

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Jonathan Bender

**Chief Operating Officer
SoundExchange, Inc.**

October, 2016

BACKGROUND AND QUALIFICATIONS

I am the Chief Operating Officer of SoundExchange, Inc. (“SoundExchange”), a position I have held since September 2011. In this role, I oversee the collection, processing and distribution of royalties for all types of services eligible for statutory licensing, including the satellite digital audio radio services (“SDARS”) and preexisting subscription services (“PSS”) at issue in this proceeding. The groups within SoundExchange that handle repertoire management, rights management, licensee management, data management, account services, and distribution services all report to me. Additionally, I oversee SoundExchange’s technical involvement with licensees and assist with coordination of its systems requirements, development, testing and operations.

In all, I have over 25 years of music industry business and management expertise, including senior operational roles at Concord Music Group, Universal Music Group, and EMI Music. I was senior vice president, operations, IT and digital development at Concord Music Group. Before joining Concord, I spent seven years with Universal Music Group, most recently as vice president, digital asset management and logistics. I also spent nine years with EMI Music, most recently as Director of New Technology. I hold a bachelor’s degree from the University of North Carolina at Chapel Hill and an MBA from Harvard Business School.

SUMMARY

In this testimony, I describe the operations of SoundExchange and the services it provides, and I explain why SoundExchange should be the sole collective for collecting and distributing royalties under the Section 112 and 114 licenses from the SDARS and PSS. I also provide certain information concerning the activities of the SDARS and PSS under the statutory licenses as they relate to SoundExchange. Finally, I explain the rationale for SoundExchange’s

proposals with respect to royalty rates for SDARS and PSS, minimum fees, treatment of ephemeral royalties, and terms and other regulatory language for the statutory licenses at issue in this proceeding.

DISCUSSION

I. SoundExchange's Services

A. Overview of SoundExchange

SoundExchange is a Section 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 their recordings under the statutory licenses in Sections 112(e) and 114 of the Copyright Act. The Copyright Royalty Judges have consistently designated SoundExchange as the sole collective to receive statements of account and royalty payments from licensees and to distribute such royalty payments to copyright owners and performers. SoundExchange was so designated for the services at issue in this proceeding in both *SDARS I* and *SDARS II*. 78 Fed. Reg. 23,054, 23,074 (Apr. 17, 2013); 73 Fed. Reg. 4080, 4099 (Jan. 24, 2008).

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 currently held by two recording artists and five artist representatives.

SoundExchange often refers to the artists and copyright owners that have specifically authorized us to collect royalties on their behalf as “members.” We currently have approximately 79,000 artist members and approximately 41,000 rights owner members (including both record companies and artists who own the copyrights in their own recordings). SoundExchange also distributes statutory royalties to nonmember artists and copyright owners as if they were members. In total, we maintain about 125,000 payee accounts for recording artists and copyright owners.¹

Since its founding, SoundExchange has paid out about \$4 billion in statutory royalties (plus additional royalties collected for members from foreign performing rights organizations and under direct licenses administered by SoundExchange²). In 2015, we distributed over \$800 million in royalties from services subject to statutory licensing.

SoundExchange strives to minimize the administrative costs associated with royalty collection and distribution. In 2015, our administrative rate was 4.6%. For comparison purposes, the American Society of Composers, Authors and Publishers (“ASCAP”) reported an

¹ There is not a one-to-one mapping of member and non-member artists and copyright owners to payee accounts. For example, members of a band may direct us to pay the band’s corporate entity, multiple copyright owners may direct us to pay their distributor, and artists sometimes are the copyright owners of their recordings. In each of these scenarios, multiple artist or copyright owner accounts map to a single payee account.

² One of the services that SoundExchange provides to its members is collecting from foreign counterpart organizations royalties its members earn when their recordings are played abroad. SoundExchange also handles distribution of the artists’ share of performance royalties under certain direct license agreements. We do so principally for the major record companies, who have agreed to allow SoundExchange to perform this function under all their direct licenses for statutory services. One independent record company has asked SoundExchange to perform this function under a direct license it has granted Sirius XM.

operating expense ratio of 12.3% for 2015. ASCAP, 2015 Annual Report, at 25, *available at* <http://www.ascap.com/~media/files/pdf/about/annual-reports/2015-annual-report.pdf>.

