filing the petition to participate was a strategic move designed not only to preserve the litigation option, but also to gain leverage in the negotiations by making SoundExchange believe that NAB would be involved in *Web III* if settlement discussions broke down. Hr'g Tr. 5083:17-5084:2 (May 20, 2015) (Newberry).

1050. Mr. Newberry tried to suggest that litigation was not a viable option for NAB at the time because the broadcast industry had been hit hard by the Great Recession. Hr'g Ex. NAB 4001 ¶ 23 (Newberry WDT). But, as Mr. Newberry himself acknowledged, the recording

industry was experiencing financial difficulties of its own in 2009. Hr'g Tr. 5114:21-24 (May 20, 2015) (Newberry). Moreover, even during the depressed years of 2008 and 2009, the broadcast industry was generating approximately $13 billion in revenues. Hr'g Tr. 5115:8-16 (May 20, 2015) (Newberry); Hr'g Tr. 5782:18-5783:2 (May 26, 2015) (Katz). The recording industry's combined revenue in these same years was a fraction of this amount. Hr'g Ex. SX-26 ¶ 20 (Huppe WRT); Hr'g Ex. SX-41. In short, as "a nonprofit organization with a limited mission representing the interests of creators who are subject to a statutory license" in an industry in the midst of a steep revenue decline, SoundExchange likewise had incentives to avoid litigation expenses. Hr'g Ex. SX-26 ¶¶ 20, 25 (Huppe WRT).

1051. In any event, NAB also had a costless alternative to negotiating with SoundExchange: it could have simply relied on the statutory license and the rates set by the Judges in *Web III*. Hr'g Ex. SX-26 ¶¶ 16, 26 (Huppe WRT). Many statutory licensees, including some major players, elect to not participate in the proceedings and instead take this "wait-and-see" approach. Hr'g Ex. SX-26 ¶¶ 16, 26 (Huppe WRT); Hr'g Tr. 7575:23-7576:5, 7634:8-17 (June 3, 2015) (Huppe). If NAB thought that SoundExchange was demanding "monopoly rates" at the time, NAB would have presumably opted to rely on the willing buyer/willing seller rates that would be established by the Judges in *Web III*. Hr'g Ex. SX-29 ¶ 227 (Rubinfeld Corr. WRT).

1052. Since no broadcaster is legally compelled to simulcast, NAB members also always have the option to stop streaming altogether. Hr'g Ex. SX-26 ¶ 18 (Huppe WRT); Hr'g Tr. 5788:24-5789:7 (May 26, 2015) (Katz). For broadcasters, this is a particularly viable option given that they often emphasize that simulcasting is an ancillary part of their overall business model. Hr'g Tr. 7576:6-7577:13 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 18 (Huppe WRT);

Hr'g Ex. SX-29 ¶ 225 (Rubinfeld Corr. WRT); Hr'g Ex. NAB 4001 ¶ 14 (Newberry WDT) (describing streaming as a "secondary" way to reach Commonwealth's listeners); Hr'g Ex. NAB 4002 ¶ 19 (Dimick WDT) ("[S]tream audiences remain a very small fraction of our over-the-air audience despite the fact that we have been streaming continuously for more than eight years."); Hr'g Ex. NAB 4005 ¶ 23 (Downs WDT) ("Like leather seats in a car, [streaming] is nice to have, but not necessary."). If the NAB or any of its members felt like the agreement with SoundExchange was entirely "one-sided" and not in their best interest, they would presumably opt to abandon this minor part of their business. Hr'g Ex. SX-26 ¶ 18 (Huppe WRT) (quoting Newberry WDT, Hr'g Ex. NAB 4001 ¶ 3); Hr'g Tr. 5790:1-6 (May 26, 2015) (Katz). But rather than walk away, hundreds of NAB members have voluntarily elected to stream at the rates set forth in the NAB agreement. Hr'g Ex. SX-26 ¶¶ 13, 18 (Huppe WRT).

1053. While NAB's members always have the option to not offer a statutory service at all, SoundExchange and its members do not have the same choice—any DMCA-compliant service that wants to use their music may do so, regardless of the service's business model and how the service chooses to use (or not use) their sound recordings. Hr'g Ex. SX-26 ¶¶ 18-19 (Huppe WRT). As a result, SoundExchange knew that its members would have to let simulcasters use their recordings at the *Web III* rates if it did not reach a settlement with NAB, even if they deemed the rates set by the Judges to be insufficient. *Id.* NAB's members, on the other hand, could abandon streaming if the rates set by the Judges were too high. *Id.* This asymmetry affected the parties' bargaining positions. Hr'g Ex. SX-17 ¶¶ 98, 100 (Rubinfeld Corr. WDT). Put simply, the uncertainty surrounding *Web III* created greater risks for SoundExchange and its members because they did not have the "no license" threat point. *Id.*

1054. Finally, broadcasters also always have the option to negotiate directly with individual copyright owners. Hr'g Ex. SX-26 ¶ 17 (Huppe WRT); Hr'g Ex. SX-29 ¶ 226 (Rubinfeld Corr. WRT); Hr'g Tr. 5783:3-10 (May 26, 2015) (Katz). In fact, at the time of its negotiations with SoundExchange, NAB was negotiating with the major labels to obtain waivers of certain requirements of the statutory license. Hr'g Ex. SX-26 ¶ 17 (Huppe WRT); Hr'g Tr. 7577:8-13 (June 3, 2015) (Huppe); Hr'g Ex. NAB 4001 ¶ 28 (Newberry WDT); Hr'g Ex. NAB 4101. During these very same discussions (or after the conclusion of the *Web III* proceeding) NAB could have explored the possibility of direct licenses with the majors if it was not satisfied with the progress of its negotiations with SoundExchange (or the outcome of the case). SX-26 ¶ 17 (Huppe WRT); Hr'g Tr. 7577:8-13 (June 3, 2015) (Huppe). But it did not do so. Hr'g Tr. 5783:11-21 (May 26, 2015) (Katz). The natural inference is that NAB did not believe the individual labels would willingly agree to lower rates. Hr'g Ex. SX-29 ¶ 226 (Rubinfeld Corr. WRT). Similarly, NAB could have pursued direct licenses with any or all copyright owners at any point in the last seven years if it thought the rates in the agreement it negotiated with SoundExchange were unreasonable. Hr'g Ex. SX-26 ¶ 17 (Huppe WRT).

(c) NAB Had Countervailing Bargaining Power

1055. Mr. Newberry's suggestion that SoundExchange had all the leverage in the negotiation also fails to account for the buyer-side power possessed by the trade organization representing the multi-billion-dollar behemoth that is the broadcast industry. Hr'g Ex. SX-26 ¶ 20 (Huppe WRT). In light of NAB's size, sophistication, and the substantial royalty stream it represented, the NAB-SoundExchange negotiation more closely resembled a bilateral monopoly, a scenario in which seller- and buyer-side power counteract each other. Hr'g Ex. SX-29 ¶¶ 218, 224 (Rubinfeld Corr. WRT).

1056. In the technical appendix of his written direct testimony, Prof. Katz purported to show that a large buyer like NAB would be unable to "offset SoundExchange's market power to any meaningful degree," "even if the parties are equally skillful and sophisticated bargainers." Hr'g Ex. NAB 4000 ¶¶ 38-39, 69 (Katz WDT). But, as Prof. Talley demonstrated in his own technical appendix by making a few modest corrections to the inapt assumptions in Prof. Katz's model, a negotiation between a single buyer and seller "can easily deliver prices that are close (if not identical) to competitive prices." Hr'g Ex. SX-19 at 10-12 (Talley WRT); Hr'g Ex. SX-29 ¶ 224 (Rubinfeld Corr. WRT).

1057. Moreover, Mr. Huppe testified that the agreement with NAB was in fact the product of a "vigorous back-and-forth negotiation between two sophisticated parties." Hr'g Tr. 7568:1-12 (June 3, 2015) (Huppe); Hr'g Tr. 5715:4-10 (May 26, 2015) (Katz). Indeed, NAB successfully negotiated a discount off the 2009 and 2010 statutory rates, as well as a rate for 2011 that was also lower than the rate for the last two years of the *Web II* period, belying the claim that it had no leverage in the negotiations. Hr'g Ex. SX-26 ¶ 9 (Huppe WRT); Hr'g Ex. SX-29 ¶ 223 (Rubinfeld Corr. WRT); Hr'g Tr. 5122:10-20 (May 20, 2015) (Newberry); Hr'g Ex. SX-121 at 8; *Webcasting II* at 24100.

(d) NAB Did Not Express Any Dissatisfaction With the Agreement Until This Proceeding

1058. While Mr. Newberry now considers the terms of NAB's WSA agreement to be unreasonable, neither he nor any other NAB representative expressed that view in 2009. Hr'g Tr. 7568:13-23 (June 3, 2015). In fact, NAB expressed an entirely different view at the time. Hr'g Ex. SX-26 ¶ 10 (Huppe WRT). When the settlement was announced, NAB issued an "extremely positive" press release that, among other things, heralded the agreement as "[e]nsuring the continued viability of Internet streaming for America's radio stations" and quoted

John Simson's assessment that the agreement was "good news for everyone." Hr'g Tr. 7570:17-7571:3 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 10 (Huppe WRT).

1059. In 2009 NAB also filed a joint motion with SoundExchange in which both parties asked the Judges to adopt the rates and terms in the NAB agreement for all commercial broadcasters as part of the *Web III* proceeding. Hr'g Tr. 7571:4-10 (June 3, 2015) (Huppe). In that motion, NAB told the Judges that its agreement had "already been embraced by over 380 commercial broadcasters comprising thousands of individual stations" and that the agreement "manifestly provides a reasonable basis for setting statutory terms and rates." Hr'g Ex. SX-26 ¶ 10 (Huppe WRT); Hr'g Ex. SX-122. NAB never told SoundExchange that it believed that the NAB WSA agreement was in fact not a "reasonable basis for setting statutory terms and rates." Hr'g Tr. 7571:16-7572:7-19 (June 3, 2015) (Huppe). To the contrary, NAB agreed with SoundExchange that the rates they negotiated should bind all broadcasters—even those that chose not to elect them voluntarily under the WSA. And in the five years between the submission of its joint motion in *Web III* and the submission of NAB's direct case in this proceeding, no NAB representative told SoundExchange that it thought the rates that NAB agreed to in 2009 were unacceptable. *Id.*; Hr'g Ex. SX-26 ¶ 12 (Huppe WRT).

1060. Moreover, given that streaming is voluntary, if it was not in broadcasters' best interest to simulcast at the NAB rates, broadcasters would presumably choose not to stream. Hr'g Tr. 5788:24-5789:7, 5790:1-6 (May 26, 2015) (Katz); Hr'g Tr. 7573:20-7574:1 (June 3, 2015) (Huppe). But since 2009 broadcasters have flocked to the streaming market and elected to pay the NAB rates. Hr'g Ex. SX-26 ¶¶ 11, 19 (Huppe WRT). By June 2009, 380 broadcasters had already signed on to the settlement. Hr'g Tr. 7572:3-6 (June 3, 2015) (Huppe). Two years later, 678 licensees were electing to pay the NAB rates, and this number grew to 851 licensees in

2012 and 949 licensees in 2013. Hr'g Ex. SX-26 ¶ 11 (Huppe WRT). This market behavior, which is a reflection of broadcasters' self-interested cost-benefit analysis, is more probative of the reasonableness of the NAB rates than the belated statements made by Mr. Newberry in the context of this proceeding. Hr'g Tr. 7573:5-7574:1 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 30 (Huppe WRT); Hr'g Ex. SX-29 ¶ 228 (Rubinfeld Corr. WRT).

3. NAB Agreed That The Settlement Would Be Precedential

1061. The NAB agreed to include a provision in the settlement that "expressly authorized" the submission of its rates and terms in proceedings under 17 U.S.C. § 114(f). Hr'g Ex. SX-121 at 9302, § 6.3(b). Mr. Newberry now claims that this precedential provision "was not something that [they] negotiated" and that he "did not fully comprehend that SoundExchange would be able to use the agreement against broadcasters in the future, or claim that the agreement represented willing buyer/willing seller rates in future proceedings." Hr'g Ex. NAB 4001 ¶ 30 (Newberry WDT).

1062. At the hearing, however, Mr. Newberry clarified that the precedential provision was negotiated among the parties' attorneys. Hr'g Tr. 5095:19-24; 5096:8-5097:12, 5125:8-24 (May 20, 2015) (Newberry). He also testified that he did not have any direct conversations with SoundExchange about the provision, though he did have an internal discussion about its implications with NAB's negotiating team. *Id.* The precedential provision was therefore "not something that [they] negotiated" for the simple reason that Mr. Newberry never voiced any objections to SoundExchange about it. Hr'g Tr. 7601:8-7602:17 (June 3, 2015) (Huppe).

1063. Mr. Newberry also acknowledged that NAB recognized that the agreement would be precedential in *Web III*. Hr'g Tr. 5096:8-5097:12 (May 20, 2015) (Newberry). Mr. Huppe likewise testified that submission of the settlement in *Web III* was "one of the main driving forces" for the entire negotiation. Hr'g Tr. 7579:5-14 (June 3, 2015). In fact, more than a week

before the settlement was finalized, the parties had already formally agreed that they would "jointly propose these rates and terms as a settlement in 'Webcaster 3' to the CRB in the next proceeding." Hr'g Ex. SX-1574 at 2.

1064. And in June 2009 NAB did offer the agreement to the Copyright Royalty Board as the basis to establish rates and terms for an entire category of licensees. Hr'g Ex. SX-122. It is impossible to interpret an agreement submitted in the *Web III* proceeding to set rates and terms for all broadcasters, including those that are not NAB members, "as anything other than precedential." Hr'g Tr. 7578:24-7579:20 (June 3, 2015) (Huppe); Hr'g Ex. SX-26 ¶ 10 (Huppe WRT) ("Mr. Newberry's assertion that he did not understand the precedential value of the agreement is preposterous."). Indeed, in order to submit the agreement for the Judges' consideration in *Web III*, the parties had to override the statute's bar on the submission of WSA agreements by "expressly authoriz[ing]" its submission. 17 U.S.C. § 114f(5)(C); Hr'g Tr. 7578:24-7579:20 (June 3, 2015) (Huppe).

1065. In SoundExchange's view, therefore, the precedential provision was entirely non-controversial at the time. Hr'g Tr. 7637:21-7638:23 (June 3, 2015) (Huppe) (explaining that he did not finely "parse" the implications of the provision with NAB because "they never objected to it being precedential" and "didn't make a big deal out of it").

1066. Prof. Katz argued that the parties' ability to agree to designate WSA settlements as precedential has resulted in a "selection bias in the agreements that can be used as precedent" because "SoundExchange has incentives to designate low rates as non-precedential, while designating high rates as precedential." Hr'g Ex. NAB 4000 ¶¶ 75-76 (Katz WDT). But this complaint is one for Congress. Congress, not SoundExchange, created a system in which all

settlements under the WSA would automatically be kept out of these proceedings unless the parties expressly agreed otherwise. 17 U.S.C. § 114f(5)(C).

1067. Congress set up this system because it recognized that the settlements reached under the WSA might be influenced by non-market factors and that parties would be deterred from entering such settlements motivated by "unique business, economic, and political circumstances" if they could be used as evidence of marketplace rates. 17 U.S.C. § 114f(5)(C); 154 Cong. Rec. H10279 (Sept. 27, 2008) (statement of Rep. Howard Berman) ("[T]hese conversations that have taken place under the committee's auspices are occurring in unique and extraordinary political and business circumstances that are unlike typical marketplace negotiations. This bill provides that any alternative private deal-making or any private deal regarding an alternative rate would not be precedential, unless, of course, the parties agreed that it should be. Some of the rates that are being discussed represent a large discount from what independent decisionmaking bodies have found to be marketplace rates . . . . I would expect marketplace rates to be higher and at least a reflection of what the judges decided absent the distinct circumstances that apply here."). While Congress included this anti-precedential provision in the statute to facilitate settlements—including experimental, non-market settlements—it also empowered the parties to change this default designation if both agreed that the settlement should be precedential. *Id.*

1068. In the case of the agreement with NAB, the default statutory bar on the submission of WSA settlements was unnecessary because the NAB settlement did not involve any "unique business, economic [or] political circumstances" that would distinguish it from what "would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114f(5)(C); Hr'g Tr. 7647:4-8 (June 3, 2015) (Huppe).

4. The Pureplay Settlement Was Motivated by Unique Political Circumstances

1069. By contrast, the statutory prohibition on the submission of WSA settlements was necessary and appropriate in the case of the Pureplay settlement, which was infected by unique political considerations. Hr'g Tr. 7645: 8-11 (June 6, 2015) (Huppe). As Mr. Huppe testified, at the time of the Pureplay negotiations, Pandora was "mobilizing [its] user base," "flooding legislators' offices with tons and tons of e-mail and requests," and "creating significant pressure on Capitol Hill . . . that flowed towards [SoundExchange]." Hr'g Tr. 7645:8-7647:8 (June 3, 2015) (Huppe). At the same time that SoundExchange was feeling this political pressure from Capitol Hill to reach a "solution" with Pandora, SoundExchange was engaged in a political campaign to create a performance right on terrestrial radio, an issue on which Pandora and SoundExchange were aligned. *Id.* SoundExchange thought it might be able to "take that political power being used against [it at the time] and convert it to a new ally so [Pandora] could fight with [SoundExchange] on an issue that [they] both agree on." *Id.*

1070. In sum, "there were some very intense and definite political considerations involved in [SoundExchange's] discussions with Pandora," and "[i]t was a completely different situation with the NAB and Sirius XM negotiations." *Id.* There is no evidence in the record to suggest that the express designation of only certain WSA agreements as precedential—those not motivated by unique political considerations—is anything other than what Congress intended.

B. Sirius XM's Claim That The Rates It Agreed To In The WSA Settlement Were "Above Market Rates" Is Unfounded

1071. Sirius XM's lead negotiator, David Frear, offered similar reasons as to why he now believes that Sirius XM's 2009 WSA agreement contained "above market" rates that were not the product of a willing buyer/willing seller negotiation: (i) Sirius XM was experiencing extreme financial distress at the time; (ii) Sirius XM's webcasting service was too ancillary to its

overall business to justify the litigation expense; and (iii) the regulatory backdrop biased the rates upwards because SoundExchange had incentives to negotiate a favorable precedent. Hr'g Ex. SXM 6000 ¶ 37 (Frear WDT).

1072. SoundExchange's negotiation with Sirius XM occurred in the summer of 2009, after the NAB agreement was finalized. Hr'g Tr. 7579:21-7580:6 (June 3, 2015) (Huppe). Although a few additional months had passed since the NAB agreement was negotiated, the parties to the Sirius XM agreement were not in a "different posture vis-à-vis the *Web III* proceeding," which was still in the very early stages. Hr'g Tr. 7580:2-12 (June 3, 2015) (Huppe). Accordingly, the same uncertainty about *Web III* that existed during SoundExchange's negotiation with NAB existed during SoundExchange's negotiation with Sirius XM. Hr'g Tr. 7581:16-21 (June 3, 2015) (Huppe). Neither party knew what the statutory rates for 2011-2015 would be. Hr'g Ex. SX-26 ¶ 7 (Huppe WRT).

1073. At the time of the negotiations SoundExchange "had a different view of SiriusXM's financial . . . situation" than the bleak picture Mr. Frear painted in his testimony. Hr'g Tr. 7582:6-13 (June 3, 2015) (Huppe). From SoundExchange's perspective, by the time of the negotiations, Sirius XM was "beginning to reap the benefits" of its recent merger. *Id.* Indeed, Mr. Frear's own public statements in 2009 corroborate SoundExchange's perception that Sirius XM was doing well financially at the time. Hr'g Ex. SX-26 ¶ 23 (Huppe WRT) ("At the time of our agreement, Mr. Frear reported to investors that Sirius XM had positive adjusted EBITDA for three straight quarters, its revenues were up $7 million, its contribution margin was up by $20 million, and so forth."). "Also, in the same month that the agreement was announced, Sirius XM began imposing a 'Music Royalty Fee' to pass-through royalty costs to their customers, which should have lowered Sirius XM's costs and increased their margins." *Id.* In

short, at the time of the negotiations, SoundExchange did not suspect that webcasting royalties would put Sirius XM in dire financial straits. Hr'g Ex. SX-26 ¶ 23 (Huppe WRT); Hr'g Tr. 7582:6-13 (June 3, 2015).

1074. In any event, basic economics suggests that any financial distress Sirius XM was experiencing at the time would have reduced, not increased, its willingness to pay for webcasting. Hr'g Ex. SX-29 ¶ 228 (Rubinfeld Corr. WRT). One would therefore expect a negotiation with a financially distressed Sirius XM to result in a *lower* royalty rate than the rate that would be negotiated with a healthy Sirius XM. *Id.*

1075. Mr. Frear also suggested that SoundExchange did not have the same pressure to avoid litigation expenses as Sirius XM. Hr'g Ex. SXM 6000 ¶¶ 46-47 (Frear WDT). But, to put the companies' resources in proper proportion, at the time of the negotiations Sirius XM had recently spent $150 million on a single regulatory proceeding, the same amount that artists and labels received from SoundExchange in total royalties in 2009. Hr'g Ex. SX-26 ¶ 24 (Huppe WRT). Moreover, SoundExchange's litigation budget is funded on the backs of the thousands of copyright owners and artists it represents, as compared to the *millions* of subscribers that contribute to Sirius XM's litigation budget. Hr'g Ex. SX-26 ¶ 25 (Huppe WRT).

1076. Sirius XM was under no obligation to litigate the case in any event; it had the "costless short-term option" of simply allowing the *Web III* proceedings to play out and taking advantage of the rates set by the Judges, as many other licensees do. Hr'g Ex. SX-26 ¶ 26 (Huppe WRT). Sirius XM instead made the affirmative choice to engage in the negotiation to obtain a discount off the statutory rates in 2009 and 2010. Hr'g Tr. 5436:6-5437:5 (May 22, 2015) (Frear) (testifying that the settlement with SoundExchange "was worth doing" to get rate relief in 2009 and 2010).

1077. All of the other options to negotiating with SoundExchange that were available to NAB were likewise available to Sirius XM: in addition to sitting out *Web III* and accepting the rates set in that proceeding, it could have litigated, chosen not to stream, or pursued direct licenses. Hr'g Ex. SX-26 ¶¶ 26-27 (Huppe WRT); Hr'g Tr. 7581:22-7582:5 (June 3, 2015) (Huppe); Hr'g Tr. 5478:23-5479:22 (May 22, 2015) (Frear). But "Sirius XM did not choose any of these paths; it voluntarily agreed to rates [with SoundExchange] that it has willingly paid ever since." Hr'g Ex. SX-26 ¶ 27 (Huppe WRT).

1078. In fact, rather than shut down the webcasting service that is ancillary to the company's satellite service and for which Mr. Frear had "total indifference" in 2009 (Hr'g Tr. 5431:6-10 (May 22, 2015)), in the past five years Sirius XM has added features to its webcasting service and [ ], all while paying the rates it negotiated in its WSA agreement with SoundExchange. Hr'g Tr. 5451:7-5452:2 (May 22, 2015) (Frear); Hr'g Ex. SX-1752 .

1079. Like NAB, Sirius XM was a party with countervailing bargaining power given its millions of subscribers (including hundreds of thousands of standalone subscribers to its internet service in 2009) and the hundreds of millions it pays in statutory royalties. Hr'g Ex. 29 ¶ 224 (Rubinfeld Corr. WRT); Hr'g Ex. SX-26 ¶ 25 (Huppe WRT); Hr'g Tr. 741:3-742:3 (Apr. 29, 2015) (Huppe); Hr'g Ex. SXM 6000 ¶¶ 7, 49 (Frear WDT). As shown below, Sirius XM used its leverage to negotiate discounts off the only statutory rates that had been set at the time (2009 and 2010), as well as lower rates for 2013-2015 than the rates contained in the NAB settlement:

Year	CRB Rates	NAB WSA	Sirius XM WSA
2009	.0018	.0015	.0016
2010	.0019	.0016	.0017
2011	[.0019]	.0017	.0018
2012	[.0021]	.0020	.0020
2013	[.0021]	.0022	.0021
2014	[.0023]	.0023	.0022
2015	[.0023]	.0025	.0024

Hr'g Ex. SX-121 at 8; Hr'g Ex. SX-124 at 2; *Webcasting II* at 24100; *Webcasting III Remand* at 23120; Hr'g Tr. 7581:1-20 (June 3, 2015) (Huppe).

1080. Finally, Mr. Frear's suggestion that the agreement's precedential value gave SoundExchange extra incentives to negotiate a high rate is belied by the fact that *both* parties had to expressly agree to designate the settlement as precedential. Hr'g Ex. SX-26 ¶ 29 (Huppe WRT); 17 U.S.C. § 114f(5)(C). Otherwise, by default, any settlement reached pursuant to the WSA would have been barred from these proceedings. *Id.* Sirius XM "expressly authorized" the settlement's submission in proceedings under 17 U.S.C. § 114(f). Hr'g Ex. SX-124 at 3, § 5.3. As Mr. Huppe testified, "Mr. Frear is now simply trying to back away from what he agreed to in 2009." Hr'g Ex. SX-26 ¶ 29 (Huppe WRT).

1081. In addition to attacking Sirius XM's WSA settlement, Mr. Frear set forth Sirius XM's rate proposal in this proceeding: a rate of $0.0016 for each year during the 2016-2020 period. Hr'g Ex. SXM 6000 ¶ 52 (Frear WDT). Sirius XM's rate proposal has no sound basis. The proposal was simply plucked from the first year of the Sirius XM WSA settlement. *Id.* ¶ 61. This selective reliance on the low-end rate in an agreement that Mr. Frear now expressly disavows is both arbitrary and internally inconsistent. Moreover, Sirius XM has offered no evidence whatsoever to support Mr. Frear's bald assertion that "the annual rate increases

included in the SXM WSA Settlement Agreement" are not "tied to the fair market value of the statutory license." *Id* At the hearing, Mr. Frear could offer little more than the following as rationale for Sirius XM's proposed rate: "You know, [] it just strikes me that based on economics in the marketplace and everything else, [] it's a good place to put a rate." Hr'g Tr. 5447:10-12 (May 22, 2015) (Frear). Such vague, speculative analysis is no foundation for a rate proposal.

XIII. THE RECORD SHOWS THAT CONSUMER USE OF STATUTORY SERVICES INTERFERES WITH HIGHER-ARPU COPYRIGHT OWNER REVENUE FROM DIRECTLY LICENSED SERVICES; THE RECORD FAILED TO SUPPORT THE SERVICES' CONTENTION THAT CONSUMER USE OF STATUTORY SERVICES IS "NET PROMOTIONAL" (AS COMPARED TO USE OF DIRECTLY LICENSED SERVICES) OF COPYRIGHT OWNER REVENUE

A. The Statutory Standard Is Clear: In Applying the Willing Buyer-Willing Seller Standard, The Judges Must Base Their Decision On Evidence Going To Whether Consumer Use Of Statutory Services Would Promote Or Interfere With Other Sources Of Copyright Owner Revenue

1082. Section 114 provides that, in establishing rates and terms "that would have been negotiated in the marketplace between a willing buyer and a willing seller," the Judges are to "base their decision on economic, competitive and programming information presented by the parties, including— whether use of the [statutory] service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings." 17 U.S.C. § 114(f)(2)(B)(i). The inquiry is fundamentally two questions: (1) does consumer use of webcasting services enhance or substitute overall for other copyright owner revenue streams flowing from the exploitation of sound recordings? (2) If there are such effects, how would willing buyers and willing sellers factor those effects into rates and terms to which they would agree in a world unencumbered by the statutory license, i.e., would the effects raise or lower the hypothetical rate to which the parties otherwise would agree? *Webcasting III Remand*, 79 Fed.

Reg. 23102, 23119 n.50 (Apr. 25, 2014) (explaining that "negotiated prices" factor these effects into the rate) (citing *Web II Final Order*, 72 Fed. Reg. 24084, 24095 (May 1, 2007); *Web I Final Order*, 67 Fed. Reg. 45240, 45244 (July 8, 2002)).

1083. The Judges have made clear that this factor directly addresses conditions in the consumer-facing market. The Judges must analyze "[t]he promotional or substitutional *effects of the use of webcasting services by the public* on the sales of phonorecords or other effects of the use of webcasting that may interfere with or enhance the sound recording copyright owner's other streams of revenue from its sound recordings." *Webcasting III (Remand)*, 79 Fed. Reg. at 23110 n. 25 (emphasis added). The relevant question here is whether, all else equal, consumer use of statutory webcasting services leads to more or less revenue flowing to copyright owners through the other revenue channels they use to exploit their copyrighted sound recordings. These revenue channels include, among other things, sales of CDs or permanent downloads, as well as royalties from directly licensed streaming services.

1084. Given the fundamental shift from ownership to access models that is currently underway—and that will continue and accelerate during the 2016-2020 rate term—it is especially critical that the Judges in this proceeding give careful consideration to the effect that consumer use of statutory webcasting services has on consumer willingness to other access-based services, particularly those that are directly licensed. The share of copyright owner revenues coming from access-based services is increasing dramatically compared to sales-based revenue; that share undoubtedly will continue to increase over the coming rate term. Accordingly, substitution for (or interference with) copyright owner revenues from the higher-ARPU offerings of those directly licensed partners is a significant concern. *See* Sections V.A and V.B, *supra*. As explained above, it is clear as a matter of economic logic and the evidence

submitted in this proceeding that in a market unencumbered by a statutory license, copyright owners would not agree to license services like Pandora, iHeart and others to exercise the full extent of the functionality they now utilize to the detriment of opportunities to convert consumers from free-to-listen tiers to higher-ARPU subscription tiers of services that offer the same or highly convergent functionality. *See* Section V.B, *supra*. The analysis of these issues above is directly relevant to the promotion/substitution issues discussed in this Section.

1085. Before turning to an analysis of the parties' evidence, it is important to establish several additional points that relate to the entire discussion.

1086. First, the statute by its express terms directs the Judges to consider the extent to which consumer use of statutory services substitutes for or promotes "the sound recording copyright owners' *other* streams of revenue from its sound recordings." 17 U.S.C. § 114(f)(2)(B)(i) (emphasis added). Under the plain language of the statute, therefore, the revenues that copyright owners receive from statutory webcasters for the exercise of rights under the statutory license is irrelevant to the § 114(f)(2)(B)(i) inquiry. This limitation is important because the Services in this proceeding have argued that the royalties they pay to copyright owners through SoundExchange are net accretive as compared to the absence of revenues that copyright owners realize when their sound recordings are performed on terrestrial radio. Those royalties paid through SoundExchange do not count for purposes of the § 114(f)(2)(B)(i) inquiry because they are not "other streams of revenue."

1087. Second, it is important to be clear on several definitional points:

Expansionary Promotion: An activity has the effect of expansionary promotion if on balance it grows the market for the product—i.e., it expands the overall pie—and leads to more total sales or revenues from the activity flowing to the industry. Hr'g Ex. SX-24 ¶ 7 (Blackburn WRT).

Substitution: Substitution is the polar opposite to expansionary promotion: it means that "consumers are purchasing or spending less on recorded music (sound recordings) as a result of using webcasting services than they otherwise would." Hr'g Ex. SX-24 ¶ 7 (Blackburn WRT).

Diversionary Promotion/Substitution: Diversionary promotion/substitution means that the activity may encourage purchases of one sound recording over another, but at the expense of purchases of another sound recording. In contrast to expansionary promotion—which expands the total pie—diversion simply changes the size of the slice that one seller has in relation to other sellers. Hr'g Ex. SX-24 ¶ 8 (Blackburn WRT). Mr. Pittman pithily described this type of activity as [ ]. Hr'g Tr. 4835:16-23 (May 20, 2015) (Pittman).

Net Promotion/Substitution Effect: For a type of service to be "net" promotional, consumer use of the service must on balance expand revenue as compared to all other revenue streams and not just one. Hr'g Ex. SX-24 ¶ 9 (Blackburn WRT) ("Indeed, it is possible that statutory, non-interactive webcasting is neither promotional nor substitutional—it may be neutral to the industry (perhaps being substitutional to some channels and expansionary promotional to others.)"). Net promotion/substitution is sometimes also used to refer to whether the use of an entire type of service enhances or interferes with other revenue streams as compared to consumer use of a different service type.

Music Discovery: Consumers can "discover" and become aware of new music across a multitude of platforms and media, including terrestrial radio, television, and, both statutory and directly licensed services. Hr'g Ex. SX-4 ¶ 10 (Burruss WRT). Discovery is not the equivalent of promotional to revenues because discovery in of itself is not revenue generating.

1088. Third, the single most relevant consideration for the section 114(f)(2)(B)(i) analysis is whether consumer use of statutory webcasting services has an expansionary or substitutional effect—i.e., does it expand or shrink the pie overall. Prof. Katz theorized that diversionary promotion could be relevant because section 114(f)(2)(B)(i) uses the singular terms "sound recording copyright owner's" and "its sound recordings." Hr'g Tr. 5665:9-5668:4 (May 26, 2015) (Katz). That reading, however, is contrary to the Judges' prior construction of the terms of section 114(f)(2)(B). The Judges construe this factor to refer to the *market* effects, not the effects on a particular copyright owner. *See, e.g. Web II Final Order*, 72 Fed. Reg. at 24095 (discussing promotional/substitutional effects in the "benchmark market" and the "hypothetical target market"). The same section also refers to a "willing buyer" and "willing seller"—both singular—but the Judges (and previously the CARP) have recognized that these terms represent the larger group of willing buyers and willing sellers. *Web III Remand*, 79 Fed. Reg. at 23113

(citing *Web II Final Order*, 72 Fed. Reg. at 24087 and *Web I Final Order*, 67 Fed. Reg. at 45244).

1089. Prof. Katz's view that diversionary substitution/promotion should count also is wrong from an economic perspective. The statutory question necessarily focuses on promotion *to the industry* because it seeks to adjust (upward or downward) the industry-wide rate. As Dr. Blackburn explained:

> "All else equal if the use of the service increases revenue from other sources the market rate would be lower because the use creates secondary revenue."
>
> "All else equal if the use of the service decreases revenue from other sources the market rate would be higher to compensate for that substitution."

Hr'g Ex. SX-24 ¶ 7 (Blackburn WRT).

1090. Prof. Katz attempts to link the concept of diversionary promotion to the concept of steering. In his view, if a service were to steer toward a record label by increasing the label's share of performances on the service, the record label would benefit from the promotional effect of this additional market share on its other revenue streams (e.g., CD sales). Even accepting, for the sake of argument, Prof. Katz's assumption that non-interactive performances could promote purchases or other sources of revenue, his interpretation of section 114(f)(2)(B)(i) falls short. In order to give record label A additional market share, the webcaster must take that market share from *another* record label—record label B. *See* Hr'g Tr. 5759:4-8 (May 26, 2015) (Katz) ("Q. In diversionary promotion, that means that a sale made by one record company would be taken away from another record company, correct? A. That's my understanding of how he's using the definition, yes."). If Prof. Katz is right about the promotional effect of non-interactive performances, then the reduction in market share for record label B would "interfere with . . . the sound recording copyright owner's other streams of revenue," § 114(f)(2)(B)(i), and the Judges

would have to account for it. In other words, steering would produce no net benefits for the purposes of the section 114(f)(2)(B)(i) inquiry across any range of agreements.

1091. Fourth, the other economists in the proceeding agree that, for purposes of section 114(f)(2)(B)(i), what is relevant is the difference between buyers, and how any such difference (if one could be shown to exist) would relate to the interactivity adjustment to be applied (or not) to the benchmark rates under direct licenses between copyright owners and services. In Prof. Shapiro's words: "It's the difference between the two buyers – let's say, if you concluded that Pandora had exactly the same net promotional role as Spotify, then you don't need to make an adjustment here. It's all about the difference between the buyers because we're adjusting [Dr. Rubinfeld's] proposed benchmark." Hr'g Tr. 2714:17-23 (May 8, 2015) (Shapiro). An adjustment is appropriate only if the evidence proves that the benchmark in question has a larger net promotion or net substitution effect than the webcasting industry generally. *See, e.g.*, Hr'g Ex. IHM 3054 at 20 ¶ 37 (Fischel/Lichtman WRT).

1092. The analysis of the evidence in this Section proceeds as follows:

1093. Section B discusses the possibility that promotional and/or substitutional effects already are taken into account in the benchmark agreements. In prior proceedings, the Judges have concluded that the statutory consideration under § 114(f)(2)(B)(i) (and § 114(f)(2)(B)(ii), which deals with relative contribution, as well) already have been factored into the negotiated prices in benchmark agreements. The experts in the case appear to agree in general that this remains true in this proceeding, although the Services' experts focused on a far narrower set of benchmark agreements than Prof. Rubinfeld did. The evidence does not allow the Judges to find that the Services' proposed central benchmark agreements—namely, the Pandora-Merlin and

iHeart-Warner agreements—factor in adjustments for promotion and substitution that may be extrapolated to the industry overall.

1094. Section C discusses the evidence as to whether statutory webcasting services substitute for copyright owners' other revenue streams, most notably, revenues from directly licensed services. The evidence clearly shows that statutory webcasting does interfere with those other revenue sources. As already noted, this proposition is unsurprising given the increasing convergence between statutory and directly licensed services: all else equal, if two services provide the same large group of consumers the same type of functionality, consumers will prefer the free service and avoid the paid service. Free statutory services with robust consumer offerings substitute for the "freemium" offerings of higher-ARPU services. And, the evidence in Section C shows that this is being borne out in the streaming market today. The evidence further shows that statutory webcasting is not leading to expansionary promotion of revenues overall from all other revenue streams.

1095. Section D shows that iHeart's attempt to show that non-interactive webcasting is net promotional as compared to interactive webcasting failed. The data that Dr. Kendall used was highly biased in favor of finding a net promotional effect; when that bias is corrected, the differential that Dr. Kendall purports to find evaporates. Moreover, there were numerous other methodological flaws with Dr. Kendall's analysis. The evidence further showed that, when Dr. Blackburn analyzed the same data set that Prof. Danaher (iHeart's withdrawn expert) had produced—data that came from the same consumer-monitoring service that Dr. Kendall used—there was no difference in promotional impact.

1096. Section E shows that none of the remaining evidence that the Services point to prove they are promotional can overcome clear market trends that indeed webcasting services are

net substitutional for other sources of revenue earned from copyrighted sound recordings. If anything, the documents produced are inconclusive, as the experts acknowledge.

B. The Broad Range Of Benchmark Agreements Considered By Prof. Rubinfeld Likely Factor In Promotional And Substitutional Considerations; The Evidence, However, Does Not Allow the Judges To Reach A Similar Conclusion Regarding The Services' Central Benchmarks

1097. In prior proceedings, the Judges have agreed that by adopting "an adjusted benchmark approach to determine the rates . . . such statutory considerations implicitly have been factored into the negotiated prices utilized in the benchmark agreements." *Webcasting III* Remand, 79 Fed. Reg. at 23119 n.50; *see also Web II Final Order*, 72 Fed Reg. at 24095; *Web I Final Order*, 67 Fed. Reg. at 45244.

1098. Likewise, here, the net promotion/substitution effect is reflected in the rates negotiated by buyers and sellers in the interactive service agreements. Hr'g Ex. SX-29 at ¶ 235 (Rubinfeld Corr. WRT). Accordingly, to the extent that no clear and quantifiable difference in the net promotion/substitution effect exists across services, no adjustment should be made. *See* Hr'g Ex. SX-29 ¶¶ 237-238 (Rubinfeld Corr. WRT). Even so, as Prof. Rubinfeld makes clear—the interactivity adjustment would account for a promotion/substitution difference to the extent it was reflected in the difference in consumer prices. Hr'g Ex. SX-29 ¶ 239 (Rubinfeld Corr. WRT).

1099. Pandora's and iHeart's economic experts expressed the view that the agreements they relied on centrally as benchmarks—Pandora-Merlin and iHeart-Warner—each incorporated the respective parties' understandings of whether that service has a net promotional or substitutional effect. *See, e.g.*, Hr'g Ex. IHM 3034 at 14 ¶ 27 (Fischel/Lictman AWDT); Hr'g Tr. 5317:23-5318:2 (May 21, 2015) (Fischel); Hr'g Tr. 2713:14-23 (May 8, 2015) (Shapiro). The evidence, however, does not support extending to the Pandora-Merlin or iHeart-Warner

agreement the Judges' traditional presumptions about directly negotiated agreements factoring in the parties' assessments of promotion and substitution. These singular agreements do not necessarily represent the market's (as compared to one party's) view of the promotional/substitutional impact of these services.

1100. The Pandora-Merlin agreement was the first agreement between any rights owners and Pandora, and thus, is not representative of how other rights owners (or the industry on the whole) view the promotional/substitutional effect of Pandora. Likewise, the economic theory assumes perfect information and that parties to an agreement know, going into the agreement, what the promotional or substitutional effects will be.

1101. The parties' estimations (if they made them at all) as to the promotional or substitutional effects of Pandora may not be well-informed and may indeed evolve after they have seen how the agreement performed. With particular reference to the Pandora-Merlin agreement, [ ]. Hr'g Tr. 6910:3-21 (June 1, 2015) (Lexton). [ ].

1102. Likewise, one would expect that different recorded music companies would have different estimations of the net promotional or substitutional effect for each service. For example, if Warner had a view of the promotional or substitutional value of iHeart that was not shared by Universal or Sony, its agreement would not be representative of the promotional or substitutional effects as understood by the other major record labels.

1103. Similarly, that the iHeart-Warner agreement included an economic incentive to perform more Warner sound recordings, does not imply that Warner viewed the agreement as "promotional." Instead, it was interested in those provisions because they guaranteed a higher total return to Warner. As Mr. Wilcox testified in response to questioning regarding how Warner valued the purported promotional advantages of the economic incentive to perform Warner content more on iHeartRadio:

Hr'g Tr. 2372:11-25 (May 7, 2015) (Wilcox).

1104. Simply put, the internalized promotional or substitutional effects of a singular benchmark proposal, as opposed to a thick market of agreements, cannot necessarily be extrapolated to the entire market. However, if a significant number of services and record labels all incorporating the promotion/substitution considerations into agreements over several years, one could have confidence that the promotion/substitution effects are fairly measured across the range of agreements. That is not the case with the Pandora-Merlin or iHeart-Warner agreements.

C. The Evidence Showed That Statutory Webcasting Services Substitute For Other Copyright Revenue Streams

1. Webcasting Services Admit that They Substitute for Other Streams of Record Company Revenue

1105. As detailed in Section V.C, *supra*, statutory and non-statutory services are becoming closer and closer in their market offerings as they compete for the same consumers. This competition creates natural substitutes, even and especially among users who consume both non-interactive and on-demand streaming.[51] It is evident from numerous internal company documents that Pandora and iHeartRadio are seeking to compete for the same consumers and the same listening time as directly licensed services, such as Spotify. *See e.g.*, Hr'g Ex. SX-211 at 6 ([ ]); Hr'g Ex. SX-1189 ([ ]). *See also* Hr'g Ex. SX-1190 ([ ]).

[51] As Ms. Butler found in her survey:

> So we find that those -- of those people who are respondents who use on-demand services already, they're more likely to indicate that they would shift to an alternative on-demand service if they couldn't listen to Pandora or iHeart. In fact, that's across all of the respondents, so it's not even just for that on-demand listening. People generally shift to a service that they use already.

Hr'g Tr. 6840:23-6841:7 (May 29, 2015) (Butler). Contrary to the Services' argument that use of, for example Pandora and Spotify, makes these services complements for any particular consumer, they are actually the most likely substitutes for one another..

1106. Likewise, Pandora internally tracks its competitors through [redacted]. In one such document Pandora identified [redacted] Hr'g Ex. 266 at 12; Hr'g Tr. 3483:23-3484:10 (May 13, 2015) (Herring). It went on to [redacted]. Hr'g Ex. 266 at 15-21; *see also* Hr'g Exs. SX-1652; SX-2244. And in its [redacted]. Hr'g Ex. SX-263 at 23.

1107. Mr. Pittman's written direct testimony describes iHeart's strategy to "make the local radio programming they love available in more places and on more devices--at home, in their cars, and now on their computers, smartphones, and tablets." Hr'g Ex. IHM 3222 ¶ 9 (Pittman WDT). Testifying at the hearing, Mr. Pittman confirmed that he understood that same strategy to be shared by Pandora, Spotify, and Apple as well. Hr'g Tr. 4877:19-4878:1 (May 20, 2015) (Pittman). That is, such services are actively trying to appeal to users around the clock, including the time they might otherwise spend listening to on-demand services. Pandora and iHeartRadio's ad-supported model interferes with copyright owners' other streams of revenue—including but not limited to revenue from directly licensed services—because the growth of such services is predicated on having as many consumers as possible and as much music consumption time as possible.

1108. Pandora's marketing strategy includes [redacted]

RESTRICTED GRAPHIC

Hr'g Ex. SX-170 at 19.

1109. The Services' own documents and testimony show that they recognize they are substitutional and not promotional for other streams of copyright owner revenue. Mr. Pittman has repeatedly stated in internal emails and public documents that he views Pandora as a "music collection" service and [ ]. On October 12, 2013, Mr. Pittman said about Pandora and Spotify: [ ] Hr'g Ex. SX-1028 at 1.

RESTRICTED EMAIL

Hr'g Ex. SX-373.

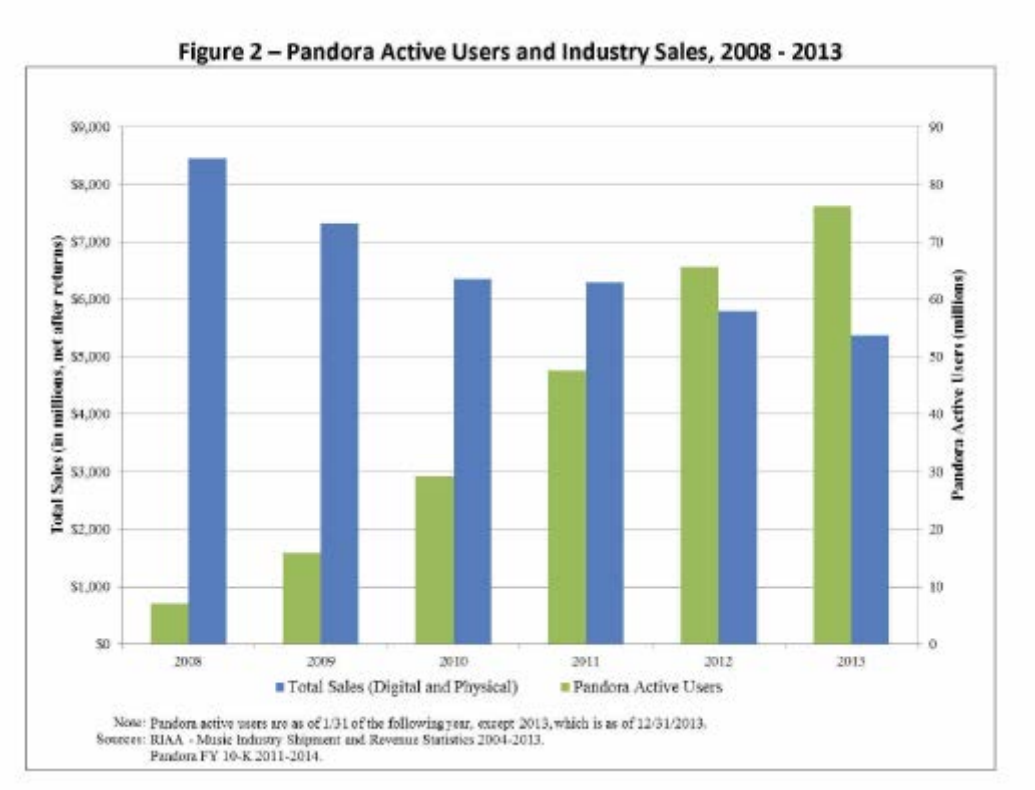
1110. Mr. Pittman's attempt at the hearing to discount the significance of these statements was not persuasive. He testified: [ ]. Hr'g Tr. 4858:16-18 (May 20, 2015) (Pittman). Notably, iHeart did not bring forward any internal emails or documents showing Mr. Pittman expressing this newly changed opinion. *Compare* Hr'g Ex. IHM 3222 ¶ 13 (Pittman WDT) (distinguishing "Broadcast radio and streaming stations" from "Interactive services like Spotify have replaced CDs and downloads as the modern equivalent of a music collection, a

personally curated library that listeners turn to in order to escape the outside world.") *with* Hr'g Ex. SX-1683 at 4 ([ ]).

1111. Pandora's documents likewise establish that it is seeking to compete with and draw listeners away from interactive services, as well as work to keep users on its platform. Hr'g Ex. SX-29 ¶ 106 (Rubinfeld Corr. WRT); Hr'g Ex. SX-269 at 20-21; Hr'g Tr. 3490-10-3491:4 (May 13, 2015) (Herring).

2. Market Evidence Shows that Statutory Webcasting Services Are Net Substitutional Rather than Net Promotional

1112. The evidence is clear that, as statutory webcasting services have gained in popularity, music industry revenues have continued to decline. Were Pandora net promotional, one would expect that Pandora's growth to 80 million active users who listen on average over 20 hours a month to have resulted in industry growth. The opposite has happened. Since 2008 as Pandora has grown, sales to the recorded music industry have dropped by approximately $3 billion.



Hr'g Ex. SX-24 at 15 Figure 2 (Blackburn WRT). The same trend holds with growth generally in SoundExchange distributions and overall industry revenues falling. Hr'g Ex. SX-24 at 17 Figure 5 (Blackburn WRT). For example, from 2011 to 2013, SoundExchange revenues doubled whereas industry total revenues fell by 15 percent. Hr'g Ex. SX-24 at 17-18 (Blackburn WRT).

1113. The Services assert that industry revenues have been in decline since 1999 because of piracy and the fact of "adjusting to [the] Internet." Hr'g Tr. 2613:14-25 (May 8, 2015) (Shapiro). According to Prof. Shapiro, there has been a stabilization since 2010 and webcasting revenues are now net contributing to record company revenues. Hr'g Tr. 2614:1-12 (May 8, 2015) (Shapiro). Contrary to this narrative, it is generally recognized that the advent of legitimate download sales through the Apple iTunes Store—not statutory webcasting—was the marketplace development that helped to combat (though by no means eliminate) piracy. Hr'g Ex. SX-24 ¶ 57 (Blackburn WRT). Prof. Shapiro does not and cannot assert that statutory

webcasting has led to expansionary promotion. On the contrary, industry revenues have continued their overall decline. *See* Section V.A, *supra*.

1114. Prof. Shapiro also did not account for the recent decline in digital download sales. As discussed in Section V.A, *supra*, the download market has started to decline and is expected to be in decline for the foreseeable future. January is typically the biggest month for download sales (iTunes gift cards are a common holiday present). However, starting in January 2014, [ ]. Hr'g Ex. SX-10 ¶ 11 (Harrison Corr. WDT). Notably, this happened despite iTunes Radio's launch and anticipated boost to the download market. Hr'g Ex. SX-3 at 62 (Blackburn WDT) (citing a Billboard article that reports "Buying music on iTunes Radio clashes with the nature of radio. Users simply don't want to lean forward to buy music when they're enjoying iTunes Radio's lean-back listening experience."). As reported by *Billboard*, for the year 2014, with just one exception ("Happy" by Pharrell Williams), every song in Billboard's "Top 200" list of download sales in 2014 through week 32 had sold fewer downloads than songs in the corresponding place on the same chart in 2013. Hr'g Ex. SX-12 at 20 (Kooker WDT). As a result, digital sales to the industry overall have fallen in 2014 and that trend is expected to continue. Hr'g Ex. SX-12 at 21 (Kooker WDT).

1115. Dr. Blackburn analyzed a natural experiment caused by the iHeart-Warner agreement in order to assess whether an increase in performances would lead to an increase in sales. Hr'g Ex. SX-24 at 18 (Blackburn WRT). This admittedly is a different issue than whether statutory webcasting writ large is net promotional or substitutional; and Dr. Blackburn's analysis concerns only *diversionary* rather than expansionary promotion. Nevertheless, Dr. Blackburn's findings do shed light on the strength of the Services' argument that increased performances on statutory webcasting services promote sales of sound recordings.

1116. Dr. Blackburn looked at the first six months of the iHeart-Warner agreement, during which time iHeart [ ]. Hr'g Ex. SX-24 at 19 (Blackburn WRT).

1117. Dr. Blackburn also looked at specific Warner catalogue tracks that received increased performances. This analysis therefore was not affected by circumstances such as an overall light release schedule that may have effected Warner's overall market share during the period studied. He chose specific tracks that had also been analyzed in Dr. McBride's Music Sales Experiments (discussed in further detail below). Dr. Blackburn looked at the three months prior to the iHeart-Warner agreement (July to September 2013) and the six months after (October 2013 to March 2014). Dr. Blackburn found that while [ ].

Hr'g Ex. SX-24 at 21 Table 1 (Blackburn WRT).

1118. Dr. Blackburn's analysis yields two important conclusions. First, it demonstrates that increased performances on iHeart do not have an expansionary (or diversionary) effect on Warner's sales of catalogue tracks.

1119. Second, it provides a useful data point (one of many) to compare to Dr. McBride's study. It provides further evidence that, as discussed below, even if Dr. McBride's results had force with respect to Pandora (which they do not, for reasons discussed), the results could not be extrapolated to all statutory webcasters.

3. The Experience of Copyright Owners Is That Statutory Webcasting Is Net Substitutional

1120. The shift from ownership to access models means that "Streaming is not promoting sales of product. It is the product." Hr'g Ex. SX-12 at 19 (Kooker WDT). This is in part due to the fact that consumers are quite simply purchasing less. Whether it be directly or indirectly attributable to webcasting services and other music streaming services, this is an undeniable transition of the market. *See* Section V.A, *supra*. Accordingly, record companies of all types—charged with maximizing overall revenue—testified that they simply do not view "promotion" as meaning what it once did to the industry and webcasting services are certainly not viewed as promotional. Rather, the question they ask themselves with each new service that they license is what impact—what substitutional impact—it will have on their other revenue streams, whether that be purchases or revenues from other directly licensed streaming services. As Mr. Harrison explained:

> You know, we -- in terms of substitutional effects, we have to consider the marketplace as a whole. So we never negotiate deals in a vacuum. We always consider, you know, where this particular service would fit in the overall digital ecosystem and, you know, we hope that services are as additive as possible, but we're realistic

> in knowing that there is a potential cannibalization aspect to each new service that we license, so we have to figure out, you know, how each service can differentiate from other services and hopefully grow the market overall.

Hr'g Tr. 975:2-14 (April 30, 2015) (Harrison).

1121. The evidence shows that competition between statutory and directly licensed services has direct ramifications for the licensing market. "Direct licensees find themselves competing for listeners with closely comparable services that pay substantially reduced rates and that make little or no effort to convert free listeners to paying subscribers." Hr'g Ex. SX-12 at 18 (Kooker WDT); Hr'g Ex. SX-27 at 3 (Kooker WRT). It is difficult for directly licensed services to convince users that it is worth paying for the few differences as remain between the consumer offerings of statutory and directly licensed services. Hr'g Ex. SX-12 at 18 (Kooker WDT). At the consumer level, this means that there is little incentive for consumers to migrate from free statutory services to the free versions or paid versions of directly licensed services. Hr'g Ex. SX-12 at 18 (Kooker WDT). The competition for users by robust ad-supported webcasters such as Pandora frustrates copyright owner "efforts to close the gap in revenue caused by declining sales" by trying to incentivize users to pay for a subscription service. Hr'g Ex. SX-12 at 19 (Kooker WDT). *See* Section V.B, *supra*.

1122. Further, as statutory webcasters increasingly customize and curate programmed streams for individual users, the consumer may become "increasingly confident that the next song they hear or the next playlist they select will be closely in synch with their musical preferences" and, as a result, "it becomes increasingly difficult to persuade consumer[s] that they should buy tracks or albums." Hr'g Ex. SX-12 at 20 (Kooker WDT); *see also* Hr'g Ex. SX-10 ¶ 10 (Harrison Corr. WDT) ("If a user has 'customized' her or his preferences through a streaming service, the user knows they have a good chance of hearing songs they like, or others

like them, and thus see diminished need to own the particular recording."). Likewise, as statutory webcasters (whether customized, programmed, or simulcast) continue to converge with subscription services it makes it that much less likely that a consumer will pay for a subscription.

1123. Independent labels too are sensitive to the substitutional effect of webcasting services and streaming services generally. As Mr. Wheeler described it "we cannot afford to be platform agnostic in a consumption-based market"—they want to see consumers streaming music on Spotify, and they hesitate to license to services that "dilute the market value" of that consumer listening time. Hr'g Ex. SX-21 ¶¶ 26, 30 (Wheeler WDT). For Beggars Group, agreeing to a lower rate for a product that competes with products offering higher value per user, would be "subsidizing our own demise." Hr'g Ex. SX-21 ¶ 30 (Wheeler WDT). Mr. Wheeler sees this happening with statutory services that "offer enough of a complete music experience . . . to draw consumers away from the higher-revenue-per-consumption services." Hr'g Ex. SX-21 ¶ 31 (Wheeler WDT). He would expect marketplace negotiations for webcasting services to result in licenses that closely approximate the rates for on-demand streaming services because "there is a real danger that webcasting services provide *enough* functionality such that most consumers will not need to or will choose not to look to on-demand subscription services."[52] Hr'g Ex. SX-21 at 16 ¶ 35 (Wheeler WDT).