B. Royalty Collection and Distribution

SoundExchange's core mission is to collect and distribute statutory royalties as efficiently and accurately as possible. We have developed sophisticated systems, extensive databases and business processes uniquely suited to the challenging task of distributing statutory royalties, and are always working on improvements to our systems, databases and business processes. We are particularly proud of our major technology initiatives over the last several years, including our client portal "SoundExchange Direct," our licensee portal "Licensee Direct,"³ our public site that allows searching of International Standard Recording Codes ("ISRCs"),⁴ and our next generation information technology platform that we call "Next Gen." Next Gen was purpose-built to carry out SoundExchange's mandate, using the latest technology, and consists of a set of six interoperating expert systems supporting the various stages of the royalty collection and distribution process. Below I briefly describe the operational procedures and systems that SoundExchange employs in carrying out our royalty collection and distribution functions.

Receipt of Payment and Reports. SoundExchange's royalty collection and distribution function begins with the receipt of royalty payments and, in general, when licensees comply with applicable regulations, 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

³ <http://licenseedirect.soundexchange.com>.

⁴ Our ISRC search site is available at <https://isrc.soundexchange.com/#!/search>. We are also working on plans to provide access to ISRC information through an application program interface (API), which will allow licensees to obtain in bulk the ISRCs for the recordings they use.

of sound recordings. Historically, these were mostly sent to SoundExchange by postal mail, and in the case of the reports, electronic mail. Today, they are mostly delivered through Licensee Direct,⁵ a service that SoundExchange provides to facilitate licensees' compliance with their payment and reporting obligations. That portal calculates royalty payments, and allows licensees to make their royalty payments by credit card, directly upload statements of account and reports of use, and view their account history. Licensees paying through Licensee Direct can view and print confirmations of their payments, and the account history available through Licensee Direct reflects previous payments and reports received by SoundExchange (whether through Licensee Direct or not). Licensees also can view their past reports of use, see the lines of data therein that SoundExchange has identified as not complying with the Judges' reporting regulations, and download ISRCs for their lines of reported usage data that SoundExchange has been able to match to its Repertoire Database (described below).

Whether payments, statements and reports are provided through Licensee Direct or sent by other means, the seven staff members in SoundExchange's License Management Department ensure that the payments, statements and reports are logged into the License Management module of Next Gen and linked to each other. If the licensee operates multiple types of services covered by different statutory rate categories (as do Sirius XM, Music Choice and Muzak), the royalty payments are allocated to the applicable rate categories based on the statements of account. Next Gen then performs various quality assurance checks and flags issues for follow-up by our License Management staff.

If a licensee does not provide a payment or report of use that we are expecting, SoundExchange's License Management staff will try to obtain it from the licensee. If a provided

⁵ Music Choice and Muzak use Licensee Direct to provide their reports of use.

report does not conform to the required format and delivery specifications, they will identify the kinds of corrections that need to be made, and work with the licensee to obtain a corrected report, or in the case of Sirius XM (as described below) and some other licensees, reformat the data themselves, so the report can be loaded for use in the distribution process.

Matching Reported Usage to Repertoire and Payment Information. Under the statutory license structure, data matching is at the heart of SoundExchange's role as collective, because the payment process requires matching the recordings reported in licensee reports of use with information in SoundExchange's databases of known recordings and their copyright owners and performers. This matching presents a complicated data processing challenge, because licensees describe the recordings they use in many varying ways, and frequently incompletely, erroneously or ambiguously. The Usage Data Management module of Next Gen is a sophisticated system designed to make sense of the usage data reported to us to the maximum extent practicable.

In the first instance, the Usage Data Management module seeks automatically to match reports of use against SoundExchange's Repertoire Database, another module of Next Gen. The Repertoire Database is an authoritative repository of information identifying sound recordings. It currently contains identifying information for approximately 20 million unique recordings, which was sourced directly from the copyright owners of the recordings, and includes ISRCs for all of those recordings. We receive electronic data feeds from over 30 larger record companies and distributors to populate this database in real time with information about new releases. This real-time data covers almost all commercially-significant U.S. recordings, and a large number of foreign-origin recordings as well. We have also received repertoire information in other forms from thousands of other rights owners. Three staff members in our Repertoire Management Department are devoted to gathering repertoire information and managing this database.