1124. Artists and artists representatives also see the substitutional impact that music streaming services have had on purchases of music. As Mr. Hair testified: "digital performance

[52] "This is not to say that the two consumption-based experiences are exactly the same but only that the distinction between them is a less and less meaningful difference for consumers when consider how they use and appreciate our repertoire. Many people do not understand the difference between say Pandora and Spotify they are just listening to music. With this in mind would expect that negotiating framework for webcasting would largely approximate the on-demand service framework identified above." Hr'g Ex. SX-21-016 ¶ 36 (Wheeler WDT).

royalties are important because patterns of music consumption are changing, so that 'listening' is replacing 'purchasing.'" Hr'g Ex. SX-8 at 6 (Hair WDT). As revenues from streaming become more and more of the income for each artist, it must be the case that the revenues from "listening" sources are sufficiently high to cover artists' costs and encourage more artists to make more music. Ms. Roberts, an independent musician, testified to her personal net substitution effect: "Instead of getting weekly payments ranging between $200-$750 from my distributor" for CDs and downloads, Ms. Roberts received an average monthly check for $11.36 from all distributed streaming services and has received $470 total since 2004 from SoundExchange. Hr'g Ex. SX-016 at 9, 13 (Roberts WRT).

4. Survey Evidence Confirmed that Statutory Services Substitute for Directly Licensed Services

1125. At the most basic level, all music streaming services are competing for listening time when consumers have a limited number of hours in the day. For every moment that a consumer is listening to a statutory streaming service, she is not listening to a directly licensed service. Hr'g Ex. SX-12 at 19 (Kooker WDT) ("if someone is listening to 22.5 hours per month on Pandora—and that is just the average—it decreases the likelihood they will have the additional time, interest or inclination to consider paying for music on higher-ARPU directly licensed subscription services."). In that instance, the use of the statutory service is interfering with—indeed decreasing—the stream of revenue from the directly licensed service. Accordingly, the direct competition between statutory and directly licensed services is by definition an interference with that stream of revenue.

1126. Economic incentives discourage Pandora, iHeartRadio, and the other webcasters from actively promoting or encouraging users in any way to pay for a subscription service. As Mr. Wheeler testified, "And, it is my sense that streaming music on one service, such as a

webcaster, will not induce a consumer to buy a premium subscription on another service, such as an on-demand service. Indeed, it is the incentive of the webcaster to do the exact opposite and encourage consumers not to switch." Hr'g Ex. SX-21 at 19 (Wheeler WDT).

a. *The Butler Survey Demonstrated a Substitutional Effect*

1127. Sarah Butler, a survey expert, designed and conducted a consumer survey to determine for which other types of music listening, Pandora and iHeartRadio substituted in the opinion of consumers. Hr'g Ex. SX-5 at 3 ¶ 2 (Butler WRT). To conduct her survey, Ms. Butler started with a representative sample of adults as well as a proportion of teenagers (13 to 17) through a well-established survey panel: Survey Sampling International ("SSI").[53] Hr'g Ex. SX-5 at 15 ¶ 31 (Butler WRT).

1128. Screening questions gathered information on age, gender, and familiarity with various types of music listening formats. As Ms. Butler reports, a number of respondents were familiar with more than one streaming service or even currently used more than one music streaming service. Ms. Butler defined the relevant population as those individuals who self-identified as currently using iHeartRadio or Pandora. For those who used both, Ms. Butler randomly assigned them to one of the two groups. Hr'g Ex. SX-5 ¶¶ 30-31 (Butler WRT).

1129. The survey respondents were asked a framing question:

> Thinking about the time you spend listening to iHeart Radio, do you mostly listen to iHeart…?
> At home
> At work
> While commuting or in transit
> While working out
> Other (Type in response)
> Don't know/ unsure

[53] Ms. Butler's survey contains a number of quality control measures to ensure the reliability of the sample. Hr'g Ex. SX-5 ¶ 34.

This question orients respondents to answer with regard to the time they typically spend listening to iHeartRadio (or Pandora).

Then survey respondents were asked two substantive questions. First:

> Imagine you could no longer listen to music on iHeartRadio. Which of the following statements represents what you would be most likely to do?
> I would find a substitute for the music I listen to on Pandora
> I would stop listening to music
> Don't know/ unsure

Hr'g Ex. SX-5 ¶ 38 (Butler WRT). The second question was tailored to the specific music streaming services that respondents had reported they had heard of in an earlier survey question. Respondents were always shown the first five choices and the last three choices but the remaining choices varied with awareness:

> You said you would find a substitute for the music you listen to on iHeart Radio. Which of the following, if any, would be your most preferred substitute for iHeart Radio?
> FM or AM radio (e.g. "terrestrial" or traditional radio)
> Satellite radio
> CDs
> Purchased downloaded music / MP3s
> Other downloaded music / MP3s
> YouTube
> Pandora (free/paid)
> iTunes Radio
> Spotify (free/paid)
> Google Play
> Beats Music
> Amazon Prime Music
> MyStro
> Last.fm
> Rdio
> Rhapsody
> SiriusXM Online (not satellite radio, but listened to on a computer/phone)
> Slacker Radio
> Songza
> TuneIn Radio
> SoundCloud
> Listening to less music

Other (Type in response)
Don't know / not sure

Hr'g Ex. SX-5 ¶ 40 (Butler WRT).

1130. Ms. Butler reported several findings important for understanding substitution patterns among webcasting consumers. First, the most common substitute for Pandora are any one of the directly licensed music streaming services. For Pandora users, 43.3% would otherwise listen to one of the following services: Spotify (19.7%), iTunes Radio (9.7%), Amazon and Rhapsody (approximately 4% each), Google Play and Slacker (approximately 2% each), and Beats and Rdio (approximately 1% each). [54] Hr'g Ex. SX-5 ¶ 48, Figure 3 (Butler WRT). The results were similar, but not identical for iHeartRadio. The largest share of iHeartRadio listeners (30%) would switch to Pandora. This is due, in part, to the fact that many of these consumers already listen to Pandora. Another 23.1% would listen to a directly licensed service including Spotify (10.7%), iTunes Radio (7.5%), and Amazon, Google Play, Slacker, and Rhapsody (approximately 1% each). Hr'g Ex. SX-5 ¶ 50, Figure 5 (Butler WRT).

1131. As Ms. Butler testified, these results are not predictive of future behavior but they do indicate the frequency with which respondents view directly licensed music streaming services as a substitute for Pandora or iHeartRadio. These results illustrates a trend that one would expect in the hypothetical world in which statutory webcasting services were no longer available: consumers would turn first and foremost to other music streaming services and, in

[54] During cross-examination, counsel for Pandora suggested that the results of Ms. Butler's survey would have been different if she had asked those iHeartRadio users who also used Pandora what they would do if Pandora were no longer available. This criticism does not diminish the survey results. The question at hand regarding substitution is whether and to what extent use of webcasting services as a class substitutes for or interferes with *other* streams of revenue. If respondents' had not been given the option of *any* other webcasting service, the percentages of respondents reporting they would switch to a directly licensed service would be even greater.

particular, to directly licensed services that provide greater ARPU to the recorded music industry.[55] In particular, a large share of consumers responded that they would otherwise use Spotify—19.7% for Pandora users and 10.7% for iHeart users. Hr'g Ex. SX-5 ¶¶ 48, 50 (Butler WRT). Whether using the ad-supported or subscription Spotify service, these consumers would be providing a higher ARPU to the industry and a greater chance of conversion to a paid subscription.

b. ***The Rosin Substitution Survey Was Methodologically Flawed; Notwithstanding Its Biased Questions, the Survey Still Demonstrated that Statutory Webcasting Services Substitute for Higher-ARPU Subscription Services***

1132. Pandora offered a survey by Larry Rosin to rebut the notion of substitution and, instead, to suggest that Pandora does not draw away listening time or users from on-demand subscription services.

1133. Mr. Rosin's survey had a number of methodological flaws. First, Mr. Rosin's survey was a telephone survey. However, Mr. Rosin did not rotate the final answer in a number of important response sets. This created a "recency effect," which biased users toward choosing the last item read to them over the telephone. Hr'g Tr. 3755:13-24 (May 14, 2015) (Rosin) (describing and acknowledging that a recency effect biases users toward choosing the last answer in question). For example, in the following question, while the first four choices were rotated, every respondent heard "Or would you just listen to less music" as their last choice.

[55] Mr. Rosin confirm that few users revert after adopting digital music streaming services and other technologies. He said, about rising rates of adoption: "Over time, the weekly percentage is getting closer and closer to the monthly number. This means that users of the technology are getting more habituated to it and that it is becoming a more regular part of people's lives." Hr'g Tr. 3791:18-24 (May 14, 2015) (Rosin).

10. Now I want to propose a hypothetical situation. Suppose ALL FREE Internet radio or music services no longer existed. This means there would not be a free version of Pandora or Spotify or any other similar free services, and there would not be FM radio stations available via streaming. I'm going to read four possible ways you might replace your listening to free Internet radio and music services. Which of the following would you be most likely to do instead? **(READ LIST; SHUFFLE CODES 1, 2, 3, and 4; REPEAT ANSWER CODES IF NEEDED. ACCEPT ONLY ONE RESPONSE)**

Pay a subscription fee every month to use an on-demand Internet music service like Spotify or Rhapsody	1
Listen to free FM radio on a traditional radio	2
Listen to your CDs and music downloads	3
Watching music videos or listening to music on YouTube or Vevo	4
(ALWAYS READ LAST) Or would you just listen to less music	5

Hr'g Ex. PAN 5021 at App. B. Perhaps unsurprisingly, 15 percent of respondents said they would listen to less music. Hr'g Ex. PAN 5021 at Figure 10.

1134. Mr. Rosin acknowledged that "certainly," it is true that "even small wording differences have the potential to substantially affect the answer that people provide." Hr'g Tr. 3753:1-4 (May 14, 2015) (Rosin). Mr. Rosin's survey asked users about their willingness to pay for direct price points, in contrast to prior non-litigation survey work that Mr. Rosin has done where he framed willingness to pay questions as whether the respondent would be "willing to pay a small fee." Hr'g Tr. 3770:20-3771:6 (May 14, 2015) (Rosin). Common sense tells us that survey respondents would be much more likely to answer "yes" to a question worded "would you be willing to pay a small fee" than a question worded "how likely would you be to pay $9.99 every month." Hr'g Ex. PAN 5021 at Figure 6.

1135. Other wording choices impacted Mr. Rosin's results as well. Mr. Rosin's willingness to pay questions described a very bare-bone set of features offered by the hypothetical subscription service. His description was merely three sentences, and it omitted the majority of the features that subscription services typically market as "upsell" benefits to a paid subscription:

> "There are paid online music services that give you on-demand access to a music library. These services allow you to stream entire albums or individual songs that you choose. You do not

> own this music but would have access for as long as you are paying for that service."

Hr'g Ex. PAN 5021 at Figure 6. Mr. Rosin's survey did not describe the service as having playlists that might be curated by the service, artists, or tastemakers despite knowing these exist and following them closely as a part of his daily work. Hr'g Tr. 3760:23-3761:20 (May 14, 2015) (Rosin). It did not tell respondents anything about mobile abilities of the service or the ability to listen to the service offline despite being aware that those are features advertised by subscription services. Hr'g Tr. 3761:21-3763:8 (May 14, 2015) (Rosin). The question also did not mention in the description that the paid service would be free of advertising, that it would have unlimited skips, that it would have enhanced sound quality, nor that users could access it through their home devices (e.g. Sonos) although he was aware that each of these are marketed as features that come with a paid subscription service. Hr'g Tr. 3763:9-3764:17 (May 14, 2015) (Rosin).

1136. Mr. Rosin's survey question—"Suppose all free Internet radio or music services no longer existed . . . which of the following would you be most likely to do instead?"—is biased in two ways. Hr'g Ex. PAN 5021 at Figure 10.

1137. First, the option given for on-demand services emphasizes that it requires payment: "Pay a subscription fee every month to use an on-demand Internet music service like Spotify or Rhapsody." Hr'g Ex. PAN 5021 at Figure 10. This stands in contrast to the option for terrestrial radio which emphasizes that it is free: "Listen to free FM radio on a traditional radio." Hr'g Ex. PAN 5021 at Figure 10. When asked at the hearing, Mr. Rosin did not recall why he phrased it to include the modifier "free". Hr'g Tr. 3786:22-24 (May 14, 2015) (Rosin).

1138. Second, despite purporting to test the substitution between statutory services and services like Spotify, Mr. Rosin's survey did not ask any questions regarding whether Pandora

users might otherwise use the ad-supported or other free versions of directly licensed services, such as Spotify's Shuffle or Spotify's Desktop service. This crucial flaw evades the very question of substitution here—would consumers otherwise use the free *or* paid versions of higher ARPU directly licensed services?

1139. Despite the methodological flaws in Mr. Rosin's survey, his substantive results support a finding that Pandora and other non-interactive services are substituting for paid on-demand subscriptions. Mr. Rosin finds that 12% of Pandora users—that is 12% of 80 million active users, or 9.6 million people—would be very likely or somewhat likely to pay for an on-demand subscription at the $9.99 level. Hr'g Tr. 3757:4-3758:18 (May 14, 2015) (Rosin); Hr'g Ex. PAN 5021 at Figure 6. That number—9.6 million—is more subscribers than Spotify has in the United States. That is, Mr. Rosin's survey demonstrates that paid on-demand subscriptions at the $9.99 level have the [ ] were Pandora not available. Hr'g Tr. 1051:6-8 (Apr. 30, 2015) (Harrison) ([ ]). Of course, this is not an insubstantial amount of money. Assuming 9.6 million subscriptions at $9.99 per month over the course of the year—that is $1.058 billion dollars in revenues to the on-demand subscription services and a corresponding [ ]. In other words, the potential substitution cost as shown by Mr. Rosin's survey is [ ].[56] Even if you deducted the royalties paid by Pandora from this amount (which is not "other sources of revenue" under the statute)—[ ]

[56] This level of substitution is corroborated by Mr. Rosin's hypothetical—"Suppose all free Internet radio or music services no longer existed . . . which of the following would you be most likely to do instead?"—to which 9% of users would say they would pay for a subscription. Hr'g Ex. PAN 5021 at Figure 10.

[redacted]]—the net impact would still be positive on the recorded music industry of between [redacted]]. *See* Hr'g Ex. SX-2250 (Pandora 2014 SoundExchange Total Payments).

1140. Furthermore, at lower price points the likelihood of subscribing greatly increases, showing that Pandora and non-interactive service users have a demand for subscription services—it is just one that is met by the statutory alternatives. At $4.99 per month, 30% of weekly Pandora and non-interactive service users would be very likely or somewhat likely to subscribe to an on-demand service and at $2.99, a combined 42% would be very likely or somewhat likely to subscribe to an on-demand service. Hr'g Tr. 3758:24-3759:12 (May 14, 2015) (Rosin); Hr'g Ex. PAN 5021 at Figures 6-8.

D. iHeart Tried And Failed To Show That Non-Interactive Services Have A Net Promotional Effect Relative To Interactive Services

1141. Two experts—Dr. Kendall for iHeart and Dr. Blackburn for SoundExchange—conducted empirical analysis in an effort to determine whether non-interactive and interactive streaming services have different effects on digital download sales. Dr. Kendall opined that his analysis showed that non-interactive services are net promotional; Dr. Blackburn found no such effect.

1142. Both experts conducted a study using data from the same company that tracks website and application usage on a PC computer as well as digital downloads purchased on a PC computer. Importantly, this data cannot determine the overall *net* promotion/substitution effect on sources of revenue because it is limited to a single revenue source and does not account for the substitution effect of non-interactive services on revenues from directly licensed services. The data is further limited only to desktop, because Dr. Kendall had no comparable mobile data

and testified that he had no way of linking mobile data to purchases. Hr'g Tr. 3213:3-9 (May 12, 2015) (Kendall).

1143. For the reasons discussed below, Dr. Kendall's study was fundamentally flawed and cannot serve as the basis for a finding that non-interactive webcasting services are net promotional as compared to interactive services. Dr. Blackburn's analysis of data relied on by iHeart's original testifying expert (Prof. Danaher) shows no net promotional effect one way or another.

1. Dr. Kendall's Study Was Fundamentally Flawed

1144. Dr. Kendall conducted a study that purported to compare the "time that individuals spend listening" to online streaming services and their purchases of digital downloads on PC computers. Dr. Kendall looks to the relationship for each "individual"—using a fixed effects model—between increases or decreases in purported "time spent listening" and increases or decreases in purchases. Dr. Kendall then takes this data (which is biased as discussed below) and analyzes it to two ends. He purports to find that all music streaming services are promotional of sales and he finds that non-interactive services are 15 time *more promotional* than interactive services. Dr. Kendall's study was deeply biased and cannot be credited.

a. *Dr. Kendall's Data Is Biased To Overestimate the Time Spent Listening of Interactive Services Overstating the Purported "Different" Effect*

1145. A number of problems impact the reliability of Dr. Kendall's study, but a single bias in the data that Dr. Kendall fails to address drives his conclusions and the purported 15-fold difference he finds between the promotional effect of non-interactive and interactive streaming. Dr. Kendall reports that machines in his sample spend 18 times more time listening to interactive

as compared to non-interactive services.[57] Hr'g Tr. 3274:1-7 (May 12, 2015) (Kendall). Specifically, the mean listening to non-interactive services is approximately 37 minutes, and to interactive services is approximately 679 minutes. Hr'g Tr. 3273:9-25 (May 12, 2015) (Kendall).

1146. Dr. Kendall did nothing to confirm whether or not this 18 times difference was accurate. He testified: "Well, it seemed reasonable to me" and suggested that there was other evidence which he did not identify and did not cite in his report. Hr'g Tr. 3275:7-25 (May 12, 2015) (Kendall).

1147. The record, however, includes evidence pointing the opposite direction. For example, Profs. Fischel/Lichtman—whom Dr. Kendall supported—note in their written rebuttal testimony that for subscribers, Pandora users [redacted] exhibit more intense listening than Spotify users [redacted]. Hr'g Ex. IHM 3054 at 31 ¶ 61 (Fischel/Lichtman WRT). Further, Mr. Herring testified that the disparity in listening that is found in Dr. Kendall's data is inconsistent with his knowledge of relative time spent listening to the different types of services:

[redacted]

[57] If Dr. Kendall's data is accurate—as compared to Pandora users who spend an average of 22 hours a month on Pandora, interactive service users would be spending 396 hours per month streaming music through on-demand services or over one-half of the total number of hours in a month. Hr'g Tr. 3330:6-3331:13 (May 12, 2015) (Kendall).

[redacted]

Hr'g Tr. 3441:1-3442:17 (May 13, 2015) (Herring.).

1148. The cause of the wildly divergent mean times spent listening is quite simple. Dr. Kendall's dataset includes information tracking data from (1) websites—which measure the time the website is open and the user has interacted with the website at least once during the 30 minutes—and from (2) apps—which measure the time the app is open ***without any set minute limitation*** on the frequency with which the user must interact with the app.[58] Hr'g Ex. IHM 3148 at 5 n.14 (Kendall WRT); Hr'g Tr. 3290:16-21 (May 12, 2015) (Kendall). As a result, time spent listening on apps will, by definition, be overstated as compared to time spent listening on websites. Moreover, Dr. Kendall admitted that, all else equal, the greater the amount of time shown as someone listening to a service, the smaller the reported "promotional" effect on music purchases would be:

> Q. And the bottom line to all of this is that the fair characterization is that the number of listening hours turns out to make a -- the amount of time listening to these respective services winds up making a pretty sizable difference in terms of what the denominator of the fraction is, correct?

[58] Dr. Kendall's explanation reads: "Duration of listening for a service's desktop application is defined as the total time that an app is open on a user's desktop, and the computer is not in hibernation mode, screen saver mode or similar. Duration of listening for a service's website is defined as the total time that a browser window is open, and the user has interacted with the website within the last 30 minutes." Hr'g Ex. IHM 3148 at 5 fn. 14 (Kendall WRT).

> A. For this calculation where we're translating to dollars per performance, you know, I think it's the -- dividing one thing by another. So both things matter. But the way you've shown the calculation here, just mathematically, the difference between those two numbers is primarily in the denominator. Sure.

Hr'g Tr. 3287:17-3288:6 (May 12, 2015) (Kendall).

1149. The reason for this disparity in time recorded as listening to the two types of services—and thus for Dr. Kendall's ultimate conclusions as to the claimed relative differential in promotional effect—had no relationship to real world listening. Rather, it was the result of a bias in Dr. Kendall's data set and the purported measurement of time listening. First, Spotify is much more widely used on desktop application, and Pandora is much more widely accessed through the web. Hr'g Ex. SX-1568; Hr'g Tr. 3305:11-23 (May 12, 2015) (Kendall) ("And is that consistent with your understanding, Dr. Kendall, of the data that you received, that . . . virtually all the access to a streaming service through an app was through the Spotify app in the data that you received from [ ] . . . A: Yeah. I certainly knew that the Spotify app was highly popular among apps."). Accordingly, what Dr. Kendall counted as time listening on Pandora was subject to the 30-minute inaction cut-off in hugely disproportionate numbers relative to what counted as time spent listening on Spotify. Spotify "listening" time instead was overwhelmingly measured based on the desktop application parameters. This meant that the listening clock continued to run so long as the "app is open on a user's desktop, and the computer is not in hibernation mode, screen saver mode or similar. Duration of listening for a service's website is defined as the total time that a browser window is open, and the user has interacted with the website within the last 30 minutes." Hr'g Ex. IHM 3148 at 5 n.14 (Kendall WRT). This bias impacts well over 5,000 data points for Spotify as compared to a mere 27 for Pandora.

1150. Second, the bias for time on Spotify recorded as "listening" was further exacerbated by the fact that the default setting on the Spotify app is to launch (i.e., to open) once the computer is turned on. Hr'g Tr. 3306:19-3307:5 (May 12, 2015) (Kendall) (responding to questions as to whether he was aware that Spotify started automatically on launch that he was "not sure about that, but it sounds right"). This means that when a Spotify app user turned on their machine—whether they started listening to music or not—they would be reported as listening to Spotify in Dr. Kendall's data. Hr'g Tr. 3309:7-15 (May 12, 2015) (Kendall). And the "clock" would not stop unless she either closed the app or the computer enters hibernation or sleep mode. Hr'g Tr. 3311:14-20 (May 12, 2015) (Kendall).

1151. Dr. Kendall did not re-run his dataset by excluding the app data—but from the backup materials he provided, one can. Hr'g Exs. SX-1567, SX-1568. Rerunning that data results in Dr. Kendall's experiment without the app data reduces the mean time spent listening for interactive services—a simple average calculation—from approximately 679 minutes (as reported in Kendall's study) to 43 minutes (excluding the app data). That changes the disparity factor 18x to 1.3x—a decidedly closer mean amount of time spent listening. What follows is a recreation of Dr. Kendall's Exhibit C, the numbers that change due to the exclusion of the apps (including the 27 Pandora apps) are as follows with different numbers highlighted:

Exhibit C
Summary Statistics for Variables Used in Analysis

Variable	Entire Sample [1] Mean	Entire Sample [1] Standard Deviation	Among Non-Interactive Listeners [1] Mean	Among Non-Interactive Listeners [1] Standard Deviation	Among Interactive Listeners [1] Mean	Among Interactive Listeners [1] Standard Deviation
Monthly total listening time (in minutes)	8.30	75.37				
Monthly non-interactive listening time (in minutes)	3.95	45.82	33.49	129.61		
Monthly interactive listening time (in minutes)	4.32	59.76			43.17	184.50
Monthly YouTube watching (in minutes)	662.05	1216.04	741.50	1212.49	954.85	1515.66
Monthly time spent visiting music-interest website (in minutes)	3.14	31.13	5.64	31.77	9.87	59.64
Monthly purchases of music	$ 1.26	$ 13.14	$ 1.55	$ 11.65	$ 2.16	$ 12.83
Monthly number of songs purchased	0.98	10.12	1.21	9.05	1.67	9.95
Observations	60,000		7,082		6,000	

(1) Listeners and listening time are defined as those observations that indicate listening of more than 90 seconds in a given month to the specified type of service

1152. The bias in Dr. Kendall's data further affected his ultimate conclusion because the difference between interactive and non-interactive services in terms of time spent listening was a major driver of their differential promotional/substitutional impact as Dr. Kendall calculated it. Removing the app data results in a final adjustment number of between $0.0001 and $0.0002 for the dataset *including* iTunes, Amazon and Google. For reasons explained below, however, Dr. Kendall should have *excluded* iTunes, Amazon and Google and the results would require an adjustment *in favor* of the interactive services. That is—an adjustment *upward* for the stronger promotion effect of interactive services of between $0.0002 and $0.0003. What follows is a recreation of Dr. Kendall's Exhibit H, with different numbers highlighted:

Exhibit H
Estimated Difference in Interactive and Non-Interactive Royalty Rates Due to Differences in Net Promotional Effects

		Among Listeners to Specified Services		Among Listeners to Specified Services who Purchased Music	
		Include iTunes, Amazon, and Google	Excluding iTunes, Amazon, and Google	Include iTunes, Amazon, and Google	Excluding iTunes, Amazon, and Google
Additional Music Spending per Non-Interactive Performance	[1] = From Exhibit F	$0 00125	$0 00049	$0 00898	$0 00356
Additional Music Spending per Interactive Performance	[2] = From Exhibit G	$0 00096	$0 00096	$0 00428	$0 00429
Difference in Music Spending per Performance	[3] = [1] - [2]	$0 00029	-$0 00047	$0 00469	-$0 00073
Assumed Retailer Margin	[4]	30%	30%	30%	30%
Difference in Interactive and Non-Interactive Marginal Cost	[5] = [3] x (100% - [4])	$0 00020	-$0 00033	$0 00328	-$0 00051
Low Pass-Through Rate	[6]	50%	50%	50%	50%
Low Difference in Interactive and Non-Interative Royalty Rates	[7] = [5] x [6]	$0 0001	-$0 0002	$0 0016	-$0 0003
High Pass-Through Rate	[8]	100%	100%	100%	100%
High Difference in Interactive and Non-Interative Royalty Rates	[9] = [5] x [8]	$0 0002	-$0 0003	$0 0033	-$0 0005

b. *Other Flaws in Dr. Kendall's Study Make it Unreliable*

1153. Several other methodological flaws undermine the reliability of Dr. Kendall's experiment as well. First, Dr. Kendall did not analyze *individuals*; he analyzed *machines*. Hr'g Tr. 3245:3-8 (May 12, 2015) (Kendall). This impacts Dr. Kendall's conclusions. He cannot confirm that his data represent a single individual's behavior because one household member could be accessing the streaming services and a different household member could be purchasing downloads on the same computer.

1154. Second, Dr. Kendall did not do anything to confirm or determine whether his sample of machines was representative of the US census or the general population of people who listening to music streaming services—the population that would be relevant here. Hr'g Tr. 3246:1-13 (May 12, 2015) (Kendall). Dr. Kendall's sample also excluded teenagers, despite the fact that he agreed that teenagers are a significant portion of the population that listen to online streaming services. Hr'g Tr. 3251:10-25 (May 12, 2015) (Kendall).

1155. Third, Dr. Kendall's machines are not selected randomly. He could only obtain 8,000 machines that streamed music, so he chose to include another 2,000 machines that did not stream but instead purchased downloads. Hr'g Tr. 3249:19-23 (May 12, 2015) (Kendall). Dr.

Kendall gives no methodological reason for a sample of 80/20 streaming machines vs. purchasing machines. His only explanation for this non-random proportion is that [redacted] refused to give him a total of 10,000 machines that streamed so they decided to ask for the remaining machines as purchasers: "since we can only get 8,000 of the listeners, no point in going back and saying, can you get me more, they've already said no, so we got 2,000 people who purchased music at some point during the sample." Hr'g Tr. 3249:19-23 (May 12, 2015) (Kendall).

1156. Fourth, Dr. Kendall purports that his data tracks listening time on Google Play, Apple iTunes Radio, and Amazon, but it surely does not. The very websites tracked by the [redacted] data point to websites which are *not* websites from which one can access the music streaming services. The websites tracker were as follows:

> **iTunes Radio**: Apple.com/iTunes/?cid=oas-us-domains-iTunes.com?
>
> **Amazon:** amazon.com/gp/feature.html?ie=UTF8&docId=1001316131
>
> **Google:** play.google.com/store/music

At best, these are a pathway through which someone might access the music streaming services, but the data provides no information as to whether or not someone actually did. Hr'g Tr. 3321:24-3322:3 (May 12, 2015) (Kendall). It was for that very reason that Dr. Kendall "did the analysis both ways. Because that's a potential concern." Hr'g Tr. 3322:3-5 (May 12, 2015) (Kendall). That is to say, to the extent that any of the analyses Dr. Kendall ran actually tracked websites on which music streaming took place, it is the set of analyses that *exclude* the iTunes, Amazon and Google data.

1157. Dr. Kendall asserted at the hearing that, because other businesses (and Dr. Blackburn) rely on data from the same service Dr. Kendall utilized, that data must be reliable.

See Hr'g Tr. 3247:14-18 (May 12, 2015) (Kendall); *see also* Hr'g Tr. 3310:14-16 (May 12, 2015) (Kendall) ("Because the data—this company, their whole job is providing these data. If the data aren't reliable, the whole company is gone."). However, there is no evidence that any company or researcher (Dr. Blackburn or anyone else) used the data to conduct the same experiment that Dr. Kendall does. Just because the data may be reliable for certain uses does not mean that Dr. Kendall's particular study is immune from critique.

1158. Even if Dr. Kendall's analyses were methodologically sound—which they are not—the analyses would have minimal if any probative value. Dr. Kendall did not even report the statistical significance of his test between the differential promotional effects of non-interactive streaming services and interactive streaming services. We know from his declaration filed in response to SoundExchange's Motion *in Limine* that Dr. Kendall's study fails to meet the 95% confidence threshold. Declaration of Todd Kendall dated April 6, 2015. The level of confidence is even less using the data that excludes iTunes, Amazon, and Google. Dr. Kendall fails to report any of these confidence intervals in his testimony.

2. Dr. Blackburn's Recreation of Prof. Danaher's Study Confirms that Non-Interactive Services Are No Different in Promotional or Substitutional Effects

1159. Dr. Blackburn also conducted a study using [ ] data that had been produced by iHeart when Prof. Danaher submitted his corrected testimony. Dr. Blackburn and Dr. Kendall share a data source, and both are limited to desktop uses of music streaming services and desktop purchases of digital downloads. Beyond the data similarity, Dr. Blackburn and Dr. Kendall conduct fundamentally different studies. Unlike Dr. Kendall, Dr. Blackburn's analysis did not turn on time spent listening at all. Dr. Blackburn—like Prof. Danaher before him—looked at "discovery events" that were a "yes or no" rather than a duration of time spent listening. Hr'g Ex. SX-24 ¶ 40 (Blackburn WRT). To be clear, Dr. Kendall analyzed increases

in purchasing corresponding to increases in time spent listening. He did nothing to analyze what effect, if any, using a webcasting service at all had on purchasing. In contrast, Dr. Blackburn attempted to discern whether there was any meaningful promotional or substitutional effect as between those who use webcasting services and those who do not.

1160. Dr. Blackburn found *no* statistically significant difference between the promotional and substitutional effect of interactive and non-interactive services. Hr'g Ex. SX-24 ¶ 39 (Blackburn WRT). Dr. Blackburn also found that the promotional or substitutional effect on digital download purchases made on a desktop of using either a non-interactive or interactive services (again, on a desktop) could not be distinguished from zero. Hr'g Ex. SX-24 ¶ 42 (Blackburn WRT). As Dr. Blackburn explained, the very nature of his study (as well as Dr. Kendall's) means that unobserved events can bias the data positively showing a "false" promotional effect.

1161. As counsel for iHeart noted during cross examination, the "point estimates"—that is the best estimate of an unknown parameter—that Dr. Blackburn found for the impact of sales on discovering non-interactive as compared to interactive streaming services were different. Hr'g Tr. 5979:2-7 (May 27, 2015) (Blackburn). However, from an econometric perspective, the statistical tests, specifically the confidence intervals, are crucial to determine whether a sample point estimate can be reliably extrapolated to an entire population. In Dr. Blackburn's analysis, there is no statistical certainty. In fact, his results are statistically indistinguishable from zero. Hr'g Tr. 5981:6-18 (explaining that the estimates are statistically indistinguishable from zero). Accordingly, Dr. Blackburn concluded that one cannot show a difference between non-interactive and interactive services' promotional/substitutional effects.

E. The Evidence Does Not Support A Finding That Webcasting Services Are Promotional

1. Dr. McBride's Music Sales Experiments Do Not Show Net Promotion

a. *Dr. McBride Analyzed the Wrong Economic Question*

1162. Dr. McBride conducted a series of Music Sales Experiments that he argues prove spins on Pandora promote sales of that record.[59] These experiments do not prove net promotion.

1163. First, as Pandora's internal documents recognize, the experiments do not ask the proper "expansionary promotion" questions addressed by these proceedings. An internal memorandum written before Dr. McBride arrived and written by a former economist at Pandora, Jonathan Hall makes this point clear. The memorandum notes [ ] when describing an experiment nearly identical to that here—[ ]. Hr'g Ex. SX-24 at App. 3 (Blackburn WRT). The memorandum goes on to explain:

[ ]

Hr'g Ex. SX-24 at App. 3 (Blackburn WRT).

[59] Notably, unlike the steering experiments, Prof. Shapiro had no involvement in Dr. McBride's Music Sales Experiments.

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[redacted]

Hr'g Ex. SX-24 at App. 3 (Blackburn WRT). Notably, the memorandum recognizes the relevant question in these proceedings, and what Pandora would have to do if it wanted to use its computers and algorithms to address it: [redacted]. Hr'g Ex. SX-24 at App. 3 (Blackburn WRT). Dr. McBride did not attempt to address this question with his Music Sales Experiment.

1164. By design, Dr. McBride aims to determine only whether Pandora has a diversionary promotional effect. As a result, the Music Sales Experiments do not provide information whether the promotion that Dr. McBride purportedly measures comes at the expense of decreased sales of other artists' and record labels' sound recordings. The study also says nothing about Pandora's *net* impact on other streams of revenue to the industry because Dr. McBride does not analyze the impact on paid streaming subscriptions. Finally, Dr. McBride's study is limited to Pandora—it says nothing about the relative promotional or substitutional impact of other webcasting services.

b. ***Dr. McBride's Study Is Inconsistent with Pandora's Buy Button Data***

1165. Tellingly, Dr. McBride's study tries hard to prove something that, if Pandora were obviously and undeniably promotional, would be easy to prove. Take, for example, Pandora's buy button. It is the most simple way to purchase if you are listening to Pandora. Yet, nowhere in Dr. McBride's analysis, nor anywhere in Pandora's case, does Pandora present any data related to the frequency with which Pandora users do or do not use the buy button. For good reason, because the Pandora buy button data shows only a paucity of purchases compared to the actual usage of Pandora.

1166. As Dr. Blackburn analyzes, [ ]. Hr'g Ex. SX-24 ¶ 19 (Blackburn WRT).

c. *Dr. McBride's Study Is Flawed and Unreliable*

1167. Dr. Blackburn described two significant flaws in the experiment design as well. First, the very design relies on matching sales and Pandora plays by geography. Yet the data that Dr. McBride chose to rely upon in the Music Sales Experiments cannot accurately link where Pandora listeners are (and thus whether or not people in an area were subject to the treatment or the control) with where many purchases were made. As Dr. Blackburn points out--and apparently Pandora admits—a disproportionately large share of listeners are supposedly located

in 90210. Hr'g Ex. SX-24 at 5. This inability to accurately locate the subjects of the experiment destroys the randomization which is crucial to controlling for other variables.

1168. Second, Dr. McBride excluded at least some number of experiments which have zero sales. Although Dr. McBride states that he simply did not have sales data for some of these experiments—at the same time he admits that he did exclude some experiments that he knew with certainty had zero sales. Hr'g Tr. 4351:8-10 (May 18, 2015) (McBride) ("[Dr. Blackburn] criticized the research for excluding experiments for which the vast majority have no data available."). Dr. McBride never testifies to how many zero sales experiments *were* excluded. This methodological approach biases Dr. McBride's analysis toward finding promotion because he omits data showing flat—no increase—in sales due to spins on Pandora. Dr. McBride admitted that such "no sales" information would, albeit "weakly," give some indication "about the promotional effect of Pandora." Hr'g Tr. 4429:14-16 (May 18, 2015) (McBride). We cannot know to what extent Dr. McBride's analysis is biased upward, making his results an unreliable metric for any proposed promotion or substitution adjustment.

2. Recorded Music Companies' Market Behavior Is Inconsistent with a View of Statutory Services As Net Promotional And Consistent With The View That They Are Net Substitutional

a. *Marketing and Promotion Efforts Target Directly licensed Partners—Not Webcasters*

1169. More and more, recorded music companies are targeting substantial efforts to market and promote artists to their directly licensed service partners, such as Spotify. As Ms. Fowler's testimony makes clear: Sony Music spends a substantial amount of time and effort working with its directly licensed partners to see Sony Music's repertoire featured in playlists and editorial content, which in turn drives streams. Hr'g Ex. SX-7 ¶¶ 12-13, 15 (Fowler WRT). Even Mr. Poleman—who is on the receiving end of promotion from the record labels as related

to iHeart's terrestrial radio stations—acknowledged that recorded music companies digital marketing departments promote to on-demand services like Spotify. Hr'g Tr. 5204:23-5205:1 (May 21, 2015) (Poleman).

1170. In contrast, recorded music companies do not spend time and energy marketing and promoting, or even advertising to services like Pandora. As Ms. Fowler testified:

> "If anything, consumption of music on statutory services reduces users' interest in or desire for subscribing to higher-ARPU interactive services. I am not aware of any marketplace evidence showing that the use of statutory services promotes users to sign up for on-demand subscription services. In the music-access world, the substitution of statutory services for directly licensed subscription services undermines one of our most important sources of revenue generation."

Hr'g Ex. SX-7 ¶ 6 (Fowler WRT). Furthermore, Sony Music has seen lackluster success in paid advertisements on Pandora—a mere [ ]—especially as compared to other services with which Sony Music partners such as Shazaam. Hr'g Ex. SX-7 ¶ 10 (Fowler WRT).

1171. "Promotion" as traditionally understood is inconsistent with a customized, personalized, algorithm service. Record labels understand—as the public understands—that Pandora's algorithm, not tastemakers (whether they be DJs on terrestrial radio or playlist creators on digital services) dictates how often songs are played and to whom. Hr'g Ex. SX-7 ¶ 9 (Fowler WRT). In Sony Music's experience, even Pandora's purported promotional programs drive streaming and consumption *on the Pandora* platform, not on other higher revenue generating platforms for the music industry. Hr'g Ex. SX-7 ¶ 6 (Fowler WRT). As Ms. Fowler testified during the hearing, Sony Music tried a Pandora Presents concert series with a prominent artist, Jack White, and were disappointed by the results:

[

Hr'g Tr. 6995:10-6996:17 (June 1, 2015) (Fowler).

1172. Charlie Walk, whose testimony iHeart offered by deposition, does not believe that Pandora is promotional:

Hr'g Ex. Walk Deposition at 147:10-15, 149:24-150:5 (Walk Deposition).

b. *Statutory Webcasters Are Not A Part of the Typical Marketing and Promotion Plan*

1173. Of the numerous marketing and promotion plans in evidence, with hundreds of pages of marketing and promotional efforts—targeting terrestrial radio, directly licensed partners, live events, television and other publicity—only scattered references are to webcasters. Those that are usually refer to an iHeartRadio promotional appearance or digital promotion. In total, however, the overwhelming share of marketing and promotional efforts are not directed to statutory webcasting services, and not to Pandora in particular. And for Sony Music, at least [ ]. Hr'g Tr. 6997:6-11 (June 1, 2015) (Fowler); Hr'g Tr. 7045:2-5 (June 1, 2015) (Burruss) ("Q: When you're working to create a marketing plan, does internet simulcast ever come up in the marketing? A: No, it does not").

1174. It is further true that artists and sound recordings have "broken" without substantial terrestrial (or webcasting) airplay:

> Many Columbia releases have "broken"—i.e., have come to public attention—without significant radio airplay. Some recent examples include Beyoncé's December 2013 release of *Beyoncé*, announced by her on Facebook and simultaneously made available for download through the iTunes Store; J. Cole's promotion of his December 2014 release, *2014 Forest Hills Drive*, through Twitter and interviews with the press and others; the various Glee albums and individual tracks, for which the successful television show led to the sale of tens of millions of downloads; Barbara Streisand's latest album *Partners*, driven in part by her appearance on the Jimmy Fallon Tonight Show; Tony Bennett *Duets 1*, due to, among other things, an NBC special featuring his music; and Jackie Evancho, after gaining attention as contestant on America's Got Talent. Beyoncé and J.Cole received significant radio airplay after their releases, but otherwise none of these examples received significant radio airplay before or after release.

Hr'g Ex. SX-4 ¶ 10 (Burruss WRT). It is simply the reality of the music industry that multiple efforts come together to achieve success for any given artist or release—there is no single form of "promotion."

c. *Participation in AIP, On the Verge, DAIP Promotional Programs Proves Statutory Performances Are Not Promotional*

1175. Participation in special promotional programs like AIP, On the Verge, and DAIP that advertise the song and provide a "where to purchase" message prove that the typical statutory performance is not promotional. As Mr. Burruss testified, Columbia Records spends no resources to promote its artists to DAIP: "A: Again, we do not have any resources dedicated to DAIP. We only concentrate our efforts on terrestrial radio." Hr'g Tr. 7050:6-11 (June 1, 2015) (Burruss). Nonetheless, these programs are advertisements that provide promotional value above and beyond the content because they explicitly involve a call to action to purchase.

1176. Importantly, none of these programs were developed at the request of the recorded music industry—they were rather tools developed by iHeartRadio to improve industry relations:

> DAIP was a program that was presented to us to be able to help promote and market music for iHeart through a program that they created. We did it as a favor. We wanted to be able to give them the opportunity to play great music, to give them great music. It's a very simple thing that we do. To submit it seemed very nominal to spend a few minutes a month to be able to support it.

Hr'g Tr. 7066:9-16 (June 1, 2015) (Burruss). Apparently, these programs were also designed to create royalty-free use of record company content; that is something that Columbia Records, at least, did not realize were royalty-free. Hr'g Tr. 7066:21-24 (June 1, 2015) (Burruss). In any event, iHeart's insistence on the promotional value of its promotional programs speaks only to the contrast between these programs—which are advertisements—and the straightforward

performance of a sound recording pursuant to the statutory license. Only the latter is the subject of this proceeding, and that does not involve any royalty waiver.

d. *Promotion to Terrestrial Radio Is Irrelevant to Determining Promotional/Substitutional Effect of Statutory Services*

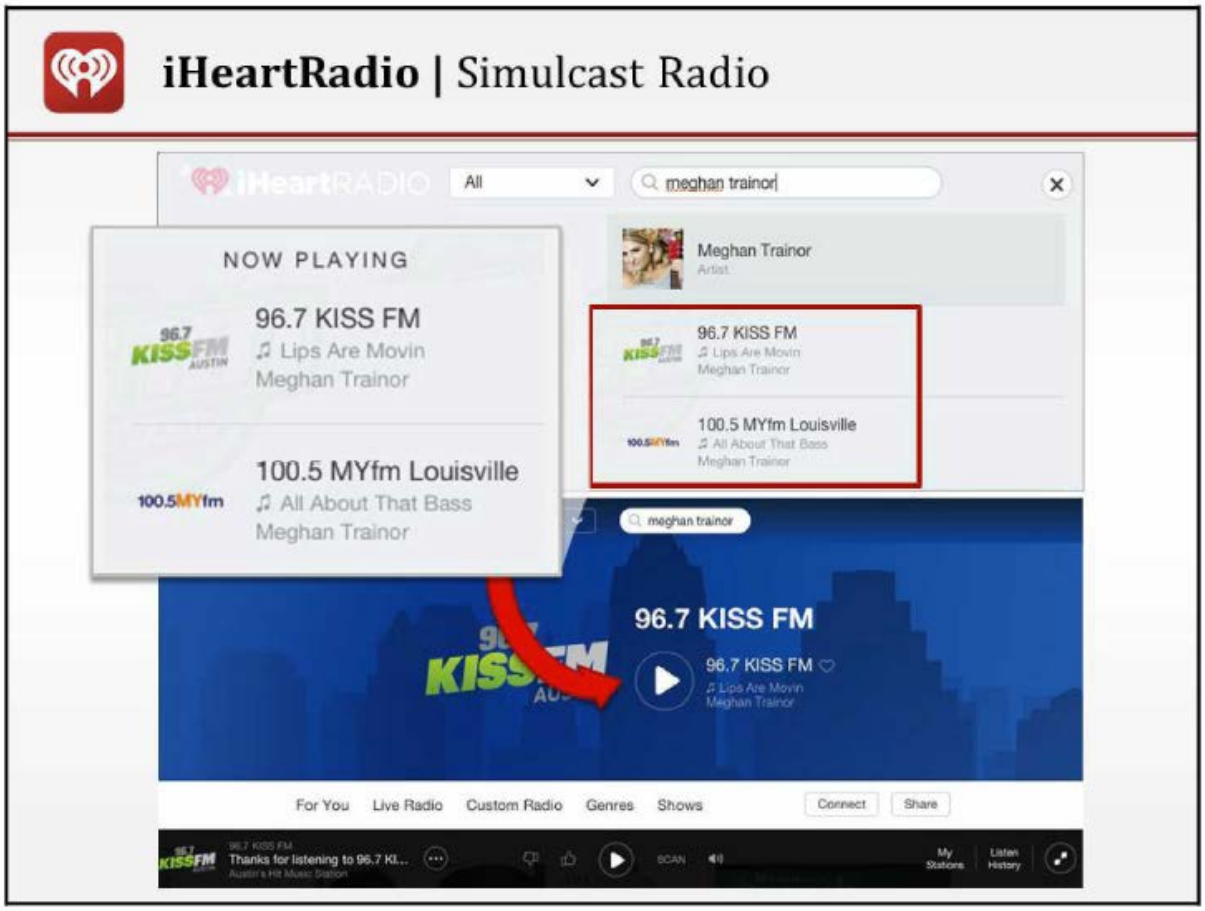
1177. Terrestrial radio promotion is unique in that it originates from a legal anomaly that denies artists a performance right in their work when it is broadcast over terrestrial airwaves. Hr'g Ex. SX-4 ¶ 8 (Burruss WRT). As a result, the music industry uses its promotional staff to ensure that sound recordings played over the airwaves are those record label priorities.

1178. The Services'—in this case, iHeart and NAB—argue that *simulcast* is promotional because simulcast purportedly has identical content to that on terrestrial radio. That is not correct. As explained fully in Section X.B.1, *supra*, simulcast services are fundamentally different from terrestrial radio along a number of dimentions.

1179. iHeart witnesses testified that their Song Exchange technology means iHeartRadio simulcasts *do not* play the same content as iHeart's terrestrial radio stations. Hr'g Tr. 3662:16-21 (May 13, 2015) (Littlejohn). iHeart's Song Exchange program is currently functional on its simulcast stations, operating pursuant to the statutory license. If iHeart's definition of simulcast is accepted, up to 49% of all content on simulcast stations could be different than what is broadcast over terrestrial radio. Furthermore, as demonstrated during Mr. Dimick's testimony, a service like TuneIn permits pausing, skipping, and recording of simulcast streams so they can be played back out of sync with terrestrial programming. Hr'g Tr. 5842-5851 (May 26, 2015) (Dimick).

1180. Of course, beyond the content, simulcast streaming services are different user experiences. Unlike terrestrial radio, there is no geographic restriction, which means that any user has hundreds of simulcast stations available to search and stream as compared to the few

terrestrial radio stations of that format broadcast in their geographic region. Likewise, "a user can search iHeart simulcast radio service by genre and/or geographic area and all simulcast stations responsive to that search will appear to that user along with the songs currently being played on those stations. The user can then immediately listen to that song." Hr'g Ex. SX-27 at 44 (Kooker WRT).



This stands in stark contrast to terrestrial radio stations. Whereas a user can with some degree of predictability find popular artists and tracks by searching the simulcast functionality, those same artists—even in top demand—are being played only a small fraction of the time on terrestrial radio. Hr'g Ex. SX-27 at 7 n.4 (Kooker WRT); Hr'g Ex. SX-4 ¶ 15 (Burruss WRT). This makes

simulcast much less like terrestrial radio and much more like a digital streaming service. Hr'g Ex. SX-27 at 6 (Kooker WRT).

e. ***The Services Incorrectly Asserted that the Record Companies' Internal Documents Showed that they Believe Statutory Webcasting Is Promotional, but Services Were Selective in the Documents they Cited, and the Documents Themselves Were at Most Outdated and/or Inconclusive***

1181. During cross-examination of record company witnesses and through the testimony of their experts, the Services occasionally suggested that the companies' internal documents showed that they believed statutory webcasting had a significant effect on record sales.

1182. Those experts who have actually reviewed the record determine that internal company documents show a mixed picture regarding the promotional/substitutional effects of streaming services. Ms. Butler reported: "In terms of the market research, it's a really a very mixed bag, if you will. There are lots of different studies done for lots of different reasons." Hr'g Tr. 6762:1-8 (May 29, 2015) (Butler).

1183. Prof. Shapiro also admits that the record is mixed as to whether any distinction can be drawn between the promotional/substitutional impact of non-interactive and interactive services: ["[redacted]"]. Hr'g Tr. 2715:19-21 (May 8, 2015) (Shapiro). He further admits that he did not have sufficient information to analyze the very few internal record company documents that he has found on this point:

[redacted]

Hr'g Tr. 2720:15-23 (May 8, 2015) (Shapiro).

1184. Nonetheless, the Services pluck select documents out of context to try to disprove the clear market trends and licensing strategies of the recorded music companies. For example, the Services focus on Pandora Exhibit 5027, a [ ]. Hr'g Tr. 559:5-560:8 (April 28, 2015) (Kooker). As Mr. Kooker explained, [ ]. Hr'g Tr. 560:9-24 (April 28, 2015) (Kooker). Likewise, the services focus on a particular [ ]. Hr'g Ex. PAN 5046. [ ] Hr'g Tr. 1182:23- 1183:7 (April 30, 2015) (Harrison). Of course, to the extent that either of these documents address the issue of promotion/substitution, it is in the context of digital downloads and CDs. Neither speaks to the impact that non-interactive services are having on paid subscriptions.

1185. Of course, other documents tell the opposite story. For example, an internal Sony [ ] from May 2014 shows the substitution that Pandora has on download sales.

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Hr'g Ex. SX-2077 at 17. This deck shows that Pandora, much more than Spotify [ ]. *Id.*

1186. That experts on both sides reviewed the internal record company documents and found no clear trend is telling. This is a rapidly evolving industry and opinions, particularly with regard to a changing issue such as promotion/substitution, are likely to equally rapidly evolve.

XIV. THE FINANCES AND PROFITABILITY OF THE WEBCASTING MARKET

A. The Short-Term Profitability Of A Webcaster Or Of The Webcasting Industry Does Not Determine The Appropriate Royalty Rate

1187. The Judges are tasked with "establish[ing] rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a

willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). "Rate-setting proceedings under section 114 of the Act are not the same as public utility rate proceedings." *Web III Remand*, 79 Fed. Reg. 23102, 23107 (Apr. 25, 2014). Accordingly, the Judges are "not to identify the buyers' reasonable other (non-royalty) costs and decide upon a level of return (normal profit) sufficient to attract capital to the buyers." *Id.*

1188. In addition, the evidence in the record, including testimony by experts in economics, establishes that "the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller," 17 U.S.C. § 114(f)(2)(B), cannot be discovered by studying the current or short-term profitability (or unprofitability) of any webcaster or of the webcasting industry. This evidence, which is described below, has not been challenged or contradicted by any evidence offered by the Services.

1189. Prof. Lys testified that "[f]rom the standpoint of economics, a company's ability to pay royalties while still remaining profitable and the 'willing buyer/willing seller' standard are two very distinct concepts." Hr'g Ex. SX-28 ¶ 103 (Lys WRT). Prof. Lys explained that "[a] company's 'ability to pay,' while still remaining profitable in the short term, is a static analysis driven by that firm's observed financial performance." "By contrast," according to Prof. Lys, "the price that would be set between a willing buyer and a willing seller represents a dynamic market-based determination." *Id.*

1190. To illustrate this economic principle, Prof. Lys used the example of an airline that experiences an increase in fuel costs:

> Consider an airline that charges $100 per ticket and incurs $98 per ticket in costs. A static analysis of that airline's ability to pay would suggest that it could not afford to pay an additional $2 per ticket in fuel costs while still remaining profitable. But this analysis, which focuses only on current profitability, ignores many important factors. For instance, the airline may have been offering

> low priced fares to attract new business and, as a result, may be able to raise its prices to compensate for its increased costs. Similarly, the increase in fuel costs could force an inefficient rival airline out of the market, which would increase demand for the airline's tickets and allow it to increase its prices.

Hr'g Ex. SX-28 ¶ 104 (Lys WRT).

1191. Prof. Lys connected this economic principle to the webcasting industry: "In economic terms, it does not make sense to analyze a webcaster's ability to pay royalties and remain profitable by examining a fixed market equilibrium. Doing so will only provide a result for *that specific equilibrium.* But changes to the royalty rate *change the equilibrium.*" Hr'g Ex. SX-28 ¶ 105 (Lys WRT). Using the example of Pandora, Prof. Lys noted that a change in the royalty rate would likely result in Pandora adjusting its advertising or subscription rates or would result in its less-efficient competitors exiting the market. This adjustment would result in a new equilibrium.

1192. Prof. Lys provided further real-world evidence of the disconnect between market-based pricing and webcaster profitability. He noted that the prices of "other cost inputs, whose levels are also determined in the marketplace, are agnostic as to the financial position of the buyer." Hr'g Ex. SX-28 ¶ 106 (Lys WRT). For example, "in an open market, a webcaster could not seek lower prices for servers or for network bandwidth based on its current profitability." *Id*.

1193. Pandora's Chief Financial Officer, Michael Herring, also recognized the fundamental disconnect between the willing buyer–willing seller standard and a webcaster's ability to pay. Mr. Herring testified:

> The Judges are not, as I understand it, tasked with determining the rate any particular party theoretically could pay and remain in business. The rate that Pandora is theoretically *capable* of paying is simply not informative to the Judges of the rates at which Pandora would be a 'willing buyer' of statutory sound recording performance rights.

Hr'g Ex. PAN 5016 ¶ 4 (Herring AWRT).

B. Because Webcasters Are Oriented Towards Future Profits, Focusing On Current Profits Provides An Incomplete And Misleading Picture of Webcaster Finances

1194. Undisputed evidence establishes that webcasters, like many firms, face a tradeoff between current profits and future profits. Because webcasters have resolved that tradeoff by prioritizing growth and future profits over current or short-run profits, focusing on current or short term profitability will provide a particularly misleading picture of webcasters' ability to pay royalties.

1195. Prof. Marc Rysman noted that "[f]irms must often choose between current profits and future profits." Hr'g Ex. SX-18 ¶ 11 (Rysman WRT). "Investments in future profitability can take many forms." *Id.* ¶ 12. For example, "selling at a loss today can be an investment in future profitability." *Id.* As Prof. Rysman noted: "selling at a loss in the short run can make sense if it leads to increased profits in the long run." *Id.*

1196. Other witnesses provided similar testimony. Dr. Peterson, an expert witness for NAB and Pandora, noted: "[w]hen actions today affect profitability in the future, firms may not maximize profits in the current period because doing so is too costly in terms of future profits." Hr'g Ex. NAB 4013 ¶ 75 (Peterson WRT). During cross-examination, Prof. Katz acknowledged the same principle: "If you are asking me, is it rational strategy for Internet firms to potentially run losses in the short run while they're building bases in the future, the answer is yes." Hr'g Tr. 3117:9-12 (May 12, 2015) (Katz). Similarly, Prof. Lys noted that "[c]ompanies electing to focus on growth do so with the conscious understanding that profits can often take a long time to arrive." Hr'g Ex. SX-28 ¶ 106 (Lys WRT). And Dr. Blackburn noted that a "firm's investment decisions will incorporate current and future profits, and it may be maximizing value even when it incurs short-run losses." Hr'g Ex. SX-3 ¶ 58 (Blackburn WDT).

1197. Given the tradeoff between current and future profits, if industry participants are oriented towards growth, market leadership, and future profits, "[a] rate setting approach centered on current profits would fail to account for webcasters' willingness to invest in their growth and scale by accepting rates that may result in current or short-run losses or modest profits." Hr'g Ex. SX-18 ¶ 10 (Rysman WRT). Similarly, Prof. Lys testified that "[i]n growth industries, it is particularly misleading to try to infer the market price for an input by focusing on the current or past profitability of market participants." Hr'g Ex. SX-28 ¶ 106 (Lys WRT).

1198. "Based on the observed behavior of certain webcasters as well as their public statements," Prof. Rysman concluded that "certain firms in [the webcasting] industry have, in fact, engaged in high-growth strategies that focus on future profits and growth at the expense of current profits." Hr'g Ex. SX-18 ¶ 9 (Rysman WRT).

1199. For instance, Prof. Rysman quoted an internal strategy presentation that described iHeartMedia's webcasting strategy as follows: [ ] As Prof. Rysman noted, iHeartMedia has followed through on this [ ] by offering its listeners a customized radio service that is similar to Pandora but that does not have commercial interruptions. Hr'g Ex. SX-18 ¶ 80 (Rysman WRT).

1200. "Songza is another example of a webcaster oriented to future profits." Hr'g Ex. SX-18 ¶ 81 (Rysman WRT). As with iHeartRadio, Songza plays no advertisements between song tracks. *Id.* As Prof. Rysman noted: "Songza's strategy appears to have paid off, as it was acquired by Google in July 2014." *Id.*

1201. Pandora has also focused on its long term growth rather than its present profits. In this proceeding, Michael Herring acknowledged this strategy:

> Q. You agree that Pandora is not necessarily attempting to maximize the profitability in its current quarter, right?
>
> A. That's correct.
>
> Q. And, in fact, you're focused on what you call future profits, right?
>
> A. Yes.