It is frequently not possible automatically to match reported usage to a recording in our Repertoire Database. That is overwhelmingly the result of a licensee providing incomplete, erroneous or ambiguous information in its report of use, although licensees occasionally do report use of obscure (mostly foreign) repertoire that was not previously known to us. In such cases, the Usage Data Management module of Next Gen will try to match the use against our records of usage previously reported by licensees. In many cases we will have manually reviewed a similar report (from the same licensee or another) at some point in the past and made a judgment as to what recording was probably used. In other cases, the 17 staff in our Data Management Department will manually review and if necessary research the reported use. In such a case, the results of that research will inform the automatic matching of similar reports in the future.

Royalty Processing and Distribution. Once usage is matched, the Royalty Processing module of Next Gen allocates a licensee's royalty payment for a given period to the sound recordings used by the licensee based on the amount of usage reported, after deduction of SoundExchange's costs under Section 114(g)(3) (sometimes referred to as SoundExchange's "administrative fee"). In the case of the SDARS and PSS, this allocation is made on the basis of plays to the audience on a channel of the service, or what we sometime refer to as "spins." This is in contrast to webcasting royalties, which we distribute on the basis of "performances" to listeners. In the case of the PSS, this is what the Judges' regulations clearly require, because the PSS are only expected to report the playlists of their channels, and not any information about

actual listenership. 37 C.F.R. § 370.3(d). Historically at least it was understood that the architectures of their services did not enable them to collect actual listenership information.⁶

In the case of Sirius XM, the applicable report of use regulations are the same ones that apply to webcasters. Thus, the regulations do require reporting of performances to individual listeners, or as an alternative, aggregate tuning hours (“ATH”) and other information that would allow us to weight distributions by satellite listenership at the channel level. 37 C.F.R. § 370.4(d)(2)(vii). However, Sirius XM has never provided that information. Instead, it has asserted “that such reporting is not possible because Sirius XM’s satellite radio service is ‘one way.’” Comments of Sirius XM Radio Inc. in Docket No. 14-CRB-0005 (RM), at 6-7 (June 30, 2014). While that may be changing, as discussed below, to date, SoundExchange has had no alternative but to distribute SDARS royalties on the basis of the spin information contained in what Sirius XM provides as its reports of use. *See* 37 C.F.R. § 382.13(f)(1) (SoundExchange to distribute SDARS royalties “based upon the information provided under the reports of use requirements”). This information does not reflect the number of actual listeners.

Royalties are allocated first to what SoundExchange refers to as “earning entities” (the artist, artist heir or copyright owner who has earned the royalties from a tax standpoint) and then to payees (which may be the artist, heir or copyright owner, or a management company, production company or producer whom SoundExchange has been directed to pay on behalf of the earning entity).

The right to be paid based on use of recordings frequently changes, as record company catalogs are bought and sold, exclusive licenses and distribution arrangements are entered into or

⁶ If it was now practicable for the PSS to provide listenership information, SoundExchange would be interested in receiving that information in reports of use.

end, artists change managers or sometimes pass away, and foreign artists and record companies change their performance rights organization affiliations. Nine staff in our Rights Management Department are devoted to ensuring that our Rights Management Database is always populated with the most current information about who is entitled to be paid for use of recordings in our Repertoire Database, and handling situations where there are overlapping claims as to who should be paid for the use of a particular recording.

Through SoundExchange Direct, artists and record companies can register⁷ with SoundExchange and manage their own SoundExchange account and payment information. In addition, the 32 staff in our Account Services Department work to register additional artists and record companies, assist with managing account and payment changes, answer questions, and log all such interactions in the Client Relationship Management module of Next Gen.

The actual royalty distribution process is carried out by the 12 staff members in our Distribution Services Department. For payees who have registered for electronic payment, SoundExchange presently makes monthly distributions of statutory royalties for payees who have royalties due in excess of \$100 and quarterly distributions for payees who have royalties due in excess of \$10. For payees who have not registered for electronic payment, SoundExchange issues paper checks quarterly to payees who have royalties due in excess of \$100. After taking into account any necessary payment adjustments, and withholding taxes

⁷ Before SoundExchange can pay an artist or copyright owner, it needs to receive certain information from the artist or copyright owner, such as verification of identity, identification of payees (including payee shares for artist groups), payment information (including direct deposit information for payees that wish to be paid electronically), and tax information required by the I.R.S. *See, e.g.*, 37 C.F.R. 382.13(f). We refer to the process of providing this information as “registering” with SoundExchange.

where necessary, our banking partner either transfers the royalty payment electronically or mails a check.

Artists, copyright owners and other payees have access to both summary and detailed statements documenting their royalty payments. The detailed statements provide complete information about the usage involved, including the licensee, type of service and amount of usage, by reporting period. Through SoundExchange Direct, artists and record companies can view their complete payment history and download statements in spreadsheet form.