Hr'g Tr. 3418:25- 3419:6 (May 13, 2015) (Herring).

1202. Prof. Rysman relied on a number of similar public statements made by Pandora executives that acknowledge this strategy. Hr'g Ex. SX-18 ¶ 82 (Rysman WRT). For example, in 2014, Michael Herring stated during a Pandora earnings call: "[w]hile we think it is important to continue to improve margins and maintain profitability, now is not the time to optimize either, but rather maximize the potential for long-term growth." *Id.* (quoting Hr'g Ex. SX-160 at 7). Similarly, in 2013 Pandora stated: "Given our substantial market opportunity, our bias is revenue and market share growth over profitability at this time." *Id.*

1203. Pandora's financial reports have also acknowledged its strategy to focus on future growth at the expense of current profits:

> [W]e expect to invest heavily in our operations to support anticipated future growth. As a result of these factors, we expect to incur annual net losses on a U.S. GAAP basis in the near term.

Hr'g Ex. SX-159 at 17 (Pandora Form 10-K for 2013).

> A key element of our strategy is to increase the number of listeners and listener hours to increase our industry penetration, including the number of listener hours on mobile and other connected devices. … In addition, we have adopted a strategy to invest in our operations in advance of, and to drive, future revenue growth.

Hr'g Ex. SX-158 at 19 (Pandora Form 10-K for 2014).

1204. Prof. Lys relied on these reports, Pandora's public statements, and other information to conclude that "Pandora made a voluntary decision to adopt a business strategy aimed at rapid growth." Hr'g Ex. SX-28 ¶¶ 19-25 (Lys WRT).

1205. Simulcasters are also focused on future profitability. Lincoln Financial Media Company's [ ] When cross-examined about this document, John Dimick of Lincoln acknowledged that having a digital presence, including streaming, "helps Lincoln meet its needs." Hr'g Tr. 5861:9 – 5861:22 (May 26, 2015) (Dimick). Mr. Dimick also agreed that Lincoln's motivation for streaming is that its "audience and [its] advertisers are moving online, and Lincoln wants to keep up." *Id.*

1206. Mr. Dimick's testimony further shows that Lincoln Financial Media Company is focused on future profits. In response to a question from the Judges regarding why Lincoln Financial Media Company streams if streaming is, in fact, currently unprofitable, John Dimick explained that Lincoln Financial Media Company is focusing on future profits:

> Q. What's the economic incentive to do that for eight years? If you're losing money chronically, you're certainly not making it up on volume.
>
> A. No, no. Really it's, you know, kind of – one of the things that we do is try to skate to where the puck is going to be.
>
> And so, you know, trying to be in all places, the same with HD, is to have our services there where listeners might find us.
>
> So – because they start moving over to streams, you know, we want to be there like everybody else, like our competitors.
>
> . . . .

> Q. And you're hoping that loss gets offset down the road when the market finally takes off?
>
> A. Yes, sir.

Hr'g Tr. 5836:13 – 5838:24 (May 26, 2015) (Dimick).

1207. Prof. Rysman explained why it is rational for webcasters to sacrifice current profitability in exchange for the possibility of future profits. Hr'g Ex. SX-18 ¶¶ 50-76, 86 (Rysman WRT). The webcasting industry exhibits certain features that favor scale and market leadership, including network effects, economies of scale, and seller learning. Hr'g Ex. SX-18 ¶ 86 (Rysman WRT). Given these factors, it is economically rational for a webcaster to adopt a strategy focusing on long-run profitability at the expense of short-run profits. *Id.*

1208. Based on the observed behavior of webcasters and their strong incentives to focus on growth and future profits over current profits, Prof. Rysman concluded that "a rate setting approach that focuses on current profits ignores a fundamental feature of the webcasting industry—the fact that industry participants are oriented towards growth, market leadership, and future profits and not towards short-term profitability." Hr'g Ex. SX-18 ¶¶ 10, 87 (Rysman WRT).

C. Focusing On The Standalone Profitability Of Webcasting Ignores The Overall Value Of Webcasting

1209. In *Web III*, the Judges rejected Dr. Fratrik's analysis of Live365's webcasting costs because Dr. Fratrik failed to "address the *synergistic* nature of Live365's various lines of business." *Web III*, 79 Fed. Reg. 23102, 23108 (emphasis added). By focusing on standalone webcasting profits, the Services make the same misstep here.

1210. Prof. Lys testified that focusing only on the standalone profitability of music streaming "fails to account for the value music brings to . . . companies' larger platforms." Hr'g Ex. SX-28 ¶ 134 (Lys WRT). Prof. Lys noted that companies may operate break-even or

unprofitable digital music services to support other aspects of their business. *Id.* This suggests that these companies "value music's contribution to their platforms in an amount *greater than* the royalty rates." *Id.*

1211. Prof. Rysman also explained how including music streaming services as part of a larger Internet platform can lead to synergistic effects:

> Inclusion in a larger portfolio of Internet services is one way Internet media companies generate revenue. Inclusion creates several benefits for both the larger Internet company and the webcaster. For consumers, they can log into a single account and obtain access to a range of services, such as their e-mail, calendar and music selections. For the larger Internet company, consumers that value a single point of access to these services will be more likely to consume each individual service from that company. This phenomenon contributes to lock-in of the consumer with regard to individual services. It is possible that the larger Internet company can now learn more about the individual. For instance, if the company observes shopping behavior, it could combine that data with music listening behavior to sell more valuable advertisements in both services. Additionally, the larger company may benefit from sales of associated hardware. For the music service, inclusion further creates value by driving consumers to the music service, and increasing the ubiquity of the music service. Thus, the music service provides value as part of a larger "Internet ecosystem."

Hr'g Ex. SX-18 ¶ 47 (Rysman WRT).

1212. The testimony of David Pakman, an expert witness for NAB and iHeartRadio, shows that it is misleading to consider the standalone profitability of webcasting. Mr. Pakman acknowledged that "large companies like Google and Amazon seem to be willing to operate break-even or unprofitable digital music services because their other companion businesses are wildly profitable and subsidize the music service." Hr'g Ex. IHM 3216 ¶ 28 (Pakman WDT). According to Mr. Pakman, these services are willing to "subsidize" streaming "*in order to make profit elsewhere* on other related businesses." *Id.* (emphasis added). In response to questioning

by the Judges, Mr. Pakman acknowledged the synergistic nature of these companies' lines of business:

> Q. You refer to it as subsidizing the poor economics, but another spin on that certainly would be that they're willing to invest in the noninteractive space, right, in order to get greater returns on other lines of business that they have so it becomes a net positive return on investment or so they would project, which is why they go into it. Isn't that just another form of investment?
>
> A. I believe that their willingness to operate unprofitable businesses is because it provides them some benefit in some other part of their company for sure.

Hr'g Tr. 6242:8-20 (May, 27, 2015) (Pakman).

1213. Streaming has an accretive effect on broadcasters' other lines of business. Prof. Lys testified:

> [T]he testimonies [of NAB witnesses] . . . indicate that the profitability of terrestrial radio's simulcasting activities should not be considered on a "stand-alone" basis. The NAB's witnesses appear to be ignoring the full value being created by streaming sound recordings. For example, John Dimick, a witness for Lincoln Financial Media Company ("LFMC") noted that "[p]art of the value we provide as a broadcaster is enabling our listeners to hear our programming in the car, at work, in their home, and wherever else they may be." Yet these benefits are not accounted for in Mr. Dimick's computations.

Hr'g Ex. SX-28 ¶ 218 (Lys WRT) (quoting Hr'g Ex. NAB 4002 ¶ 14 (Dimick WDT)).

1214. Mr. Dimick reported financial numbers for certain Lincoln stations that appeared to indicate that those stations were streaming at a loss. Hr'g Ex. NAB 4002 ¶ 27 (Dimick WDT). [For 2014, [redacted]] *Id.* However, Mr. Dimick admitted that although Lincoln's simulcast listeners hear the same commercials as Lincoln's terrestrial listeners, the financial numbers he provided did not include *any* of the revenue earned from such commercials. Hr'g Tr. 5863:10 – 5864:2 (May 26, 2015) (Dimick). In addition, this is despite the fact that roughly 1%

to 2% of Lincoln Financial's listeners actually come from its simulcast service. *Id.* at 5864:20 – 5865:5.

1215. By way of example, Mr. Dimick estimated that Lincoln Financial's revenues in 2014 were approximately [Hr'g Tr. 5874:22 – 5875:3 (May 26, 2015) (Dimick). Given that Mr. Dimick reported streaming losses in [,] if even just one percent of this [ )] were allocated to streaming, it would materially alter the financial numbers reported by Mr. Dimick.

1216. In sum, the evidence shows that it is misleading to consider the standalone profitability of webcasting without considering the value webcasting generates for a company's other lines of business.

D. In Any Event, Webcasters, Including Pandora, Can Afford SoundExchange's Rate Proposal

1217. After analyzing Pandora's public statements, its internal projections, and independent analyst research, Prof. Lys concluded that Pandora can afford higher royalty rates and can afford SoundExchange's rate proposal. Hr'g Ex. SX-28 ¶¶ 79-101 (Lys WRT).

1218. Prof. Lys testified that "public statements made to investors by company executives [are] an extremely valuable source of information." Hr'g Ex. SX-28 ¶ 15 n.10 (Lys WRT). This is because "[t]hese statements are made outside the context of an adversarial court proceeding where the executive may have an incentive to avoid volunteering certain information." *Id.* "Moreover, these statements are subject to S.E.C. regulations that require statements to be truthful and not misleading to investors." *Id.*

1219. Prof. Lys also concluded that it was reasonable to rely on analyst reports and noted that "[a]nalyst reports from reputable research firms are an extremely valuable source of

information, to be evaluated along with other sources of data and information, such as company statements." Hr'g Ex. SX-28 ¶ 15 n.11 (Lys WRT).

1220. Prof. Shapiro testified that a company's internal course-of-business documents are valuable sources of information. Hr'g Tr. 2717:10-25 (May 8, 2015) (describing such documents as "the best stuff"). By contrast, "you have to read [documents created for litigation] a little more carefully." *Id.*

1221. In response to the suggestion that rates comparable to the *Web III* rates would be unsustainably high for Pandora, Prof. Lys demonstrated that Pandora believes that it can afford such rates. Hr'g Ex. SX-28 ¶¶ 80-82 (Lys WRT). Prof. Lys pointed out that a little over a month before he submitted his written direct testimony in this matter, Michael Herring made the following statement to investors regarding this proceeding:

> I think the worst case scenario is [the Copyright Royalty Board's rates] go up by like 50% or something. That would be not great for us, but because the business model is so good, *I don't think it would be a problem.*

Hr'g Ex. SX-28 ¶ 81(Lys WRT) (quoting Hr'g Ex. SX-161 at 8) (emphasis added)."

1222. Prof. Lys conservatively assumed that Mr. Herring was referencing the lower Pureplay rates and not the rates established by the Judges in *Web III*. Hr'g Ex. SX-28 ¶ 82 (Lys WRT); Hr'g Tr. 6665:15-6666:17 (May 29, 2015) (Lys). And because Mr. Herring made his statement in September 2014, Prof. Lys assumed that Mr. Herring was referencing the lower 2014 Pureplay rate and not the 2015 Pureplay rate. Hr'g Ex. SX-28 ¶ 82 (Lys WRT); Hr'g Tr. 6665:15-6666:17 (May 29, 2015) (Lys). Prof. Lys then performed the following analysis:

> Pandora paid $0.00130 per advertising-supported performance in 2014. As such, the 50% increase described by Mr. Herring would result in a rate of $0.00195 per advertising-supported performance. This calculated rate is plainly comparable to the *Web III* rates, which range from $0.00190 per performance at the beginning of the period to $0.00230 per performance in 2014.

Hr'g Ex. SX-28 ¶ 82 (Lys WRT).

1223. Thus, Prof. Lys's analysis of Pandora CFO Michael Herring's recent public statements to investors demonstrates that a royalty rate of "$0.00195 'wouldn't be a problem'" for Pandora. Hr'g Ex. SX-28 ¶ 82 (Lys WRT).

1224. Prof. Lys also performed an analysis of Pandora's projected gross margin under SoundExchange's rate proposal and under Pandora's rate proposal. Hr'g Ex. SX-28 ¶¶ 84-96 (Lys WRT). That analysis confirms that Pandora can afford SoundExchange's rate proposal. *Id.*; Hr'g Tr. 6683:4-6684:6 (May 29, 2015) (Lys).

1225. Prof. Lys explained that Pandora's gross margin is driven by two key variables—"RPM" and "LPM"— that are tracked and reported by Pandora. Hr'g Ex. SX-28 ¶ 84 (Lys WRT); Hr'g Tr. 6668:10-20 (May 29, 2015) (Lys). RPM represents the revenue Pandora earns for every thousand listening hours. Hr'g Ex. SX-28 ¶ 84 (Lys WRT). LPM represents Pandora's content costs per thousand listening hours. *Id.*; Hr'g Tr. 6668:10-20 (May 29, 2015) (Lys). Sound recording royalties are 91% of LPM for Pandora. Hr'g Ex. SX-28 ¶ 90 (Lys WRT).

1226. With respect to RPM, Prof. Lys concluded that Pandora will achieve an RPM of $60 early in the next period. Hr'g Ex. SX-28 ¶ 85 (Lys WRT).

1227. Prof. Lys's conclusion that Pandora will achieve an RPM of $60 was based on Pandora's public statements, its internal projections, and analyst research. Hr'g Ex. SX-28 ¶ 85 (Lys WRT).

1228. During the last quarter of 2014, Pandora achieved an RPM of $48.19. Hr'g Ex. SX-28 ¶ 16 (Lys WRT). Pandora's RPM has grown, on average, approximately 10% each year since 2011. *Id.* ¶ 51. Mr. Herring explained in September 2014 that Pandora is within "striking distance" of an RPM of $60 and that some of Pandora's business is already north of $60 RPM.

Id. ¶ 64 (quoting Hr'g Ex. SX-161 at 10). In this proceeding, Mr. Herring noted that Pandora has achieved an RPM of $75 in the San Francisco market for desktop listeners. Hr'g Ex. PAN 5016 ¶ 47 (Herring AWRT). Mr. Herring expects "that favorable metric to extend to additional markets" over time. *Id.*

1229. In addition to relying on Pandora's public statements, Prof. Lys relied on the RPM projections from Morgan Stanley's analyst report. Hr'g Ex. SX-28 ¶ 64 (Lys WRT). Prof. Lys used the Morgan Stanley report only after ensuring that it was more conservative than the consensus estimates of all analysts. *Id.* at App. C ¶¶ 259-262. Morgan Stanley projects that Pandora will achieve an RPM of $59.37 in 2016 and an RPM of $73.78 by 2018.

1230. [ ]

1231. In sum, Prof. Lys relied on a variety of sources to ensure that it is reasonable to conclude that Pandora will achieve an RPM of $60 early in the next rate period. Prof. Lys's analysis on this point is undisputed. The Services have not provided any evidence to suggest that Prof. Lys is incorrect regarding Pandora's expected RPM.

1232. With respect to LPM, Prof. Lys derived the relationship between the per-performance rate and Pandora's LPM. Hr'g Ex. SX-28 App. E (Lys WRT). In particular, Prof. Lys calculated that Pandora's LPM would be $39.12 under SoundExchange's rate proposal of $.0025 per performance for 2016. *Id.* ¶ 91, Figure 25.

1233. Prof. Lys testified that based on an RPM of $60 and a per-performance rate of .0025, Pandora would achieve a gross margin of 28.6%. Hr'g Ex. SX-28 ¶ 95, Figure 28 (Lys WRT). By contrast, under Pandora's own rate proposal, it would achieve a gross margin of 61.8% at an RPM of $60. *Id.* Prof. Lys also explained that as Pandora achieves higher RPMs, its gross margins will improve as well. *Id.* ¶ 94.

1234. Prof. Lys also testified that a gross margin of 29% would be in line with Netflix's gross margin of 31.8%. Hr'g Ex. SX-28 ¶ 96 (Lys WRT). According to Prof. Lys, Netflix is a relevant comparable company to Pandora because it is a public company and one that offers "online content distribution to end users for which it faces content acquisition costs." *Id.* ¶ 57.

1235. Prof. Lys also examined the effect of SoundExchange's rate proposal on Pandora's Earnings before Interest Taxes Depreciation and Amortization ("EBITDA"). The result of this analysis is inconsistent with the conclusion that Pandora cannot afford SoundExchange's rate proposal. Hr'g Tr. 6689:10-6690:5 (May 29, 2015) (Lys).

1236. Prof. Lys examined Pandora's EBITDA because "[EBITDA] gives you a measure of operating cash flows." Hr'g Tr. 6689:13-15 (May 29, 2015) (Lys). According to Prof. Lys, in deciding whether Pandora can afford SoundExchange's rate proposal "[t]here's no doubt" that "EBITDA is a much better measure." Hr'g Tr. 6756:15-22 (May 29, 2015) (Lys). Unlike EBITDA, net income "contains a lot of noncash items which have nothing to do with affordability." *Id.* And "net income is affected by many items that are not decision relevant."

Hr'g Tr. 6707:11-14 (May 29, 2015) (Lys). For instance, Prof. Lys testified that stock compensation is a significant *noncash* expense that is reflected in net income but is not a part of EBITDA:

> Q. Please take a look at the line that says "Stock-based compensation" below.
>
> A. Okay.
>
> Q. What is the stock-based compensation for Pandora for the year 2014?
>
> A. Yes, it's 87 million dollars.
>
> Q. Is stock-based compensation a cash expense?
>
> A. No, no. This is simply issuing stock options, mostly, to executives.
>
> Q. If you add back in the value of the stock options to the net loss line, what would be the result?
>
> A. That gets you into the positive 50 million dollar range immediately.

Hr'g Tr. 6747:23-6748:12 (May 29, 2015) (Lys).

1237. Prof. Lys analyzed Pandora's projected EBITDA by relying on two analyst reports. For the years 2016 through 2018, Prof. Lys relied on the Morgan Stanley report. Prof. Lys used the Morgan Stanley report only after ensuring that it was more conservative than the consensus estimates of all analysts. Hr'g Ex. SX-28 App. C ¶¶ 259-262 (Lys WRT). "Because the Morgan Stanley Report only provides a forecast through 2018," Prof. Lys supplemented his analysis for 2019 and 2020 with a forecast from Cowen and Company. Prof. Lys determined that it was reasonable to use the Cowen and Company report because the relevant growth figures in that report are "reasonable and consistent with the Morgan Stanley overall EBITDA growth assumptions." *Id.* at ¶¶ 100 n.115, 282.

1238. Prof. Lys's analysis showed that Pandora is expected to earn a quarter of a billion dollars in EBITDA over the next period under SoundExchange's rate proposal and over 3 billion dollars in EBITDA under its own rate proposal. Hr'g Ex. SX-28 ¶ 100 (Lys WRT).

1239. During cross-examination, Pandora attempted to show that Pandora would experience a loss on a net income basis over the next rate period under SoundExchange's rate proposal. As an initial matter, Prof. Lys testified that Pandora had incorrectly calculated net income for the last two years of the rate period. Hr'g Tr. 6719:19-6720:6 (May 29, 2015) (Lys).

1240. More fundamentally, Prof. Lys noted that an economist would not look at net income in order to evaluate a company. Hr'g Tr. 6746:22-6747:9 (May 29, 2015) (Lys). And Prof. Lys noted that net income includes noncash items that have nothing to do with affordability. *Id.* at 6756:15-22. As a result, a company can have a negative net income yet a positive cash flow. *Id.* at 6746:22-6747:9. Indeed, when Prof. Lys added stock awards (a noncash, discretionary item) back into net income, he showed that Pandora would be profitable over the next rate period under SoundExchange's rate proposal. *Id.* at 6753:13-6754:6.

1241. Simulcasters can also afford SoundExchange's rate proposal. In 2014, the rate applicable to broadcasters was .0023, and as of 2015 the applicable rate is .0025. 37 C.F.R. § 380.12(a). SoundExchange's rate proposal for the next rate period begins at .0025. Ben Downs confirmed that Bryan Broadcasting voluntarily chose to stream at the prevailing rates. According to Mr. Downs, streaming is nice to have, like "leather seats" in a car. Hr'g Tr. 5234:23-5235:10 (May 21, 2015) (Downs). Yet despite the fact that streaming is optional, Bryan Broadcasting has chosen to stream at the prevailing rates and has consistently added additional streaming stations over the last rate period. *Id.* at 5238:12-5239:4. Similarly, John Dimick

testified that Lincoln Financial Media Company does not have to stream and has made a choice to stream. Hr'g Tr. 5859:4-12 (May 26, 2015) (Dimick).

E. The Webcasting Industry Has Experienced Growth And Webcasters Show High Rates Of Survival

1242. Based on his analysis of public information and SoundExchange data, Dr. Blackburn concluded that there has been "consistent entry into music streaming in general and into statutory webcasting in particular in recent years." Hr'g Ex. SX-3 ¶ 17, 22 (Blackburn WDT). Spotify entered the webcasting market in July 2011. *Id.* ¶ 21, Table 1. Google entered in May 2013. *Id.* iTunes Radio entered in September 2013. *Id.* Beats Music entered in January 2014. *Id.* And Amazon Prime Music launched in June 2014. *Id.*

1243. Dr. Blackburn testified that, based on SoundExchange data, there were 1,781 statutory webcasters in 2010. Hr'g Ex. SX-3 ¶ 22 (Blackburn WDT). By 2013, the number had risen to 2,516. *Id.* "[I]n just three years, the number of webcasters grew by more than 40 percent." *Id.*

1244. Dr. Blackburn also concluded that survival rates are high in statutory webcasting. Hr'g Ex. SX-3 ¶ 25 (Blackburn WDT). Based on SoundExchange data, Dr. Blackburn determined that most firms that existed in 2010 at the start of the rate period are still statutory webcasters today. *Id.* ¶ 27, Table 3. Dr. Blackburn also noted that "the survival rates for statutory webcasters have generally been right in line with those of all business more generally." *Id.* ¶ 28.

1245. Dr. Peterson, a witness for NAB and Pandora, re-processed Dr. Blackburn's data to include only webcasters paying commercial rates. Dr. Peterson's re-analysis does not affect the substance of Dr. Blackburn's testimony. For instance, the survival rates calculated by Dr. Peterson are in line with the survival rates for all webcasters. Hr'g Tr. 1601:5-1603:5 (May 4,

2015) (Blackburn). As Dr. Blackburn concluded: "[w]hether you look at webcasters as a whole or you look at, sort of, a commercial statutory rate webcasters, . . . you don't really draw a very different conclusion." *Id.*

1246. Dr. Blackburn's analysis supports the conclusion that existing rates, including the NAB Settlement rates, are not unaffordable to webcasters. As Dr. Blackburn explained: "[i]f licensing rates were choking off growth, we would not likely see continued growth in the number of firms operating in the industry, or the historical success of firms to survive once they have entered." Hr'g Ex. SX-3 ¶ 27 (Blackburn WDT).

XV. THE MINIMUM FEE

A. SoundExchange Proposes That The Minimum Fee Remain At the Same Level

1247. SoundExchange proposes that all commercial webcasters pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee) subject to an annual cap of $50,000.00 for a licensee with 100 or more channels or stations. For each licensee, the annual minimum fee shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalties payable for the same calendar year. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Proposed Regulations, at 3 (Feb. 24, 2015).

1248. Similarly, with respect to noncommercial webcasters, SoundExchange proposes that all licensees (as defined in 37 C.F.R. § 380.2 of the proposed regulations) that are noncommercial webcasters (as defined in the same) pay an annual, nonrefundable minimum fee

of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee, if not covered by SoundExchange's proposed settlements with CBI and NPR). For each licensee, the annual minimum fee shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalty payable for the same calendar year. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Proposed Regulations, at 4-5 (Feb. 24, 2015).

1249. These proposals are essentially continuations of the prior levels of the statutorily-required minimum fee that has been in effect for more than 10 years: $500 per channel or station, subject to a $50,000 annual cap for commercial webcasters. They are also consistent with long-established past practice, would require no additional burden on webcasters than they have come to expect in the market, and would ensure that every licensee makes some contribution to the costs of administering the statutory license. Hr'g Ex. SX-02 at 15 (Bender WDT).

1250. No party has submitted a rate proposal calling for a different amount for the minimum fee for either commercial or noncommercial webcasters.

B. SoundExchange's Minimum Fee Proposal Ensures That Every Licensee Contributes To The Cost of Administering The Statutory License

1251. In past proceedings, one rationale for assessment of the minimum fee is that "it is reasonable and appropriate for the minimum fee to at least cover SoundExchange's administrative cost." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23124 (Apr. 25, 2014). Put another way, the minimum fee should ensure that every licensee makes an appropriate contribution to the costs of administering the statutory license. To set a "minimum fee significantly below SoundExchange's actual administrative costs, would provide a webcaster

with an unjustified free ride in terms of the cost of administering the license, because SoundExchange incurs the cost *regardless of the nature of the use of the sound recording*." Final Determination After Second Remand ("*Webcasting II Second Remand*"), 79 Fed. Reg. 64669, 64673 (Oct. 31, 2014) (footnotes omitted).

1252. The uncontroverted evidence in the record is that, based on 2013 figures, SoundExchange's average annual administrative cost per licensee of $11,778 and the average administrative cost per channel or station was approximately $1,900. Hr'g Ex. SX-2 at 17-18 (Bender WDT).

1253. Every single statement of account and every single report of use must go through the entire SoundExchange process described by Mr. Bender—the payments and statements of account must be reviewed, verified, and recorded; and the reports of use must likewise be reviewed, tested, logged, and loaded into the distribution engine. Any problems with paperwork or logs can introduce problems and cause delay. Hr'g Ex. SX-2 at 17-18 (Bender WDT). In fact, Mr. Bender testified that SoundExchange does not apply a size criterion in terms of the number of aggregate tuning hours ("ATH") to determine whether to process a report of use. Hr'g Tr. 2586:17-23 (May 8, 2015) (Bender).

1254. SoundExchange has never sought to collect all of its costs from minimum fee payments. Because $500 per station or channel does not recover all of SoundExchange's administrative costs, particularly if the minimum fee is understood to include some payment for usage of sound recordings, that level of payment represents a reasonable and justified contribution to the costs of administering the statutory license. Hr'g Ex. SX-2 at 19 (Bender WDT).

XVI. NONCOMMERCIAL WEBCASTERS

A. SoundExchange's Proposal For A $500 Annual Noncommercial Royalty Rate Is Reasonable And Consistent With Past Practice

1255. SoundExchange proposes that noncommercial webcasters operating under the statutory license pay an annual per-channel or per-station performance royalty of $500 for all digital audio transmissions totaling not more than 159,140 aggregate tuning hours (ATH) in a month. For digital audio transmissions totaling in excess of 159,140 ATH in a month, SoundExchange proposes that the noncommercial webcaster pay a royalty equivalent to the usage-based per-performance fee applicable to commercial webcasting. Here, that would be $0.0025 for 2016; $0.0026 for 2017; $0.0027 for 2018; $0.0028 for 2019; $0.0029 for 2020. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Proposed Regulations, at 3-4 (Feb. 24, 2015).

1256. SoundExchange's proposal is effectively a continuation of the same royalty applicable to noncommercial webcasters during the prior license period. Because the minimum fee proposed by SoundExchange is a credit against any applicable royalty, the effective result is that if a noncommercial webcaster does not exceed the monthly ATH threshold, the noncommercial webcaster only pays a royalty fee that is the equivalent of the minimum fee. Since 2011, a full 97% of the noncommercial webcasters who were subject to the $500 statutory minimum fee paid a royalty equivalent to *only* that minimum fee. Hr'g Ex. SX-2 at 14 (Bender WDT). Thus, for nearly all noncommercial webcasters, the royalty fee proposed by SoundExchange requires them to pay nothing more than the minimum fee that (a) has remained constant for nearly a decade; and (b) is required for statutory licensees even in the absence of any sound recording usage.

1257. At least with respect to noncommercial webcasters who do not exceed the monthly 159,140 ATH threshold, this proposed rate appears to be unopposed. No party has submitted a rate proposal that proposes a royalty rate lower (or higher) than $500 annually for noncommercial webcasters at this rate of usage.

B. The NRBNMLC's Proposal To Increase The ATH Threshold Is Unsupported By Evidence

1258. Like SoundExchange, the NRBNMLC proposes that the royalty rate applicable to noncommercial webcasters should be at least $500 annually per channel or per station. This proposed royalty rate, again like SoundExchange's, comports with NRBNMLC's proposal of a $500 annual minimum fee. *See NRBNMLC Rates and Terms Proposal*, at 3 (Oct. 7, 2014).

1259. The NRBNMLC's proposal, however, differs from SoundExchange's in three ways. First, NRBNMLC wants to assess the usage threshold on an annual basis (3,504,000 ATH annually), rather than the existing monthly basis threshold (159,140 ATH monthly). Second, NRBNMLC seeks an increase in the ATH usage threshold that would be covered by the $500 flat royalty fee, whether understood annually (an increase of 1,594,320 ATH a year) or monthly (an increase of 132,860 ATH a month). This would represent a drastic (45.5%) increase in sound recording usage that would be covered by the ATH threshold. Third, NRBNMLC seeks to alter the royalty rate applicable to digital audio transmissions by noncommercial webcasters in excess of the ATH usage threshold. Unlike past practice and SoundExchange's proposal (which would apply a per-performance rate equivalent to that applicable to commercial webcasting), NRBNMLC would apply additional tiers for royalty for increased usage that are capped at $1,500 annually for any station or channel. *See NRBNMLC Rates and Terms Proposal*, at 3 (Oct. 7, 2014).

1260. All of these differences concern the very small set of cases—roughly 3% of noncommercial webcasters—who may exceed the existing ATH threshold. In fact, NRBNMLC's introductory memorandum stated that it will present evidence that "the prevailing statutory rate structure" (which mirrors SoundExchange's proposal) "is unreasonable and inappropriate for noncommercial broadcasters exceeding the threshold." NRBNMLC Introductory Memorandum at 2 (Oct. 7, 2014).

1261. However, the evidence offered by NRBNMLC at the hearing, including the testimony of both of its witnesses, only concerned noncommercial webcasters who do not come close to approaching the prevailing 159,140 monthly ATH threshold, which translates to roughly 218 concurrent listeners per station or channel.

1262. NRBNMLC's first witness was Mr. Gene Henes of the Praise Network. The listenership on Praise Network stations does not come close to the prevailing ATH threshold. The digital listenership on two of Mr. Henes's stations averages 3-4 concurrent listeners, and on his largest radio group, Good News Radio, the listenership peaks out around 20 simultaneous listeners. Hr'g Tr. 5275:22-5276:7 (May 21, 2015) (Henes). Mr. Henes even described his data plan covering 100 simultaneous listeners as more than he would need. Hr'g Tr. 5276:16-5277:14 (May 21, 2015) (Henes). By his own admission, Mr. Henes has no experience with streams that have very large audiences, as his experience is limited to streams "with very low listener levels, not even close to 218" concurrent listeners. Hr'g Tr. 5279:4-20 (May 21, 2015) (Henes). There is nothing in Mr. Henes's testimony that speaks to noncommercial webcasters who exceed the prevailing ATH threshold.

1263. In fact, Mr. Henes's stations would be different than what he described in his testimony if he were able to grow a large digital audience beyond his local area. He testified that

to get digital listeners beyond his organization's "local broadcast area to listen," his organization "would have to lose [its] localness to the communities that are in [its] terrestrial signal." Hr'g Tr. 5266:1-4 (May 21, 2015) (Henes). Thus, evidence concerning Praise Network's current experience with digital streaming does not address the experience of noncommercial webcasters who exceed the prevailing ATH threshold.

1264. NRBNMLC's second witness was Mr. Joseph Emert of NewLife FM. On average, NewLife FM has fewer than 10 concurrent online listeners and tops out at its peak at 100 concurrent listeners. Hr'g Ex. NRBNMLC 7000 ¶ 29 (Emert WDT). In fact, Mr. Emert noted that he has persuaded other religious broadcasters to stream because "their listenership is very likely to be small enough" that they would pay only the flat fee. Hr'g Ex. NRBNMLC 7000 ¶¶ 32-33 (Emert WDT). Mr. Emert also made an unspecified reference to being aware of larger noncommercial webcasters, but then provided no testimony about how their behavior or finances were affected at that scale of listening. Hr'g Ex. NRBNMLC 7000 ¶ 34 (Emert WDT). Despite references to their "ministry," Mr. Emert failed to identify a single noncommercial religious broadcaster who exceeded the prevailing ATH threshold. Hr'g Ex. NRBNMLC 7000 ¶ 35 (Emert WDT).

1265. Furthermore, the notion that a tiered cap is necessary because the royalty costs of noncommercial webcasting are too high is not just unsupported by NRBNMLC evidence. It is contradicted by NRBNMLC's own witness testimony. Mr. Henes admitted that the annual royalty costs for all five of his Praise Network digital streaming stations ($2,500) is less than 1% of the Praise Network's total revenue, which exceeds a million dollars annually. Hr'g Tr. 5281:15-23 (May 21, 2015) (Henes).

Evidence from witnesses whose stations do not approach the usage threshold does not justify a drastic departure from the core principle of the prevailing noncommercial rate structure, which SoundExchange proposes continuing: The vast majority of noncommercial webcasters have such a low usage of music that they will pay a royalty rate equal to only the minimum fee. In the rare case where usage exceeds a commercially significant ATH threshold—one that has become customary in the webcasting industry—the noncommercial webcaster's overage should be subject to the same rates as other commercially significant webcasting entities.

XVII. PROPOSED TERMS AND REGULATIONS

1266. Section 114 requires that the Judges adopt terms to be applied to statutory licensees. In so doing, they are to be guided by the same willing buyer/willing seller standard that governs the establishment of rates. 17 U.S.C. § 114(f)(2)(B) (requiring Judges to establish "terms that would have been negotiated in the marketplace between a willing buyer and a willing seller"); *Webcasting II*, 72 Fed. Reg. at 24102. The Judges likewise have an "obligation to adopt royalty payment and distribution terms that are practical and efficient. Failure to so act would produce statutory licenses that are operationally chaotic and otherwise unusable, thereby frustrating the Congressional intention underlying their establishment." *Id.* at 24106.

A. SoundExchange's Proposed Terms

1267. SoundExchange submitted its Amended Proposed Rates and Terms, along with proposed regulations implementing its requested rates and terms, on February 24, 2015. In the interest of consistency and efficiency, SoundExchange has generally proposed continuing the

terms currently set forth in 37 C.F.R. § 380, Subpart A, subject to three revisions described below.[60]

1. Payment Term Reduced to 30 Days

1268. SoundExchange proposes that the current 45-day "monthly payment" requirement reflected in 37 C.F.R. § 380.4 be reduced to a 30-day requirement. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Section III.A, and Proposed Regulations, § 380.4(c) (Feb. 24, 2015). As part of the rulemaking proceeding currently pending before the Copyright Royalty Board, SoundExchange has separately proposed implementing the same 30-day term for reports of use. *Notice and Recordkeeping for Use of Sound Recordings Under Statutory License*, Docket No. 14-CRB-0005 (RM). Requiring the submission of these items together within 30 days "would improve the quality of the royalty collection and distribution process and promote further use of the license by new webcasting services." Hr'g Ex. SX-2 at 21 (Bender WDT).

1269. SoundExchange's proposal is supported by substantial market evidence. "[A] 30-day payment window tracks the agreed-upon terms of the vast majority of the private agreements entered into between content owners and service providers." Hr'g Ex. SX-14 ¶ 85 (Lys Corr. WDT). A full 89% of the agreements reviewed by Prof. Lys specified a 30-day payment term. Hr'g Ex. SX-14 at 11, Figure 4 (Lys Corr. WDT).

1270. SoundExchange's Chief Operating Officer, Jonathan Bender, testified that the current 45-day window exacerbates administrative delays and that a modest reduction in

[60] SoundExchange has also requested striking 37 C.F.R. § 380, Subpart B in its entirety given that SoundExchange opposes applying any separate rates and terms for broadcasters, as distinct from all other commercial webcasters. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Section IV (Feb. 24, 2015).

services' payment window would substantially expedite the distribution of payments to artists and copyright owners:

> Through efforts to improve our systems and processes, SoundExchange has introduced a new norm of monthly distributions. But, under the current 45-day payment period, SoundExchange receives most of its payments from services too late in the month to be able to ingest the reports, payments, and statements of account and perform all of the operations necessary to pay copyright holders and artists by the end of the month. This creates a time lag of an additional month. By revising the requirements for service payment within 30 days – a revision of only 15 days for the service provider – SoundExchange should be able to distribute more royalties to artists and copyright owners a full one month earlier. For the sake of clarity and explanation, if Service A owes royalties for its operations during the month of August, under the current regulations, their monthly payment, report of use, and statement of account would not be due until October 15. Those payments, reports, and statements come in too late for SoundExchange to process and distribute them before the end of October, and as a result, artists and copyright owners would typically have to wait until SoundExchange's distribution at the end of November. By making a modest revision to require payment of royalties, along with reports of use and statements of account, within 30 days, in this hypothetical, SoundExchange will be better able to include Service A's August royalties in the distribution of copyright owners and artists at the end of October.

Hr'g Ex. SX-2 at 20 (Bender WDT).

1271. Moreover, as Prof. Lys explained, "prompt payment is particularly crucial in the statutory context where content owners can neither seek advance payments to protect themselves against counterparty credit risk nor refuse to enter into agreements with risky counterparties." Hr'g Ex. SX-14 ¶ 88.

1272. The Services offered two witnesses who tried to justify maintaining a 45-day payment term that is out of step with the market norm: (1) iHeart CFO Jon Pederson, and (2) Pandora CFO Michael Herring.

1273. In an attempt to respond to the overwhelming market evidence that supports a 30-day payment term (Hr'g Ex. SX-14 at 11, Figure 4 (Lys Corr. WDT)), Mr. Pederson testified that [redacted] Hr'g Ex. IHM 3220 ¶ 30 (Pederson WRT). But Mr. Pederson could not say that [redacted]. Hr'g Tr. 3706:1-3707:8 (May 14, 2015) (Pederson). This is a key distinction. [redacted]. *Id.*; Hr'g Ex. IHM 3343 at 10, § 5 (a); Hr'g Ex. SX-29 ¶ 84 (Rubinfeld Corr. WRT). Quite simply, when looking at a sample of deals involving parties of varying sizes, the relative number of agreements that contain any particular term in and of itself does not deliver meaningful information about market preference. Mr. Pederson's statistic is misleading and irrelevant to the willing buyer/willing seller inquiry.

1274. On behalf of Pandora, Mr. Herring suggested in his written testimony that delivering payment 15 days earlier would "impose significant additional burdens upon licensees" and potentially introduce errors in the distribution process. Hr'g Ex. PAN 5016 ¶ 67 (Herring A WRT). At the hearing, however, it became clear that this testimony rests on unsubstantiated speculation. Mr. Herring admitted that he did not know how long it takes for Pandora to generate its month-end reports for SoundExchange, or even whether it takes a matter of days or weeks. Hr'g Tr. 3411:22-3412:11 (May 13, 2015) (Herring). Nor could he identify any ways in which Pandora's process would change if it had to calculate its SoundExchange royalties on a

30-day window rather than a 45-day window. Hr'g Tr. 3412:22-3412:1 (May 13, 2015) (Herring).

1275. Mr. Herring did know, however, that Pandora currently has the ability to estimate its royalty liabilities within just a couple of weeks. Hr'g Tr. 3412:12-21 (May 13, 2015) (Herring). He also acknowledged that at the end of each quarter Pandora is able to calculate its royalty payments within three and a half weeks for purposes of earnings calls. *Id.*

2. "Qualified Auditor" Definition

1276. SoundExchange proposes a revision of the definition of "Qualified Auditor" in 37 C.F.R. § 380.2 to permit the use of an auditor who has specialized experience that would be useful in the audit of streaming services, regardless of whether or not the auditor is a Certified Public Accountant ("CPA"). *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Section III.A, and Proposed Regulations, § 380.2(c) (Feb. 24, 2015). This proposed change would expand, not restrict, auditor options. Not only could parties use CPAs, but they could also call on "some of the most experienced and knowledgeable royalty auditors in the music industry [who] are not CPAs." Hr'g Ex. SX-22 at 16 (Wilcox WDT).

1277. Privately negotiated marketplace agreements virtually always grant audit rights to content owners. Hr'g Ex. SX-14 ¶¶ 41, 80, Figure 6 (Lys Corr. WDT); Hr'g Ex. SX-22 at 15-16 (Wilcox WDT).

1278. The royalty audit process is "complicated to an incredible degree." Hr'g Tr. 2498:22-2499:1 (May 7, 2015) (Wilcox). As Mr. Wilcox explained:

> [A] royalty auditor may have to examine a streaming service's server logs and content databases to determine the accuracy of the service's statement of performances and royalty payments. This could require understanding how the service's systems record digital performances, how those records are retained, and how those records are used to generate royalty statements. In addition, royalty auditors must be familiar with some of the unique

> conventions and jargon in the music industry as well as the royalty terms applicable to each service provider. For instance, auditors need to understand how to calculate a pro-rata share from a label pool, how performances are defined in the relevant contracts, and how to account for non-royalty-bearing plays.

Hr'g Ex. SX-22 at 16 (Wilcox WDT).

1279. In light of the "extensive technical and industry-specific expertise" that royalty audits entail (*id.*) and the "specific nature of the webcasting industry," "it would be in the interest of all parties" for auditors "to understand the complexity of this industry." Hr'g Ex. SX-14 ¶ 80 (Lys Corr. WDT). NAB expert Prof. Roman Weil agreed: "I am not disputing that the person who does the audit needs to be an industry expert." Hr'g Tr. 3934:20-21 (May 14, 2015) (Weil).

1280. This industry-specific expertise does not typically have much, if anything, in common with CPA training. Hr'g Ex. SX-14 ¶ 80 (Lys Corr. WDT). Mr. Wilcox testified that royalty audits "do not draw on the set of skills required to pass the CPA exam" but instead require specialized knowledge of "the technical systems that WMG's partners use" so that the auditor can properly "interpret data those systems maintain and generate." Hr'g Ex. SX-22 at 16 (Wilcox WDT). As Mr. Herring put it, CPAs with the requisite technical expertise are "a little bit of a unicorn" in this industry. Hr'g Tr. 3403:4-12 (May 13, 2015) (Herring).

1281. For this reason, "WMG's agreements generally do not require that a certified public accountant ("CPA") perform royalty audits with its digital partners." Hr'g Ex. SX-22 at 16 (Wilcox WDT); Hr'g Tr. 2499:9-10 (May 7, 2015) (Wilcox). Neither should the statutory license. In an industry where CPAs with specialized knowledge or royalty audits are "a unicorn," a CPA requirement is not only "unnecessarily restrictive," but out of step with what willing buyers and willing sellers agree to in the market. Hr'g Tr. 1504:9-12 (May 4, 2015) (Lys); Hr'g Ex. SX-22 at 16 (Wilcox WDT); Hr'g Tr. 2499:9-10 (May 7, 2015) (Wilcox).

1282. In advocating against SoundExchange's proposal, the Services conspicuously failed to rely on any marketplace agreements. NAB's Prof. Weil did not even look at any:

> Q. So you don't know whether those actual marketplace contracts require a CPA or not; is that correct?
>
> A. Yes.
>
> Q. So you haven't performed the analysis?
>
> A. Yes, I have not.

Hr'g Tr. 3942:6-3942:11 (May 14, 2015) (Weil).

3. Acceptable Verification Procedure

1283. SoundExchange requests that the Judges eliminate the acceptable verification procedure provision currently reflected in 37 C.F.R. § 380.6(e), as it problematically fails to distinguish between audits concerning purely financial metrics and royalty examinations that analyze the usage and performance metrics that are relevant in the context of statutory licensees. *See Amended Proposed Rates and Terms of SoundExchange, Inc.*, Section III.A, and Proposed Regulations, § 380.6(e) (February 24, 2015).

1284. There is no dispute that royalty examinations are of an entirely different character than routine financial audits. Hr'g Ex. SX-22 at 14-15 (Wilcox WDT); Hr'g Ex. 3939:22-3940:24 (May 14, 2015) (Weil) (Q. "And a royalty audit is different from a financial statement audit, correct?" A. "No question"). A provision that would threaten to allow a financial audit conducted in the ordinary course of business to substitute for the Collective's right to verify a licensee's royalty payments frustrates the very purpose of § 380.6.

1285. Moreover, Mr. Herring candidly acknowledged at the hearing that Pandora's internal, normal-course-of-business auditors at KPMG "might have a conflict of interest" when it comes to conducting a royalty audit. Hr'g Tr. 3402:11-24 (May 13, 2015) (Herring). An audit

conducted by the service's own auditors is no substitute for the independent royalty examination to which SoundExchange is entitled.

1286. In sum, the acceptable verification provision, as currently written, threatens to fundamentally undermine SoundExchange's audit rights and allow licensees to shirk their payment obligations. A strong audit provision is critical to the operation of the statutory license. Given that SoundExchange and its members cannot terminate the license of a service that is in breach, the audit provision is the primary mechanism by which to protect the integrity of the statutory license. SoundExchange's audit rights should be as strong – if not stronger – than those found in marketplace agreements, not vulnerable to replacement by routine financial audits.

B. Responses to the Services' Proposed Terms For The Statutory License

1287. The Services have proposed a number of deviations from the statutory license's established terms, and have offered little (if any) evidence to support their proposals. As set forth below, the Services have not satisfied their burden to justify their proposed changes. *SDARS I*, 73 Fed. Reg. at 4098-99.

1. Late Fees

1288. Late fees are "crucial" to SoundExchange's operations. Hr'g Tr. 7138:13-17 (June 2, 2015) (Bender). Mr. Bender summed it up succinctly: "It's the only tool that we have to ensure the services pay on a timely basis." *Id.* If the current late fee provision were weakened in any way, the net result would be artists getting paid "later and later." Hr'g Tr. 7139:3-9 (June 2, 2015) (Bender).

(a) Pandora's Proposed Amendment

1289. Pandora has proposed that a "single late fee of 1.5% per month . . . be due in the event both a payment and the statement of account are received by the Collective after the due date." *See* Pandora Proposed Terms at 5. To support this change, Pandora relied on a mere five

lines of testimony from Mr. Herring, who baldly asserted that "duplicative payments . . . are unnecessary, and would be unreasonable and usurious." Hr'g Ex. Pan. 5007 ¶ 37 (Herring WDT).

1290. SoundExchange offered testimony from Mr. Bender that explained the importance of maintaining separate late fees for payments and statements of account that are submitted separately and late.

1291. As an initial matter, Mr. Bender testified that when both the payment and the statement of account are submitted late, SoundExchange must duplicate basic operational processes and incur additional administrative costs. Hr'g Ex. SX-23 at 4 (Bender WRT). It is a matter of basic fairness that the licensees be held accountable for any such unnecessary costs they create. *Id.*

1292. Under Pandora's proposal, services would have no incentive to submit their accounting statements in a timely manner when they are behind on their payments (or vice versa). Hr'g Ex. SX-23 at 4 (Bender WRT). But there is value to SoundExchange in receiving a timely statement of account even when the service is late on its payment:

> [K]nowing that the service has acknowledged a royalty liability for the broadcast period is a great help to us because then [] operationally, one, we have a liability on the books, a receivable, and when we go to enforce the collection, we are able to go to the services, [and say] you filed this statement of account for this amount, can you tell us when this payment will be forthcoming[?]

Hr'g Tr. 7137:4-12 (June 2, 2015) (Bender). Timely payments are valuable when statements of account are late for the very same reason: they make it easier for SoundExchange to collect the past-due statement from the service. *Id.* 7138:6-12.

1293. In sum, when either a payment or a statement of account is untimely, SoundExchange's ability to efficiently distribute royalties is impaired. Hr'g Ex. SX-23 at 4-5

(Bender WRT). A separate 1.5% late fee remains important to promote compliance and facilitate the quick and efficient distribution of royalties. *Id.*

(b) iHeart, NAB, and NRBNMLC's Proposed Amendment

1294. iHeart, NAB, and NRBNMLC each proposed that the current 1.5% monthly late fee charge be drastically reduced to the underpayment penalty set forth in 26 U.S.C. § 6621. *See* iHeartMedia Proposed Terms at 5; NAB Proposed Terms at 5; NRBNMLC Proposed Terms at 5. But by its terms, as a provision relating to interest on the underpayment of taxes, Section 6621 is of course inapplicable here.

1295. More fundamentally, the tax underpayment penalty in 26 U.S.C. § 6621 does not create a sufficient incentive to meaningfully encourage timely submission of payments and statements of account. Hr'g Ex. SX-23 at 5 (Bender WRT).

1296. Nor is the services' proposal in line with any late fee specified in any marketplace agreement. Their late fee proposal is entirely bereft of marketplace support. Based on his insinuation that there is considerable inconsistency with respect to the late fees contained in existing market agreements, Prof. Fischel questioned whether such agreements "provide evidence of what would have been negotiated absent the statutory license." Hr'g Ex. IHM 3054 ¶ 118 (Fischel/Lichtman WRT). Notably, however, Prof. Fischel did not quantify how many agreements incorporate the current statutory rate as opposed to a different rate. *Id.*

1297. But Prof. Lys did. He testified that in voluntary agreements between willing buyers and willing sellers, the "most common late charge by far, present in more than half of all agreements and in 63% of those containing specific interest charges for late payments, was the lesser of (A) 1.5% per month and (B) the maximum rate permitted by law." Hr'g Ex. SX-14 ¶ 39 (Lys Corr. WDT). The statutory license should remain aligned with this market norm.

2. Overpayments and Corrections to Statements of Account

1298. Pandora also proposed that a service be permitted to make "good faith revisions or adjustments to its Statements of Account." *See* Pandora Proposed Terms at 6. The proposal appears to place no time limitation whatsoever on services' ability to make such corrections. *Id.*

1299. Similarly, iHeart, proposed several amendments that would allow licensees to recover overpayments, whether they are detected in an audit or detected by the licensee within three years of submitting payment. *See* iHeartMedia Proposed Terms at 6-7.

1300. Both proposals—neither of which impose a reasonable time constraint on the requested relief[61]—should be rejected. Services are responsible for ensuring the accuracy of their statements of account and payments. Hr'g Tr. 7131:20-22 (June 2, 2015) (Bender). Granting licensees a never-ending opportunity to make corrections and recover overpayments would discourage services from taking this responsibility seriously and invite them to no longer engage in careful accounting in the first instance Hr'g Ex. SX-23 at 7 (Bender WRT).

1301. Allowing licensees a second (or third or fourth) chance to submit their statements of account or recover royalties already paid would also impose significant operational burdens and disrupt the orderly and efficient flow of royalties to artists. Hr'g Ex. SX-23 at 6 (Bender WRT).

1302. With respect to the operational burden, downward adjustments in particular present "a lot of complexity." Hr'g Tr. 7132:2-5 (June 2, 2015) (Bender). Mr. Bender testified that while SoundExchange can always allocate an additional payment (with additional effort), there is no assurance that overpayments can be recovered once they are distributed to artists and

[61] iHeart's proposals permit services to recover overpayments up to three years after their original submission to SoundExchange.

copyright owners. Hr'g Ex. SX-23 at 6 (Bender WRT). Once a payment, statement of account, and report of use are submitted, most of the money is out the door within 90 days. *Id.*

1303. Mr. Bender explained the burdensome process that SoundExchange would have to undergo if a service were to adjust a statement of account to reduce its royalty liability after those royalties had already been processed and distributed:

> The first thing you do is you have to go back to the period in question and in effect undistribute that log. We have to roll back all of the payments, all the transactions, hundreds of thousands of lines and logs and then recalculate based on the new number and then come up with a net difference, which we have to report to all of our 25,000 pay[ees].

Hr'g Tr. 7132:4-12 (June 2, 2015) (Bender).

1304. This next step in the process raises additional issues and operational challenges. To claw back the royalties that have already been distributed to artists and content owners, SoundExchange would have to create debits in the artists' and labels' accounts that would appear in their next royalty statement. Hr'g Tr. 7132:13-7133:15 (June 2, 2015). When this happens, SoundExchange "get[s] a lot of calls." *Id.*

> For artists in particular, you run into tax issues, depending on the timing of the restatement, they may have to readjust their taxes, refile their tax returns. Similarly, a lot of artists have agreements with producers who produce their records who share in their royalty stream. If the royalty stream changes, they have to go back to the producers and readjust the payment to the producers.

Hr'g Tr. 7133:4-12 (June 2, 2015) (Bender).

1305. In many cases, clawing back these royalties is simply impossible. Hr'g Ex. SX-23 at 6-7 (Bender WRT). After a deduction is assessed on an artist's royalty statement, there is no assurance that it will in fact be recovered. Hr'g Tr. 7133:16-21 (June 2, 2015) (Bender). When the royalties cannot be clawed back, it "creates unrecoverable debt on [SoundExchange's] books," and after a certain period, if never recovered, SoundExchange has to take the money

against its administrative fee, a fee assessed against all of SoundExchange's payees. Hr'g Tr. 7133:22-7135:3 (June 2, 2015) (Bender). The net result of the Services' proposals therefore would be the deduction of previous overpayments from royalties owed to different artists and content owners, a result that is not only "fundamentally unfair" but inaccurate. Hr'g Ex. SX-23 at 6-7 (Bender WRT).

1306. iHeart goes so far as to suggest that SoundExchange should not only have to shoulder the administrative burden caused by the service's mistake, but also be liable for interest on any overpayment until it is reclaimed by the service. *See* iHeartMedia Proposed Terms at 6-7. Such a proposal is manifestly unreasonable. Hr'g Tr. 7135:4-12 (June 2, 2015) (Bender) ("That's actually a little crazy, we have already paid out the money. That money is gone. I don't know where we would earn the interest."). SoundExchange is a non-profit serving the needs of creators subject to a statutory license, not a bank.

3. Notice and Cure

1307. Three Services—iHeartMedia, NAB, and NRBNMLC—propose to add a provision that would require SoundExchange to provide licensees notice of their breaches of the statutory license and an opportunity to cure the breach, apparently without penalty. *See* iHeartMedia Proposed Terms at 7, NAB Proposed Terms at 10, and NRBNMLC at 10. There is no evidence in the record to support this proposal.

1308. Mr. Bender, however, testified that such a provision is unwarranted, for several reasons:

> First, by far the most common way SoundExchange "asserts" a breach against a license is to contact the licensee informally to inquire about an issue. It would be strange indeed if we could not call or email a licensee concerning a perceived issue without first notifying the licensee by certified mail. Moreover, a notice and cure provision as a precondition to more formal action would be inappropriate and unnecessary. SoundExchange does not certify

> licensees' compliance with the terms of the statutory license. Nor should SoundExchange be expected to do so. The obligation to ensure compliance with the terms of the statutory license rests on the licensees.

Hr'g Ex. SX-23 at 9 (Bender WRT).

4. Payment Notifications and Receipts

1309. NRBNMLC proposes that regulations be added that require SoundExchange to (i) send email reminders at least one month before the annual minimum payment fee is due, and (ii) send email acknowledgements within one business day of receiving payment. *See* NRBNMLC Proposed Terms at 4.

1310. Mr. Bender testified that, to this first point, SoundExchange already sends annual reminders to all services that pay the minimum fee so long as the service has provided SoundExchange with accurate, up-to-date contact information. Hr'g Ex. SX-23 at 9-10 (Bender WRT). There is no need to add a regulation compelling SoundExchange to do something that it already does as a matter of ordinary course. *Id.* at 10

1311. NRBNMLC's second proposal should likewise not be embraced. Mr. Bender explained that acknowledgement emails can raise of host of administrative challenges such that the costs of NRBNMLC's proposal far outweigh any marginal benefit. This is especially the case in light of Mr. Bender's testimony that licensees will soon be able to submit payments through an online payment portal. Hr'g Ex. SX-23 at 10 (Bender WRT). In any event, the proposal would be unwarranted because the obligation to ensure timely payment always rests on the licensee, not SoundExchange. *Id.*

5. Unclaimed Funds

(b) NAB's Proposed Amendment

1312. NAB has proposed to amend the unclaimed funds provision to require that SoundExchange "use its best efforts to identify and locate copyright owners and featured artists in order to distribute royalties payable to them." NAB Proposed Terms at 6. This unnecessary and unjustified proposal should be rejected. As Mr. Bender testified:

> The existing standard is working. SoundExchange pays out hundreds of millions in statutory royalties each year; it has demonstrated that it is capable of ensuring that performers and owners get paid. . . Properly understood, at any given time SoundExchange's reported balance contains only a small portion of unclaimed royalties. By and large, the balance consists of money that is simply working its way through the payment and distribution pipeline in the ordinary course.

Hr'g Ex. SX-23 at 18-19 (Bender WRT).

1313. NAB's regulations also unjustifiably alter the length of time that SoundExchange retains unclaimed funds from three years to five years. NAB Proposed Terms at 10. Not only is this change arbitrary and unexplained, but it would interfere with SoundExchange's goal to efficiently distribute money to artists and copyright owners. Hr'g Ex. SX-23 at 19 (Bender WRT). In addition, a three-year span that lines up with the Copyright Act's three-year statute of limitations is far more sensible than NAB's proposed five-year period, which was seemingly plucked from thin air. *See* 17 U.S.C. § 507(b).

(c) Pandora's Proposed Amendment

1314. Pandora also has proposed a change to the current unclaimed funds provision. Pandora's proposal would foreclose SoundExchange from applying unclaimed funds against its 114(g)(3) costs. Hr'g Ex. Pan. 5016 ¶¶ 77-78 (Herring AWRT). Not only did Pandora improperly offer this proposal for the first time in its rebuttal case, but it also offered it without any foundation, much less justification or evidentiary support. While Mr. Herring set forth the proposed amendment in his written testimony, Mr. Herring has no personal knowledge or

experience whatsoever related to SoundExchange's unclaimed funds in pooled royalties. Hr'g Tr. 3417:4-9 (May 13, 2015) (Herring) (Q. "With respect to your testimony about unclaimed funds, wh¶experience do you have, what personal knowledge do you have about the unclaimed funds in pooled royalties?" A. "I don't have personal experience related to that."). The proposed amendment should be rejected out of hand.