Royalty payments that cannot be distributed because the artist or record company cannot be identified or located, or who have not provided the information necessary for distribution of royalties, are handled in accordance with applicable regulations, such as 37 C.F.R. §§ 382.8 (PSS) and 382.17 (SDARS).

C. Outreach to Artists and Copyright Owners

After more than 15 years of registering artists and copyright owners for payment of statutory royalties, we are able to pay artists and copyright owners on a current basis for the vast majority of usage reported to us. However, there are always new artists and record companies entering the business, and our goal is to ensure all artists and copyright owners are paid the performance royalties they've earned and deserve. Accordingly, the 12 staff in our Industry Relations Department make very extensive efforts to locate and contact artists and copyright owners who are owed royalties, and just as important, educate them about SoundExchange and convince them that they should register with SoundExchange. Our Industry Relations staff includes several senior professionals with deep roots in the music industry who are specifically assigned to cover the music communities in New York, Los Angeles and Nashville, and who regularly travel throughout the country, to build personal relationships with artists, managers,

artist lawyers and small labels. Because we have found that most unregistered artists and copyright owners do not immediately register with SoundExchange upon their first contact with SoundExchange, we try to connect with them in many different ways:

Direct Outreach. Part of what our Industry Relations Department does is to contact artists and record companies directly to tell them we have money for them. They use postal mail, email, phone calls, social media, and agent/management contacts to attempt to reach specific artists who are unregistered, and whose money is waiting for them.

Marketing and Online Outreach. We often hear from artists and copyright owners we contact that SoundExchange royalties sound too good to be true, and that they are afraid to provide us their personal information because they think our offer of money might be a scam. To help overcome such resistance, we undertake marketing campaigns to educate the industry about what we do. The efforts include advertising on music sites and music industry publications, social media outreach, and placing news articles concerning unclaimed funds to help raise awareness and register artists and record companies who have not yet claimed their royalties.

Conference & Event Outreach. We try to reach artists and copyright owners in person as well. In addition to our own events, we attend dozens of conferences and music festivals each year to educate, build relationships and register artists and copyright owners one-on-one. We regularly compare our unregistered artist list with event attendance and performance lists so that we can try to find specific artists at events. Sometimes we literally have had members of our Industry Relations staff wait in artists' lounges to try to find unregistered artists when they are scheduled to perform.

Industry Partner Outreach. We have matched our lists of unregistered artists and copyright owners against the contact lists of more than 150 other organizations, including ASCAP, BandPage, CDBaby, MySpace and ReverbNation, and then jointly reached out by postal mail or email to artists and copyright owners on their lists who have not previously registered with SoundExchange.

D. Compliance and Enforcement

In addition to our core royalty collection and distribution process described above, SoundExchange protects the interests of artists and copyright owners under the statutory licenses through compliance and enforcement measures, such as educating licensees concerning their obligations under the statutory licenses, following up with licensees that do not make payments or provide required reports on a timely basis, conducting audits of licensees, and occasionally seeking to enforce compliance in court when we believe that is necessary.

II. SoundExchange Should Be Designated the Sole Collective to Collect and Distribute SDARS and PSS Royalties

I do not know whether any participant in this proceeding will propose that there be any collective other than SoundExchange, but the Judges should in any event designate SoundExchange as the sole collective to collect and distribute statutory royalties from PSS and SDARS for the 2018-2022 license period. As the foregoing discussion illustrates, SoundExchange has unparalleled experience and expertise in administering the statutory licenses. It has developed sophisticated systems and business processes, perhaps the most authoritative repertoire database in the world, and a wealth of talent, all specifically oriented toward the effective and efficient collection and distribution of statutory royalties. SoundExchange has continued to increase the size of its membership and the number of record label and artist accounts it maintains, such that the vast majority of statutory royalties

SoundExchange receives are distributable to artists and record companies with which it already has a payment relationship. We have processed trillions of sound recording performances, distributed billions of dollars in statutory royalties, and provide a very high degree of service and transparency to licensees, artists and copyright owners, all with a very low administrative fee. Nobody is better situated than SoundExchange to serve as the sole collective to collect and distribute statutory royalties from PSS and SDARS for the 2018-2022 license period, and any change would be highly disruptive to the orderly flow of royalties to the artists and copyright owners that earn them.