6. Definition of Aggregate Tuning Hours ("ATH")

1315. NRBNMLC has proposed that the definition of ATH be amended to exclude "any discrete programming segments and any half hours of programming that do not include any Performance." NRBNMLC Proposed Terms at 1.

1316. The ATH cap was established by the Judges to demarcate the boundary between the noncommercial webcasting market and the commercial webcasting market. *See Webcasting II*, 72 Fed. Reg. at 24097. The Judges set the cap based on the average ATH of NPR stations under the current ATH definition. *See id.* at 24099-100. Had the Judges set the cap based on NRBNMLC's definition, the cap would be an entirely different number. To change the definition at this juncture would unjustifiably unmoor the ATH cap from its original justification and give non-commercial services significant additional value for the same minimum $500 minimum fee. Hr'g Ex. SX-23 at 10-11 (Bender WRT). NRBNMLC has not offered evidence to justify a reduction in the rates for noncommercial services.

7. Definition of "Performance"

1317. The regulations currently define royalty-bearing performances as all "instance[s] in which any portion of a sound recording is publicly performed to a listener by means of a digital audio transmission . . ." 37 C.F.R. § 380.2. The definition provides for only three narrow exceptions: (1) performances of sound recordings that do not require a license; (2) performances

of sound recordings for which the service already has a license; and (3) "incidental" performances. *Id.*

1318. When considering any change to the scope of the performance definition, it is important to remember that Prof. Rubinfeld's proposed rates were calculated under an assumption that all performances – as currently defined by the statutory license – would be royalty-bearing. *See* Hr'g Ex. SX-29 ¶¶ 212-216 (Rubinfeld Corr. WRT). The other parties' benchmark calculations rested on the same assumption. Hr'g Ex. Pan 5022 at 30-31 (Shapiro WDT); Hr'g Ex. IHM 3034 ¶ 35 (Fischel/Lichtman AWDT). Were the definition of "performance" to be narrowed in any way, the parties' rate proposals would have to be adjusted upward to account for the change.

(b) NAB's Proposed Amendment

1319. NAB has proposed two additional exclusions: (1) performances that are "15 seconds or less in duration"; and (2) "second connection[s] to the same sound recording from someone from the same IP address." NAB's Proposed Rates and Terms at 3. Both of these proposals would significantly narrow the definition of "performance." NAB offered no compelling evidence to support either change to the long-standing, established definition of "performance."

1320. To support NAB's proposed exclusion of performances of 15 seconds or less, Steven Newberry testified that "it doesn't make sense to charge a fee for a song the listener demonstrates by his or her actions that he or she doesn't want to hear." Hr'g Ex. NAB 4001 ¶ 34 (Newberry WDT). But as a matter of basic fairness, copyright owners and artists should be compensated anytime their music is used by a service, particularly in the context of a statutory license where owners and artists have no ability to withhold their content. Hr'g Ex. SX-23 at 13 (Bender WRT).

1321. Moreover, Mr. Newberry could not deny that services have the ability to limit listeners' ability to continue playing a stream when they have left the room or stopped listening. Hr'g Tr. 5114:7-11 (May 20, 2015) (Newberry). Services can likewise minimize their financial obligation for short performances by not permitting their listeners to "skip" songs. Hr'g Ex. SX-23 at 13 (Bender WRT). If a service makes a strategic business choice to not impose such limitations on their users, it should not be able to escape the financial consequences of that choice. *Id.*

1322. NAB's second proposed change to the performance definition is also misguided. NAB offered testimony by Jean-Francois Gadoury of Triton Digital explaining that media players can sometimes connect to a stream twice, and that such re-connections could be erroneously counted as a second performance. Hr'g Ex NAB 4007 (Gadoury WDT ¶¶ 2-12). NAB's proposal to exclude "second connection[s] to the same sound recording from someone from the same IP address" appears to be aimed at addressing this issue. But this is a solution in search of a problem. Hr'g Ex. SX-23 at 13-14 (Bender WRT). The current "performance" definition is already limited to transmissions "to a listener." 37 C.F.R. § 380.2. Accordingly, any re-connection made by the same listener's device due to a technical glitch would not be a second performance under the current regulations.

1323. Instead of solving a problem, NAB's proposed amendment would create one. As Mr. Bender testified, more than one user could be using the same IP address at the same time if, for example, they connected to the internet from the same location. Hr'g Ex. SX-23 at 14 (Bender WRT). As a result, a "second connection to the same sound recording from someone from the same IP address" could very often be a performance to a second distinct listener. *Id.* at

13-14 (Bender WRT). Under NAB's definition these distinct exploitations of a copyright owner's work would improperly not each be royalty-bearing.

(c) Pandora's Proposed Amendment

1324. Pandora has proposed that the definition of performance be altered to "make clear that only those transmissions to users in the United States are properly compensable under the Section 112 and 114 licenses." Hr'g Ex. Pan. 5007 ¶ 37 (Herring WDT); Pandora Proposed Terms at 3. Pandora did not support this proposed change with any evidence that the current, established definition is not working.

1325. In any event, to the extent that a licensee's activities in the U.S. implicate U.S. copyright rights, it should pay for the exercise of those rights regardless where its users are located. "[E]ach step in the [transmission] process by which a protected work wends its way to its audience" constitutes a public performance, and rights holders are entitled to compensation for all such performances that occur within the United States, even if the listener is outside the United States. *See Nat'l Football League v. PrimeTime 24 Joint Venture*, 211 F.3d 10, 12 (2d Cir. 2000) (quoting *David v. Showtime/The Movie Channel, Inc.*, 697 F. Supp. 752, 759 (S.D.N.Y. 1988)).

1326. Finally, Pandora's proposed geographical limitation is also unworkable as a practical matter given that geo-location technology is susceptible to inaccuracies. Hr'g Ex. SX-23 at 14 (Bender WRT).

1327. Pandora's proposed definition of "performance" also unjustifiably strikes the parenthetical from the definition that explains that "the delivery of any portion of a single track from a compact disc to one listener" is a "digital audio transmission." *See* Pandora Proposed Terms at 3. As Mr. Bender testified, this parenthetical is important and necessary: it makes clear that each movement of a symphony is a distinct sound recording. Hr'g Ex. SX-23 at 14-15

(Bender WRT). The Judges should reject Pandora's proposal to eliminate this clarifying language.

8. Definition of "Broadcast Retransmission" in § 380.11

1328. Both iHeartMedia and NAB propose modifying the simulcast definition in the regulations that apply to broadcasters. *See* iHeartMedia Proposed Terms at 3 and NAB Proposed Terms at 2. As an initial matter, because the same statutory license rates and terms should apply to all commercial webcasters, all of NAB and iHeart's proposed broadcaster-specific regulations are unnecessary and inappropriate.

1329. If there were to be a simulcast definition included in the regulations, neither iHeartMedia nor NAB offer a reasonable definition. The fundamentals of both services' proposals are the same. They seek to define simulcasts broadly to include programming in which a considerable amount of original programming has been replaced with other content. iHeart's definition permits replacement of up to 49% of the content. iHeartMedia Proposed Terms at 3. NAB allows content to be swapped out "occasionally" so long as the changes do "not change the character of the content of the transmission." NAB Proposed Terms at 2.

1330. Broadening the definition in this way stretches the concept of a simulcast well beyond its true meaning. Programming is either simulcast with a station's terrestrial over-the-air radio signal, or it is not, and simulcasts should be narrowly defined in a way that is consistent with this common-sense definition. At the point that 49% of the programming is no longer a simulcast of broadcast programming, any possible justification for treating simulcasts differently from all other streams under the statutory license would cease to exist. Hr'g Ex. SX-23 at 15 (Bender WRT).

1331. NAB's vague standard is also far too vague to be a feasible means by which to define simulcast streams. NAB's own expert could offer no opinion as to where NAB's

definition draws the line between what is and is not a simulcast. Hr'g Tr. 5743:5-21 (May 26, 2015) (Katz). This ambiguity and flexibility would both invite gamesmanship and cause disputes.

9. Sound Recording Performance Complement

1332. iHeart has included in its proposed terms provisions that would relax the sound recording performance complement for both simulcasters and non-simulcasters. *See* iHeartMedia Proposed Terms at 2-5. These changes that alter the very contours of the statutory license cannot be made in the context of this rate-setting proceeding. Only Congress has the authority to amend the statute.

10. Additional NAB and NRBNMLC Modifications to Regulations

1333. NAB and NRBNMLC also buried several modifications to the terms of the statutory license in their proposed regulations without making any mention of the proposals elsewhere in the record, and without redlining or marking the changes in any way in the regulations themselves. Without evidentiary support, all of these proposed regulations should be rejected out of hand. A few of the proposed regulations raise particular concerns that warrant further comment:

- In its proposed § 380.11, NAB offered an exceedingly broad definition of "Broadcaster" that reaches not only broadcasters, but also any entities affiliated with broadcasters. NAB Proposed Terms at 2. If broadcasters were to be given their own rate category or terms such that a definition of "broadcaster" was required, the broadcaster category would have to be carefully drawn to ensure that non-broadcasters could not strategically devise a means by which to opt in to the broadcaster rates or terms. In his testimony, Mr. Bender noted Pandora's recent acquisition of a radio station in Rapid City, South Dakota to lower its ASCAP royalties.[62] Non-broadcast webcasters should not be invited to do the same here. NAB's definition is far too broad. Hr'g Ex. SX-23 at 16-17 (Bender WRT).

[62] *See* Glenn Peoples, Pandora Buys Terrestrial Radio Station in South Dakota, Aims for Lower ASCAP Royalties, Billboard (June 11, 2013), *available at*
(footnote continued)

- NAB proposed amending § 380.12 so that a minimum fee would only be due for each of a broadcaster's AM/FM radio stations, rather than for each of its individual channels. NAB Proposed Terms at 4. This change would put the minimum fee dramatically out of proportion to SoundExchange's administrative costs given that SoundExchange averages costs of $11,778 per licensee. Hr'g Ex. SX-2 at 17 (Bender WDT). To permit broadcasters to operate multiple channels without any financial repercussions would also facilitate gamesmanship by broadcasters to reduce their royalties. Hr'g Ex. SX-23 at 17 (Bender WRT). Any such change to the minimum fee provision is unnecessary in any event given that the regulations already cap the total amount of minimum fees that any single licensee has to pay in a year. *See* 37 C.F.R. §§ 380.3(b).

- NAB and NRBNMLC both added language to the audit provision that would require audits to be "completed within 6 months of the date of the notification of intent to audit is serviced" on the licensee. *See* NAB and NRBNMLC Proposed Terms at 8, 9. But as Mr. Bender testified, completion of an audit requires mutual cooperation and the provision of data by the licensee. Hr'g Ex. SX-23 at 18 (Bender WRT). NAB's proposed amendment fails to account for the fact that the completion of an audit is just as dependent on the licensee as it is on the auditor, if not moreso. *Id.* Nor does NAB point to any market agreements that place any such time requirement on the completion of an audit.

- NAB added a provision to the regulations that would excuse broadcasters from reporting information about performances contained in programming provided by third parties and allow them to make "good faith estimate[s]" instead. *See* NAB Proposed Rates and Terms at 4. Mr. Bender testified that third-party programming can often constitute a substantial portion of broadcasters' programming. Hr'g Ex. SX-23 at 17 (Bender WRT). The only way to ensure artists and owners are properly compensated for this programming is to require broadcasters to obtain the requisite reporting information from their third-party providers. *Id.* at 17-18.

- Similarly, as it did in the notice and recordkeeping proceeding, NAB again requests waiving reporting requirements for small broadcasters. *See* NAB Proposed Terms at 6. SoundExchange set forth its opposition to a continued waiver for small broadcasters in its Reply comments in that proceeding. *See SX Reply Comments of SoundExchange*, Docket No. 14-CRB-0005 (RM), at 87-88 (Sept. 5, 2014).

- NRBNMLC's proposed regulations also request that some undefined category of noncommercial services be exempt from report of use requirements. *See* NRBNMLC Proposed Terms at 6. The failure to specify which noncommercial services would be eligible for the exemption—or tie eligibility to usage—renders

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http://www.billboard.com/biz/articles/news/radio/1566479/pandora-buys-terrestrial-radio-station-in-south-dakota-aims-for.

the proposal both unworkable and unacceptable. Hr'g Ex. SX-23 at 18 (Bender WRT).[63] To ensure that artists and copyright owners are paid accurately for the use of their content, deviating from the norm of census reporting is only appropriate in exceptional circumstances. *Id.* at 8. NRBNMLC have shown no such exceptional circumstances here.

XVIII. DESIGNATION OF A COLLECTIVE

A. SoundExchange Should Be The Sole Collective

1334. SoundExchange proposes that it should be designated as the sole Collective to collect and distribute royalties for the period 2016-2020. *Amended Proposed Rates and Terms of SoundExchange, Inc.* at 7 (Feb. 24, 2015).

1. Only SoundExchange Has Requested to Be Designated as the Collective

1335. The Judges "have concluded previously that designation of a single Collective is economically and administratively efficient." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23124 (Apr. 25, 2014); *see also Webcasting II Final Order*, 72 Fed Reg. 24084, 24104 (May 1, 2007) ("[S]election of a single Collective represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses."). Furthermore, the D.C. Circuit has held that "in selecting SoundExchange as the sole collective, the Judges fulfilled Congress's expectation that they would designate a single entity to receive royalty payments from licensees." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 771 (D.C. Cir. 2009).

1336. And, the Judges have designated SoundExchange as that sole Collective where "[n]o party to [the] proceeding requested a different or additional Collective" and

[63] NRBNMLC witness Gene Henes testified that his stations currently pay $100 in exchange for a reporting waiver. Hr'g Tr. 5268:24-5269:1 (May 21, 2015) (Henes). NRBNMLC's proposed rates and terms improperly seek to obtain this same benefit for noncommercial services without any in-kind remuneration flowing to SoundExchange to cover the costs associated with using a proxy model to distribute those services' royalties.

SoundExchange sought "to continue as the sole Collective for royalties paid by commercial and noncommercial webcasters under the licenses at issue in this proceeding." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23124 (Apr. 25, 2014); *see also SDARS II Final Order*, 78 Fed. Reg. 23054, 23074 (Apr. 27, 2013) (same); *SDARS I Final Order*, 73 Fed. Reg. 4080, 4099 (Jan. 24, 2008) (same). Similarly, the Judges have found that "SoundExchange is the superior organization to serve as the Collective" in past license periods for webcasting. *Webcasting II Final Order*, 72 Fed. Reg. 24084, 24105 (May 1, 2007).

1337. Those are the circumstances here. No party other than SoundExchange has requested to be selected as the Collective; no party has proposed multiple collectives; no party has opposed the designation of SoundExchange as the Collective; and SoundExchange has presented evidence of its proven track record of administering the statutory licenses efficiently and in the best interests of royalty recipients. Accordingly, SoundExchange should be designated as the sole Collective for 2016-2020.

1338. The evidence in this proceedings supports the same result as in past proceedings. SoundExchange should be designated the sole Collective and distribute royalties for the 2016-2020 statutory period.

2. SoundExchange Has Experience Administering the Statutory Licenses

1339. The Judges have recognized that "[o]ver the years of its service as the Collective, SoundExchange has gained knowledge and experience and has developed efficient systems for achieving the goals of the Collective at a reasonable cost to those entitled to the royalties." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23124 (Apr. 25, 2014). SoundExchange has considerable experience and expertise in administering the statutory licenses. SoundExchange has distributed royalties based on trillions of digital sound recording performances and processes

royalties related to tens of billions of webcasting performances each month. As of October 2014, SoundExchange has conducted a total of 61 royalty distributions and has made more than 510,000 individual payments totaling more than $2 billion. SoundExchange paid out statutory royalties of approximately $293 million in 2011, $462 million in 2012, $590 million in 2013, and, in just the first six months of 2014, SoundExchange paid out $323.6 million. Hr'g Ex. SX-02 at 5 (Bender WDT).

1340. SoundExchange has continued to increase the size of its membership and the number of record label and artist accounts it maintains. For example, whereas at the time the *Webcasting III* direct testimony was submitted, SoundExchange had approximately 9,700 record label members and 29,000 artist members (*Webcasting II Final Order*, 72 Fed Reg. 24084, 24104 (May 1, 2007)); as of October 2014, SoundExchange had approximately 18,000 rights owner members and more than 40,000 artist members. Hr'g Ex. SX-02 at 14-15 (Bender WDT). SoundExchange also pays statutory royalties to non-members—copyright owners and artists alike—as if they were also members. In total, and because some artists and rights holders maintain multiple accounts, SoundExchange maintains more than 100,000 accounts for recording artists and rights holders. *Id.* at 5.

1341. And while SoundExchange had roughly 2 million sound recordings in its database when the written direct testimony was submitted in *Webcasting III*, as of October 2014 SoundExchange had more than 6 million unique entries in its database of combinations of artist names and track titles. Hr'g Ex. SX-02 at 14-15 (Bender WDT).

3. Artists and Copyright Owners Support SoundExchange as the Sole Collective

1342. SoundExchange presented artist and copyright owner testimony in support of designating SoundExchange as the sole Collective.

1343. Ray Hair testified on behalf of AFM's 80,000 professional music members and expressed AFM's support for SoundExchange to serve as the sole Collective for the compulsory license fees at issue in this proceeding. Hr'g Ex. SX-08 at 4, 7-8 (Hair WDT). Mr. Hair identified several reasons for this support, including that SoundExchange is controlled by performer and copyright owner representatives, and SoundExchange "has earned the trust of performers and copyright owners alike." *Id.* at 7-8. Mr. Hair also noted that "[a]s a non-profit organization, SoundExchange's incentives are properly aligned with the interests of royalty recipients" and that SoundExchange "[h]as [s]ubstantial and [u]nparalleled [e]xperience [c]ollecting and [d]istributing [s]tatutory [r]oyalties." *Id.* at 8.

1344. Copyright owner testimony similarly supports designating SoundExchange as the sole Collective. Darius Van Arman, Co-Founder and Co-Owner of Secretly Group and a prominent member of the independent record community, testified that SoundExchange's organizational structure, non-profit status, and track record all support designating SoundExchange as the Collective. Hr'g Ex. SX-20 at 17 (Van Arman WDT). Warner Music Group's Ron Wilcox also testified that SoundExchange should be the sole Collective based on its commendable job in that role in past license periods. Hr'g Ex. SX-22 at 17 (Wilcox WDT).

4. SoundExchange Represents Both Copyright Owners and Recording Artists

1345. SoundExchange is governed by an 18-member Board of Directors that is made up of equal numbers of recording artist representatives and sound recording copyright owner representatives. Hr'g Ex. SX-02 at 3 (Bender WDT). Recording artists are represented by one representative each from the American Federation of Musicians ("AFM") and the Screen Actors Guild – American Federation of Television and Radio Artists ("SAG-AFTRA"), as well as seven at-large artist seats, held by recording artists, artist lawyers, and artist managers. *Id.* at 4.

Copyright owners are represented by board members associated with the major record companies (four), independent record companies (two), the Recording Industry Association of America (two), and the American Association of Independent Music (one). *Id.* at 3-4.

1346. The level of control that recording artist representatives have over SoundExchange ensures that SoundExchange is committed to serving the interests of both recording artists and copyright owners. This is demonstrated through SoundExchange's extensive efforts to make performers aware of the royalties they are owed, to find and enroll them, and to get royalties into their hands. Hr'g Ex. SX-08 at 7-8 (Hair WDT). Outreach efforts "include reaching out to performers and their representatives directly, partnering with other organizations to get the word out to their members, attending conferences, earning media attention, placing print and web ads, and using social media like Facebook and Twitter." *Id.* at 8. Perhaps the best evidence of SoundExchange's commitment to the fair representation of artists and copyright owners is that tens of thousands of recording artists and copyright owners have registered with SoundExchange. *Id.* at 8.

5. SoundExchange Is a Non-Profit

1347. SoundExchange is a 501(c)(6) nonprofit performance rights organization established to ensure the prompt, fair, and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for the use of sound recordings over, among other things, the Internet, wireless networks, cable and satellite television networks, and satellite radio services via digital audio transmissions. Hr'g Ex. SX-02 at 3 (Bender WDT).

1348. As a non-profit organization, SoundExchange litigates rates, collects royalties, and distributes them – all for the benefit of performers and copyright owners, not for its own financial gain. As Mr. Hair testified, because SoundExchange is a non-profit organization,

SoundExchange's "incentives are properly aligned with the interests of royalty recipients." Hr'g Ex. SX-08 at 8 (Hair WDT).

6. SoundExchange Administers the Statutory Licenses Efficiently

1349. SoundExchange strives to minimize the administrative costs associated with all of these efforts, including with royalty collection and distribution. SoundExchange has 142 full-time staff members. Yet, in 2013, SoundExchange's administrative cost rate was 4.5%. Hr'g Ex. SX-02 at 5 (Bender WDT). That administration rate compares favorably to every other collective management organization in the world. For instance, comparable entities in Europe may have administrative rates that are in the high teens or even above 20%. Hr'g Tr. 688:10-24 (Apr. 29, 2015) (Huppe). For comparison purposes, collective management organizations on the publishing side, which, admittedly, do not serve exactly the same function as SoundExchange but are analogous in some ways, may have administrative rates above 10%. *Id*. For example, the American Society of Composers, Authors and Publishers ("ASCAP") reported operating expenses of 11.6% for 2012. Hr'g Ex. SX-02 at 5 (Bender WDT).

1350. Even with this low administrative cost rate, SoundExchange has a demonstrated history of serving the interests of performers, seeking to maximize royalty payments to them, and working hard to find the thousands of potential recipients and get royalty payments to them (regardless of whether they are SoundExchange members). Hr'g Ex. SX-08 at 9 (Hair WDT); *see also* Hr'g Ex. SX-22 at 17 (Wilcox WDT).

B. Designating Multiple Collectives Would Be Inefficient

1351. As noted *supra*, the Judges have previously recognized that the designation of a *sole* Collective is economically and administratively efficient. There is no evidence in the record to conclude otherwise, nor has any party suggested that the Judges consider designating multiple collectives.

1352. The only evidence in the record on this subject demonstrates that designating multiple Collectives would be anathema to the concept of an efficient statutory licensing system. It would create overall costs because copyright owners and performers would have to pay for duplicative systems for license administration. Hr'g Ex. SX-02 at 15 (Bender WDT). As Mr. Hair testified on behalf of AFM, it would not be efficient to have to pay for two or more computer systems, staffs, offices, legal, and technical structures. Nor would it be efficient to require services subject to the license to have to make payments and file reports to two or more collectives. Thus, designating only one Collective would avoid redundancies and streamline costs. Hr'g Ex. SX-08 at 9 (Hair WDT).

1353. Furthermore, there is no evidence in the record establishing any other entity that has the capability to serve as a Collective. SoundExchange has already invested in the systems that are needed and has developed the experience and expertise in all the complicated aspects of receiving reports of billions of digital performances, connecting them to the proper performer and copyright owner recipients, processing the royalties, and paying them out. Hr'g Ex. SX-08 at 9-10 (Hair WDT). Given these considerable investments and the absence of evidence whatsoever about any other possible Collective, there is no reason to designate multiple Collectives.

1354. The experience in countries that have multiple sound recording royalty organizations suggests that multiple Collectives result in higher administration cost rates than the administration rate SoundExchange has maintained as the sole Collective. Hr'g Tr. 689:1-690:7 (Apr. 29, 2015) (Huppe).

C. SoundExchange's Operations

1355. SoundExchange's core mission is to collect and distribute statutory royalties as efficiently and accurately as possible. SoundExchange has developed sophisticated systems,

business processes, and extensive databases uniquely suited to the challenging task of distributing statutory royalties. Hr'g Ex. SX-02 at 5 (Bender WDT). Jonathan Bender, SoundExchange's Chief Operating Officer, testified about SoundExchange's operational procedures for managing royalty collection and distribution.

1. Receipt of Payment

1356. SoundExchange's License Management Department receives from statutory licensees both royalty payments and, when the system works properly, two reports: (1) statements of account that reflect the licensee's calculation of the payments for the reporting period; and (2) reports of use that log performances of sound recordings. SoundExchange also receive notices of election that indicate whether the licensee has utilized any optional rates and terms. When SoundExchange receives payment from a licensee, that payment is logged into SoundExchange's licensee database. If this is the first payment from a licensee, a new profile is created for the licensee. If the licensee has previously paid royalties, then the payment is entered under the existing profile. If the licensee operates services in multiple rate categories, the royalty payments are allocated among the applicable rate categories based on the statements of account. Similarly, aggregated payments by a parent corporation covering corporate subsidiaries (e.g., by a radio station group covering individual radio stations) may be allocated among the subsidiaries if the parent provides separate statements of account for each of the covered subsidiaries. Hr'g Ex. SX-02 at 6 (Bender WDT).

2. Loading Reports of Use

1357. Reports of use are associated with a service's payments and statements of account for a particular period and loaded into SoundExchange's system. Details of the required reporting vary among different types of services, but broadly speaking, the reports are supposed to provide information about matters such as the sound recording title, album, artist, marketing

label, International Standard Recording Code ("ISRC"), and other information, as well as information about the number of performances. If a report does not conform to the required format and delivery specifications, it may not load without substantial manual intervention. Instead, SoundExchange staff must review the reports, identify the kinds of corrections that need to be made, work with the service to obtain a corrected report from the service, and then attempt again to load the report into the system. In some instances, services fail to accurately report identifying data for sound recordings by, for example, specifying that the artist is "Various," a composer such as "Beethoven" or "Mozart," or the disc jockey who played the sound recording, or simply not providing required information. Because the same songs have frequently been recorded by multiple artists, artist name is a critical piece of information for matching reported use to known sound recordings. Another piece of information that is important is the ISRC, which uniquely identifies a particular recording of a performance, especially where even slight differences may affect the copyright owner. For example, if an artist records an unplugged and a studio version of the same track, the ISRC can help identify which performance, and therefore which copyright owner(s), ought to be paid. In each of these instances, it is not possible to rely on the reported artist name alone to match reported use to known sound recordings. When SoundExchange receives missing or inaccurate data, the ten or so employees in the Claims Department staff have to research the partially identified sound recording in order to identify accurately the sound recording copyright owners and performers entitled to royalties. Hr'g Ex. SX-02 at 6-7 (Bender WDT).

3. Matching

1358. SoundExchange's systems seek to match the recordings reported in licensee reports of use with information in SoundExchange's database concerning known recordings and their copyright owners and performers. SoundExchange's complex log loading algorithm

attempts to match identical and similar data elements and combinations of data elements from the incoming log against performance information previously received from the services, or against source repertoire data, or otherwise contained in SoundExchange's database. If there is a match for a particular sound recording, then the system identifies the corresponding copyright owner and performer information. However, a reported recording might not match a known recording if, for example, the service has performed a recording by an unsigned artist, or a very new, old, foreign, or other obscure recording that has not previously been reported to SoundExchange, or if the service has provided incomplete or incorrect identifying information. Hr'g Ex. SX-02 at 7-8 (Bender WDT).

4. Research

1359. SoundExchange has built its database of sound recordings from scratch, based in part on information reported to it by the services. To the extent a reported recording does not sufficiently match a known recording, SoundExchange personnel will research the recording in an effort to determine whether it should be added to SoundExchange's database or whether it is in the database under different identifying information. This research requires a significant amount of staff time. Such research is often required for new releases, works reported for the first time, works from small labels, compilation albums, and foreign repertoire. In the case of compilation albums, for example, finding copyright ownership information is particularly time-consuming because, although the album is issued by one label, each of the sound recordings on it is often owned by a different label. Hr'g Ex. SX-02 at 8 (Bender WDT).

1360. SoundExchange conducts extensive data quality assurance work to ensure the correct association of copyright owners and performers, on the one hand, and particular performances, on the other. When SoundExchange receives information that is inaccurate or in conflict with other information, SoundExchange conducts research to determine the copyright

owner and performers for the sound recording, and also has a process for identifying and resolving conflicts that arise between different payees. Hr'g Ex. SX-02 at 8 (Bender WDT).

5. Account Assignment

1361. SoundExchange then assigns reported sound recording performances to accounts belonging to copyright owners and performers. Performances for which a copyright owner or artist account is not identifiable (e.g., because the recording reported has not yet been matched to a recording known to SoundExchange) are flagged for later review and research. This is often the result of poor quality data provided by licensees, or due to artists that have not registered with SoundExchange. Once identification is made, these performances are processed through the steps that follow, with the associated royalties being released in the next scheduled distribution. Hr'g Ex. SX-02 at 8-9 (Bender WDT).

6. Royalty Allocation

1362. Once account assignment has occurred, a service's royalty payments for a given distribution period are allocated to sound recordings used by that service during that period and to SoundExchange's costs deductible under section 114(g)(3) (sometimes referred to as SoundExchange's "administrative fee"). SoundExchange distributes royalties to performers and copyright owners based on the reporting that the services provide to SoundExchange. Hr'g Ex. SX-02 at 9 (Bender WDT).

1363. Before distribution of allocated funds, SoundExchange takes several quality assurance steps to ensure accounts are payable, address and tax identification information is complete, and performances in conflict and copyright owner conflicts are resolved (to the extent practicable). Hr'g Ex. SX-02 at 9 (Bender WDT).

7. Adjustment

1364. Once allocations are completed, it is sometimes necessary to adjust particular accounts to rectify transaction-specific or recording-specific reporting and other errors that occurred in prior distributions. For example, if Copyright Owner A was incorrectly reported as the copyright owner of Recording X and received royalties for Recording X, but the actual owner of that recording was Copyright Owner B, then SoundExchange would need to credit Copyright Owner B in a future distribution and debit Copyright Owner A's account for the improper distribution. Adjustments typically take the form of an additional payment or a reduced payment to an existing account in the next scheduled distribution. For copyright owners and artists who are newly identified and for whom royalties have been accruing, a new account is created and royalties attributed to the related repertoire are transferred to the new account. Hr'g Ex. SX-02 at 9 (Bender WDT).

8. Distribution

1365. This process begins with aggregating allocations across licensees' reports of use within a license category according to earning entity (i.e., the person or entity who has earned the royalties from a tax standpoint), which are then assigned to copyright owners, artists, or certain other payees (such as a producer who an artist directs SoundExchange to pay) based on the payment instructions for each. Next, the system generates a payment file, which SoundExchange transmits to its banking partner. SoundExchange generally provides each payee with a statement reflecting the sound recording usage — and the licenses under which the sound recordings were performed — for which the royalty payment is made. When there is a payable balance in a payee's account above the distribution threshold, a check is mailed or funds are electronically transferred. Hr'g Ex. SX-02 at 10 (Bender WDT).

1366. SoundExchange's database containing payee information is derived from account information received from record labels and artists, and includes such payees as the copyright owners and artists themselves, management companies, production companies, estates, and heirs. SoundExchange must, however, verify address and other information and secure appropriate tax forms directly from each artist and label. If an earning entity fails to provide SoundExchange with tax information, then SoundExchange can still distribute royalties but must withhold a portion of the royalties pursuant to applicable Internal Revenue Service guidelines. Hr'g Ex. SX-02 at 10 (Bender WDT).

1367. As of October 2014, SoundExchange conducted monthly distributions for artists and copyright owners who had royalties due in excess of $100 (and quarterly distributions for all others) for statutorily licensed uses and, at times, for non-statutorily licensed performances for which SoundExchange has collected royalties, such as from non-U.S. performing rights organizations that have money for U.S. performers or copyright owners. The threshold for distributing royalties quarterly to a payee is $10. Distributing smaller amounts would incur significant additional transaction costs. Every payee with a balance greater than $10 receives at least one annual distribution. Payments for which SoundExchange lacks sufficient information to distribute to the appropriate copyright owner or performer are allocated in accordance with 37 C.F.R. §§ 380.8, 380.17, or 380.27 as applicable. When SoundExchange subsequently obtains the information necessary to distribute royalties to a particular copyright owner or performer, it will do so in a future distribution. Hr'g Ex. SX-02 at 10-11 (Bender WDT).

XIX. SECTION 112 ROYALTY FOR EPHEMERAL COPIES

1368. A copyright owner generally has the exclusive right to make copies of the owner's copyrighted works. 17 U.S.C. § 106(1). However, a service that is entitled "to transmit to the public a performance of a sound recording" under the Section 114(f) statutory license is

also entitled to a statutory license to make a copy of that sound recording. 17 U.S.C. § 112(e)(1). These "ephemeral" copies, are subject to certain statutory restrictions. 17 U.S.C § 112(e)(1). The Copyright Royalty Judges are tasked with establishing the rates and terms for the making of ephemeral copies. 17 U.S.C. § 112(e)(4).

1369. SoundExchange has proposed a bundled rate for both the Section 112 right and the Section 114 right, five percent of which shall be allocated as the Section 112 royalty for the making of ephemeral copies. SoundExchange's proposal aligns with the rates and terms from *Web III* for the making of ephemeral copies.

1370. SoundExchange's proposal is supported by the designated testimony of Dr. George Ford.[64] SoundExchange's proposal is also supported by the direct license agreements in the record, which all provide bundled rates for the Section 114 performance right and the Section 112 ephemeral right.

1371. No participant has proposed unbundling the Section 112 royalty and the Section 114 royalty and no participant has proposed an allocation to the Section 112 royalty of anything other than 5%.

A. Ephemeral Copies Have Value

1372. "[W]ebcasters must have both the ephemeral copy right as well as the performance right in order to operate their services." Hr'g Ex. SX-1931 at 12 (Ford WDT). Accordingly, "ephemeral copies have economic value to services that publicly perform sound

[64] Pursuant to 37 C.F.R. § 351.4, SoundExchange designated Dr. Ford's *Web III* testimony as part of its Written Direct Statement. At the hearing, the Judges admitted Dr. Ford's testimony from *Web III* into evidence. Hr'g Tr. 2587:25-2588:21 (May 8, 2015); Hr'g Exs. SX-1931, 1932.

recordings because these services cannot, as a practical matter, properly function without those copies." Hr'g Ex. SX-1931 at 11 (Ford WDT).

B. The Ephemeral Royalty Typically Is Bundled With The Correlative Section 114 Royalty

1373. As of the *Web III* proceeding, Dr. Ford concluded that "in the marketplace deals between record companies and webcasters for non-statutory forms of licenses, it is typical for ephemeral copy rights to be expressly included among the grant of rights provided to the webcaster." Hr'g Ex. SX-1931 at 12 (Ford WDT). There is no evidence that the practice in the marketplace has changed since the *Web III* proceeding.

1374. License agreements in evidence show that it is typical for ephemeral copy rights to be expressly included among the grant of rights provided to the webcaster. [ ] [ ] [ ]. [ ]. [.] [ ].

1375. No participant has offered evidence of a benchmark agreement that does not bundle performance rights and the right to make ephemeral copies.

C. The Results Of The Negotiation Between the Record Companies And The Artists Represents The Appropriate Marketplace Rate

1376. When the Section 112 right is included in a bundle with the Section 114 right, "the buyer is indifferent to the allocation of payments between ephemeral copies and performance royalties." Hr'g Ex. SX-1931 at 16 (Ford WDT). Rather, "artists and the record companies jointly have a real interest in negotiating the Section 112(e) rate." *Id*. "Because the willing buyer is disinterested with respect to that allocation, the agreement between the record companies and the artists thereby becomes the best indication of the proper allocation of royalties." *Id*.

1377. As of the *Web III* proceeding, recording artists and record companies had reached an agreement that five percent of the "payments for activities under Section 112(e) and 114 should be allocated to Section 112(e) activities." Hr'g Ex. SX-1931 at 17 (Ford WDT). No participant has presented evidence in support of a different allocation between artists and record companies.

1378. Because SoundExchange's Board represents both artists and copyright owners, its proposed rate of 5% for ephemeral copies is appropriate evidence and "credibly represents the result that would in fact obtain in a hypothetical marketplace negotiation between a willing buyer and the interested willing sellers under the relevant constraints." Hr'g Ex. SX-1931 at 17 (Ford WDT).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 24, 2015, I caused a copy of the foregoing PUBLIC — **1) PROPOSED FINDINGS OF FACT OF SOUNDEXCHANGE, INC.; 2) PROPOSED CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.; and 3) DECLARATION AND CERTIFICATION OF KELLY M. KLAUS REGARDING RESTRICTED INFORMATION** to be served via electronic mail and first-class, postage prepaid, United States mail, addressed as follows:

Kurt Hanson AccuRadio, LLC 65 E. Wacker Place, Suite 930 Chicago, IL 60601 kurt@accuradio.com Telephone: (312) 284-2440 Facsimile: (312) 284-2450 *AccuRadio, LLC*	George D. Johnson, an individual d.b.a. Geo Music Group 23 Music Square East, Suite 204 Nashville, TN 37203 E-mail: george@georgejohnson.com Telephone: (615) 242-9999 *George D. Johnson (GEO), an individual and digital sound recording copyright creator d.b.a. Geo Music Group*
Kevin Blair Brian Gantman Educational Media Foundation 5700 West Oaks Boulevard Rocklin, CA 95765 kblair@kloveair1.com bgantman@kloveair1.com Telephone: (916) 251-1600 Facsimile: (916) 251-1731 *Educational Media Foundation*	Donna K. Schneider Associate General Counsel, Litigation & IP iHeartMedia, Inc. 200 E. Basse Rd. San Antonio, TX 78209 DonnaSchneider@iheartmedia.com Telephone: (210) 832-3468 Facsimile: (210) 832-3127 *iHeartMedia, Inc.*
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Cindi Richardson

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Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

DECLARATION AND CERTIFICATION OF KELLY M. KLAUS REGARDING RESTRICTED INFORMATION

1. My name is Kelly M. Klaus. I am counsel for SoundExchange, Inc. ("SoundExchange") in Docket No. 14-CRB-0001-WR (2016-2020). I respectfully submit this declaration and accompanying Redaction Log (Attachment A) to comply with the Copyright Royalty Judges' Protective Order, dated October 10, 2014. I am authorized by SoundExchange to submit this declaration on its behalf.

2. I and/or attorneys working under my direction have reviewed SoundExchange's Redaction Log in Support of SoundExchange's Proposed Findings of Fact and Proposed Conclusions of Law. Those attorneys and I also have reviewed the terms of the Protective Order.

3. After consulting with my client and the entities whose interests SoundExchange represents in this proceeding and who have provided confidential information for the preparation of this case, attorneys working under my direction and I have determined that portions of SoundExchange's Proposed Findings of Fact and Proposed Conclusions of Law contain information that should be treated as confidential under the Protective Order. Pursuant

to the terms of the Protective Order, such confidential information has been designated and marked as "Restricted."

4. The Restricted information that SoundExchange is submitting includes, among other things, (a) materials or testimony admitted into evidence as Restricted materials or testimony by the Copyright Royalty Judges; (b) materials or testimony relating to or constituting contracts, contract terms, or performance data that are proprietary, not publicly available, commercially sensitive, or subject to express confidentiality obligations in agreements with third parties; (c) materials or testimony relating to or constituting internal business information, negotiating positions, negotiation strategy, financial data and projections, and competitive strategy that are proprietary, not publicly available, or commercially sensitive; and (d) third party information provided in confidence, not publicly available, or subject to express confidentiality obligations.

5. In addition, attorneys working under my direction and I have determined that portions of SoundExchange's Proposed Findings of Fact and Proposed Conclusions of Law contain information previously designated "Restricted" by a participant in this proceeding pursuant to the terms of the Protective Order.

6. The public disclosure of the Restricted information that SoundExchange is submitting would be likely to cause significant harm. The disclosure would provide an unfair competitive advantage to competitors and/or current or future negotiating counterparties of those whose information would be disclosed. Many but not all competitors and counterparties also are parties to this proceeding. Public disclosure of this information also would place SoundExchange, the entities whose interests it represents and their business partners, and other entities at a significant commercial disadvantage and would pose serious risk to their business

interests and strategies.

7. Pursuant to the terms of the Protective Order, SoundExchange is submitting under seal the materials designated Restricted and is redacting such materials from the Public version of its submission. Attachment A is a Redaction Log that identifies the Restricted materials in SoundExchange's submission and sets forth the basis for each designation.

Pursuant to 28 U.S.C. § 1746 and 37 C.F.R. § 350.4(e)(1), I hereby declare under the penalty of perjury that, to the best of my knowledge, information and belief, the foregoing is true and correct.

Dated: June 24, 2015

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ATTACHMENT A

SoundExchange's Proposed Findings of Fact and Conclusions of Law Redaction Log

Section	Paragraph/Graphic Source	Description and Basis for Redaction
III. The Willing Buyer Willing Seller Standard And The Hypothetical Market	¶ 154 (three redactions) ¶ 158 (two redactions) ¶ 160 (two redactions) ¶ 161 ¶ 162 ¶ 163 ¶ 164	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of a confidential license agreement.
IV. Sound Recordings Are A Unique Product, Created From The Contributions Of Recording Artists And Record Companies, That Increasingly Depend On Webcasting Revenues	¶ 183 ¶ 188 ¶ 203 (two redactions) ¶ 208 (two redactions) ¶ 184 ¶ 187 ¶ 194 ¶ 195 ¶ 202 ¶ 206 ¶ 207	Information, admitted by the CRB as Restricted Material, concerning Sony's financial information or business plans. Information, admitted by the CRB as Restricted Material, concerning Universal Music Group's financial information or business plans.
V. Overview Of Existing Direct Licensing Market	¶ 233 ¶295 ¶ 235 ¶ 236 ¶ 254 ¶ 255 ¶ 267 (two redactions) ¶ 309 ¶ 311 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning Beggars' financial information. Information, admitted by the CRB as Restricted Material, concerning confidential submissions to the Federal Trade Commission. Information, admitted by the CRB as Restricted Material, concerning Sony's financial information or business plans.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 240 (two redactions) ¶ 258 ¶ 260 (two redactions; restricted graphic) ¶ 261 ¶ 265 ¶ 267 (one redaction; restricted graphic) ¶ 269 ¶ 273 ¶ 280 ¶ 281 (two redactions) ¶ 282 ¶ 283 (two redactions; restricted graphic) ¶ 284 (two redactions) ¶ 285 (three redactions) ¶ 286 (two redactions) ¶ 296 (two redactions) ¶ 298 (two redactions) ¶ 299 (four redactions) ¶ 302 ¶ 303 (two redactions) ¶ 305 (two redactions) ¶ 306 (three redactions) ¶ 307 (three redactions) ¶ 311 ¶ 312	Information, admitted by the CRB as Restricted Material, concerning Pandora's financial information or business plans.
V. Overview Of Existing Direct Licensing Market	¶ 267 (two redactions) ¶ 309 (three redactions) ¶ 311 ¶ 269 ¶ 274 (two redactions) ¶ 286 (two redactions) ¶ 287 (two redactions) ¶ 288 (two redactions; restricted email) ¶ 289 ¶ 290 ¶ 294 ¶ 295 (two redactions) ¶ 300 (three redactions)	Information, admitted by the CRB as Restricted Material, concerning UMG's financial information or business plans. Information, admitted by the CRB as Restricted Material, concerning iHeart's financial information or business plans.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 277 (five redactions) ¶ 301 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning Sirius XM's financial information or business plans.
VII. SoundExchange's Rate Proposal Is Reasonable and Is Supported by a "Thick Market" Of Benchmark Evidence	¶ 326 ¶ 327 (two redactions) ¶ 328 (two redactions) ¶ 329 (four redactions) ¶ 330 ¶ 427 (four redactions) ¶ 428 (four redactions) ¶ 429 ¶ 430 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning the "greater-of" structure in the labels' streaming agreements.
	¶ 331 (three redactions) ¶ 350 (three redactions) ¶ 351 (four redactions) ¶ 355 ¶ 388 (three redactions; restricted graphic) ¶ 389 (two redactions) ¶ 390 (two redactions) ¶ 485	Information, admitted by the CRB as Restricted Material, concerning Pandora's financial information or business plans.
	¶ 344 (two redactions) ¶ 365 ¶ 367 (two redactions) ¶ 368 ¶ 370 (two redactions) ¶ 371 ¶ 375 (three redactions) ¶ 376 ¶ 377 (four redactions) ¶ 378 n.6 (two redactions) ¶ 379 (three redactions) ¶ 386 (three redactions) ¶ 391 ¶ 393 (two redactions) ¶ 397 ¶ 398 ¶ 406 ¶ 409 (three redactions) ¶ 432 (three redactions) ¶ 433 (four redactions)	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of a confidential license agreement.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 472 ¶ 473 ¶ 474 ¶ 475 ¶ 476 ¶ 477 ¶ 478 ¶ 479 ¶ 480 ¶ 483 (two redactions) ¶ 489 (four redactions) ¶ 492 (two redactions) ¶ 495 (four redactions)	
VII. SoundExchange's Rate Proposal Is Reasonable and Is Supported by a "Thick Market" Of Benchmark Evidence	¶ 454 ¶ 455 ¶ 456 ¶ 457 ¶ 458 ¶ 461 ¶ 462	Information, admitted by the CRB as Restricted Material, concerning confidential submissions to the Federal Trade Commission.
VIII. Pandora's Rate Proposal Is Not Supported By Admissible Or Competent Evidence	¶ 507 (two redactions) ¶ 537 (two redactions) ¶ 538 (two redactions; restricted graphic) ¶ 539 ¶ 540 (three redactions) ¶ 541 ¶ 542 (three redactions) ¶ 543 (three redactions) ¶ 544 (two redactions) ¶ 546 (two redactions) ¶ 554 (first redaction) ¶ 556 ¶ 567 ¶ 568 (two redactions; restricted graphic) ¶ 577 (two redactions) ¶ 578 ¶ 599 ¶ 606 ¶ 633 ¶ 659 (two redactions;	Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	restricted graphic) ¶ 660 (restricted graphic) ¶ 662 ¶ 663 ¶ 726 ¶ 740 ¶ 743 ¶ 744	
VIII. Pandora's Rate Proposal Is Not Supported By Admissible Or Competent Evidence	¶ 510 ¶ 511 ¶ 512 ¶ 513 (two redactions) ¶ 514 (two redactions) ¶ 515 ¶ 516 ¶ 518 (two redactions) ¶ 519 ¶ 520 (two redactions) ¶ 522 ¶ 523 ¶ 524 ¶ 525 ¶ 532 ¶ 551 ¶ 553 ¶ 559 (two redactions) ¶ 560 ¶ 562 (two redactions) ¶ 570 ¶ 571 (two redactions; restricted graphic) ¶ 572 ¶ 573 ¶ 574 ¶ 575 ¶ 579 (two redactions) ¶ 587 ¶ 588 ¶ 590 ¶ 591 ¶ 600 ¶ 602	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of the Pandora – Merlin license.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 603 ¶ 605 ¶ 607 ¶ 608 ¶ 609 ¶ 610 ¶ 611 ¶ 612 ¶ 613 ¶ 614 ¶ 615 ¶ 616 ¶ 617 ¶ 618 ¶ 619 ¶ 620 ¶ 621 ¶ 622 ¶ 623 ¶ 624 ¶ 625 ¶ 626 ¶ 628 ¶ 629 ¶ 630 ¶ 631 ¶ 632 ¶ 634 ¶ 635 ¶ 636 ¶ 637 ¶ 638 ¶ 639 ¶ 641 ¶ 642 ¶ 644 (two redactions) ¶ 645 ¶ 647 ¶ 648 ¶ 649 ¶ 651 ¶ 653 (two redactions) ¶ 654 (two redactions) ¶ 655	

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 656 ¶ 657 (four redactions) ¶ 658 ¶ 661 ¶ 679 ¶ 680 ¶ 687 (two redactions) ¶ 688 ¶ 690 ¶ 691 ¶ 692 ¶ 696 ¶ 697 (two redactions) ¶ 698 ¶ 699 ¶ 702 ¶ 703 ¶ 704 ¶ 705 ¶ 706 ¶ 707 ¶ 708 ¶ 710 (two redactions) ¶ 712 ¶ 713 ¶ 714 ¶ 715 ¶ 716 ¶ 719 ¶ 720 ¶ 733 ¶ 734 ¶ 736 ¶ 737 Subheading D.1.b.(i). Subheading D.1.b.(ii). Subheading D.1.b.(iii). Subheading D.1.b.(iv). Subheading D.3.b. Fn. 17 Fn. 18	

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 547 (three redactions) ¶ 548 (three redactions) ¶ 549 ¶ 550 ¶ 554 (second and third redaction) ¶ 582 (four redactions) ¶ 583 ¶ 584 (two redactions) ¶ 601 ¶ 604 ¶ 721 ¶ 722 ¶ 729	Information, admitted by the CRB as Restricted Material, concerning confidential information regarding performance of the Pandora-Merlin license agreement.
IX. iHeart's Rate Proposal Is Not Supported By The iHeart-Warner Agreement, By iHeart's Agreements With Independent Labels, Or By Sound Economics	¶ 755 (two redactions) ¶ 756 (nineteen redactions) ¶ 757 (two redactions) ¶ 758 ¶ 759 (three redactions) ¶ 761 (three redactions) ¶ 763 (three redactions) ¶ 765 (three redactions) ¶ 772 ¶ 773 ¶ 778 (two redactions) ¶ 779 (five redactions) ¶ 780 (six redactions) ¶ 781 (two redactions) ¶ 782 ¶ 783 (four redactions) ¶ 784 ¶ 786 (two redactions) ¶ 788 ¶ 789 ¶ 790 (three redactions) ¶ 791 (five redactions) ¶ 792 ¶ 794 (five redactions; restricted table) ¶ 798 ¶ 801 ¶ 806 ¶ 807 (three redactions)	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of the iHeart-Warner confidential license agreement.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 808 ¶ 810 (three redactions) ¶ 811 (three redactions) ¶ 812 (two redactions) ¶ 813 (three redactions) ¶ 814 (two redactions) ¶ 815 ¶ 816 (seven redactions; restricted email) ¶ 817 (two redactions) ¶ 818 (three redactions) ¶ 819 (two redactions) ¶ 820 (two redactions) ¶ 821 (three redactions) ¶ 822 (four redactions) ¶ 823 (five redactions) ¶ 824 (five redactions) ¶ 825 (six redactions) ¶ 826 (three redactions) ¶ 827 (three redactions) ¶ 828 (four redactions) ¶ 829 (two redactions) ¶ 830 (three redactions) ¶ 831 (three redactions) ¶ 832 ¶ 846 (three redactions; restricted table) ¶ 847 (two redactions) ¶ 848 (two redactions; restricted graphic) ¶ 849 (two redactions) ¶ 850 (two redactions) ¶ 851 ¶ 853 (eight redactions) ¶ 854 (seven redactions; restricted table) ¶ 856 (restricted table) ¶ 857 (seven redactions; restricted table) ¶ 858 (three redactions) (restricted table) Subheading B.3. Subheading B.5.b.	

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	Subheading B.5.c. Subheading C.2.d. (two redactions) Subheading C.2.e. (two redactions) Subheading C.2.f. Subheading C.2.g. Subheading C.4. Subheading C.5. Fn. 22 (two redactions) Fn. 25 (two redactions) Fn. 27 (two redactions) Fn. 31 Fn. 33 Fn. 34 Fn. 35 Fn. 40 Fn. 41 Fn. 38 Fn. 39	
IX. iHeart's Rate Proposal Is Not Supported By The iHeart-Warner Agreement, By iHeart's Agreements With Independent Labels, Or By Sound Economics	¶ 861 (three redactions) ¶ 862 (five redactions) ¶ 864 (three redactions) ¶ 865 (four redactions; restricted graphic) ¶ 866 (two redactions) ¶ 867 (three redactions) ¶ 793 (seven redactions; restricted table) ¶ 803 (three redactions) ¶ 804 ¶ 834 (three redactions) ¶ 835 (five redactions) ¶ 836 (two redactions) ¶ 837 ¶ 838 (two redactions) ¶ 839 ¶ 841 ¶ 842 (two redactions) ¶ 843 (seven redactions) ¶ 844 (two redactions;	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of the iHeart-Independent confidential license agreements. Information, admitted by the CRB as Restricted Material, concerning confidential information regarding performance of the iHeart-Warner Agreement.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	restricted graphic) ¶ 845 (four redactions; restricted table) ¶ 863 Fn. 26 Fn. 29 Fn. 30 Fn. 36 (three redactions) Fn. 37 (two redactions)	
X. NAB's Proposed "Zone of Reasonableness" Has No Market Basis And Is Inappropriate For This Proceeding	¶ 912 ¶ 924 ¶ 925 ¶ 927 ¶ 932	Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans.
XI. The Apple iTunes Radio Agreements, Beats "The Sentence," Rhapsody "UnRadio," Nokia "MixRadio," And Spotify "Shuffle" Support SoundExchange's Rate Proposal	¶ 940 (first and third redactions) ¶ 941 (two redactions) ¶ 942 (three redactions) ¶ 943 (six redactions) ¶ 944 ¶ 948 ¶ 952 ¶ 953 ¶ 955(two redactions) ¶ 956 (three redactions) ¶ 957 ¶ 958 (three redactions) ¶ 959 ¶ 960 ¶ 961 (two redactions) ¶ 962 (two redactions) ¶ 963 ¶ 964 ¶ 965 (four redactions) ¶ 966 ¶ 967 ¶ 968 (two redactions) ¶ 969 ¶ 970 (three redactions) ¶ 972 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of the Apple and Section III.E. confidential license agreements.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 973 (two redactions) ¶ 977 (two redactions) ¶ 978 (two redactions) ¶ 979 (three redactions) ¶ 980 (three redactions) ¶ 981 ¶ 985 (two redactions) ¶ 986 (two redactions) ¶ 988 ¶ 1001 (four redactions) ¶ 1002 (three redactions) ¶ 1003 (four redactions) ¶ 1004 ¶ 1005 ¶ 1006 (three redactions) ¶ 1007 ¶ 1008 ¶ 1010 (two redactions) ¶ 1011 (two redactions) ¶ 1013 (two redactions) ¶ 1014 ¶ 1015 ¶ 1017 (two redactions) ¶ 1018 (two redactions) ¶ 1019 (two redactions; restricted image) ¶ 1020 (three redactions) ¶ 1021 (two redactions) ¶ 1022 (three redactions) ¶ 1023 (five redactions; restricted image) ¶ 1024 ¶ 1025 ¶ 1026 (five redactions) ¶ 1030 (second and third redactions) ¶ 1031 (three redactions) ¶ 1033 (three redactions Subheading A.1.4. Fn. 46 (four redactions) Fn. 47 (two redactions) Fn. 48	

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	Fn. 49 (three redactions)	
	¶ 940 (second redaction) ¶ 1027 (two redactions) ¶ 1028 ¶ 1029 ¶ 1030 (first redaction)	Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans.
	¶ 971 (two redactions) ¶ 989 (two redactions) ¶ 990 ¶ 991 (three redactions) ¶ 992 ¶ 993 ¶ 994 ¶ 995 (two redactions) ¶ 996 (two redactions) ¶ 997 ¶ 998 ¶ 999 ¶ 1012 (two redactions) Fn. 44	Information, admitted by the CRB as Restricted Material, concerning confidential information regarding performance of the Apple and Section III.E license agreements.
XII. NAB's And Sirius XM's Attacks On Their WSA Settlements Are Unfounded	¶ 1078 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning confidential financial information.

Section	Paragraph/Graphic Source	Description and Basis for Redaction
XIII. The Record Shows That Consumer Use Of Statutory Services Interferes With Higher-ARPU Copyright Owner Revenue From Directly Licensed Services; The Record Failed To Support The Services' Contention That Consumer Use Of Statutory Services Is "Net Promotional" (As Compared To Use Of Directly Licensed Services) Of Copyright Owner Revenue	¶ 1087 ¶ 1101 (two redactions) ¶ 1103 (two redactions)	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of a confidential license agreement.
	¶ 1116 ¶ 1117 (two redactions; restricted graphic)	Information, admitted by the CRB as Restricted Material, concerning confidential information regarding performance of a license agreement.
	¶ 1105 (three redactions) ¶ 1106 (four redactions) ¶ 1108 (two redactions; restricted graphic) ¶ 1109 (three redactions; restricted email) ¶ 1110 (two redactions) ¶ 1114 ¶ 1139 (six redactions) ¶ 1147 (three redactions) ¶ 1163 (five redactions; restricted email) ¶ 1166 ¶ 1170 ¶ 1171 ¶ 1172 ¶ 1173 ¶ 1183 (two redactions) ¶ 1184 (four redactions) ¶ 1185 (three redactions; restricted graphic) ¶ 1149	Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans. Information, admitted by the CRB as

Section	Paragraph/Graphic Source	Description and Basis for Redaction
	¶ 1155 ¶ 1156 ¶ 1159	Restricted Material, concerning confidential information.
XIV. The Finances And Profitability Of The Webcasting Market	¶ 1199 (two redactions) ¶ 1230 ¶ 1205 ¶ 1214 ¶ 1215 (three redactions)	Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans. Information, admitted by the CRB as Restricted Material, concerning confidential financial information or business plans.
XVII. Proposed Terms And Regulations	¶ 1273 (three redactions)	Information, admitted by the CRB as Restricted Material, concerning the terms of a confidential license agreement.
XIX. Section 112 Royalty For Ephemeral Copies	¶1374	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of a confidential license agreement.
PROPOSED CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.		
III. The Rates And Terms Of The Pandora-Merlin Agreement Are Inadmissible And May Not Be Taken Into Consideration In Setting Rates And Terms In This Proceeding	Sub - Section A ¶ 39 ¶ 47 ¶ 48 ¶ 52 ¶ 53	Information, admitted by the CRB as Restricted Material, concerning the terms or negotiation of the Pandora – Merlin license.