III. The PSS and SDARS

This proceeding differs from the Judges' wide-ranging webcasting proceedings in that only three licensees will be eligible for the rates to be determined, which permits a greater focus on their specific circumstances than is possible in a proceeding affecting thousands of licensees. I provide below some information concerning each of these licensees and their interactions with SoundExchange.

A. Sirius XM

Sirius XM provides several types of service in reliance on the statutory licenses. In addition to its SDARS that is the subject of this proceeding, it also provides a webcasting service (subject to the rates in 37 C.F.R. Part 380), a new subscription service delivered through cable and satellite television providers (subject to the rates in 37 C.F.R. Part 383), which SoundExchange refers to as a "CABSAT" service,⁸ and a business establishment service (subject to the rates in 37 C.F.R. Part 384).

⁸ The term CABSAT is a portmanteau blending the words cable and satellite. SoundExchange uses the term to distinguish television-based new subscription services paying us at the rates

SoundExchange has had persistent issues with Sirius XM's compliance with applicable statutory license requirements. As the Judges know, we have pending under Docket No. 2006-1 CRB DSTR (2007-2012) a matter that results from referral by the U.S. District Court for the District of Columbia. SoundExchange's position in that matter is that during the *SDARS I* rate period (between 2007 and 2012), Sirius XM significantly underpaid statutory license royalties by implementing two exclusions from Gross Revenues that were not permitted by the regulations in effect at that time – one associated with its use of pre-1972 sound recordings, and one associated with its Premier or “Best Of” subscription packages.

SoundExchange also has recently received the final report of a royalty examination or “audit” of Sirius XM's payments during the 2010-2012 period. In addition to the underpayments addressed in the case pending before the Judges, that audit revealed various other underpayments during the period under audit. A copy of the audit report is provided as SoundExchange Exhibit 1.

Sirius XM has also persistently failed to provide compliant reports of use for its services, including its *SDARS*. Instead, it provides a complicated hodge-podge of documents: (1) a playlist of recordings used in all of its services, with an indication of the time and channel of each use; (2) a list of the channels available on each of its services; (3) the ATH for each of its webcast channels; and (4) a separate listing of recordings used in Sirius XM's webcasting offering called “On Demand,” with information concerning the number of performances made. Sirius XM has refused SoundExchange's repeated requests to provide compliant reports of use. To have some way of distributing the royalties Sirius XM pays, SoundExchange each month

provided in 37 C.F.R. Part 383 from subscription webcasting services, which also fall in the statutory category of new subscription service, but are subject to the rates in 37 C.F.R. Part 380.

undertakes a complicated manual process of disentangling and recombining this data to generate separate reports of use for each of Sirius XM's services in a format that can be ingested for processing by SoundExchange like other licensees' reports of use.⁹

B. Music Choice

Music Choice provides both a PSS that is the subject of this proceeding and a business establishment service (subject to the rates in 37 C.F.R. Part 384). It also webcasts, at least to subscribers of the cable services that carry its channels, through a family of apps¹⁰ and a web portal. However, Music Choice has taken the position that its webcasting is covered by its PSS license and royalty payments. As a result, it does not separately account to and pay SoundExchange for its webcasting usage, giving SoundExchange no visibility into the extent of Music Choice's webcasting.

The PSS royalties that Music Choice has paid SoundExchange in the last several years, as reported on its year-end statements of account, have been as follows:

⁹ Sirius XM has also been uncooperative in our efforts to conform its statements of account to the definition of Gross Revenues in 37 C.F.R. § 382.11 and the royalty calculation formula in 37 C.F.R. § 382.12. Pursuant to 37 C.F.R. § 382.12, deductions for use of pre-1972 recordings and direct license recordings should be taken after multiplying Sirius XM's Gross Revenues by the percentage royalty rate. Instead, Sirius XM's statements of account report Gross Revenues that have been reduced by percentages allegedly corresponding to the pre-1972 recording share and direct license share as described in 37 C.F.R. § 382.12(d) and (e). Sirius XM provides a cover letter identifying its webcasting consumption on reference channels (in total and for pre-1972 and direct license tracks), but SoundExchange must derive from the information reported by Sirius XM Gross Revenues as defined in 37 C.F.R. § 382.11 and the calculations contemplated by 37 C.F.R. § 382.12(d) and (e).

¹⁰ <http://app.musicchoice.com/>; <https://itunes.apple.com/us/app/music-choice/id573887614?mt=8>; <https://itunes.apple.com/us/app/music-choice-for-ipad/id621427918?mt=8>; <https://play.google.com/store/apps/details?id=com.music.choice&hl=en>.

Year	Royalty Payment
2013	██████████
2014	██████████
2015	██████████

C. Muzak

Muzak has withdrawn from this proceeding, but it nonetheless will be able to rely on the rate determined in this proceeding, to the extent it provides a PSS. The extent to which Muzak provides a PSS is a disputed issue.

Muzak has provided music service to businesses since the 1920s. In 1996, it partnered with EchoStar to launch a consumer music service called DishCD that was distributed through the Dish satellite network. When Congress created the PSS rate category in 1998, by grandfathering the services then in existence, the Dish service powered by Muzak was identified in legislative history as a PSS. H.R. Conf. Rep. No. 105-796, at 80–81 and 89 (1998).

In 2011, Muzak was purchased by Mood Media Corporation (“Mood”). Mood is primarily a business-to-business provider. It bills itself as “the global leader in elevating Customer Experiences.” <http://us.moodmedia.com/about/>. Mood is consolidating its various acquisitions, and has announced that it is retiring the Muzak brand.¹¹ However, Mood has maintained Muzak’s corporate existence, apparently to maintain its status as a PSS. Music is just one component of the portfolio of services Mood offers its business customers, although business music services generate about 90% of the company’s revenues.¹²

¹¹ Ben Sisario, Muzak, Background Music to Life, to Lose Its Name, N.Y. Times (Feb. 4, 2013), http://www.nytimes.com/2013/02/05/business/muzak-background-music-to-life-to-lose-its-name.html?_r=0.

¹² *Id.*

In 2012, Mood acquired DMX Holdings, Inc. and its operating subsidiary DMX, Inc., which had been the provider of the DMX music service. That service was distributed through various providers, but most notably through the DirecTV satellite network. In 1998, the DMX service was recognized as a PSS, but by 2006, it had lost that status, because that service was no longer being provided by the same business entity that had provided it in 1998. *See Designation as a Preexisting Subscription Service*, 71 Fed. Reg. 64,639, 64,646 (Nov. 3, 2006). DMX subsequently paid SoundExchange as a CABSAT service (*i.e.*, a new subscription service subject to the rates in 37 C.F.R. Part 383).

As of May 2014, Mood transferred to Muzak the right to provide music programming through DirecTV and other distributors of the DMX service, and Muzak informed SoundExchange that it would be paying for such distribution at the PSS rates. Because the PSS rates are so much lower than the CABSAT rates, this transaction resulted in a substantial diminution in the royalties being paid to artists and copyright owners through SoundExchange. SoundExchange believed (and believes) that this was improper, because the Copyright Office had previously opined that Muzak was entitled to PSS status only “so long as it provided its music offerings over the DiSH Network.” 71 Fed. Reg. at 64,646. Accordingly, SoundExchange sued Muzak in the U.S. District Court for the District Columbia for underpayment of statutory royalties. That case was dismissed, *SoundExchange, Inc. v. Muzak, LLC*, 167 F. Supp. 3d 147 (D.D.C. 2016), but is now on appeal to the Court of Appeals for the D.C. Circuit. Oral argument is scheduled for November 9, 2016.

In addition to its PSS (and potentially a CABSAT service for which it has been paying PSS rates), Muzak provides a business establishment service subject to the rates in 37 C.F.R. Part 384. I understand that historically it has also provided a business music service with on-site

storage that does not qualify for statutory licensing. It also seems to do some webcasting as an adjunct to its business service, for which it has separately paid webcasting royalties to SoundExchange.

During the current rate period, the PSS royalties that Muzak has paid SoundExchange, as reported on its year-end statements of account, have been as follows:

Year	Royalty Payment
2013	██████████
2014	██████████ ¹³
2015	██████████

IV. SDARS Rate Structure

I now turn to SoundExchange’s proposed rates and terms in this proceeding. First, I describe our SDARS rate request and the rationale therefor.

A. Greater-of Per-Subscriber and Percentage Rates

As described above, SoundExchange has had persistent issues with Sirius XM’s royalty payment practices. It has become clear to us that Sirius XM will take advantage of any arguable ambiguity in the rate regulations, and sometimes even flout regulations that we believe are entirely unambiguous, to reduce the royalties it pays to artists and copyright owners. As demonstrated by the dispute before the Judges in Docket No. 2006-1 CRB DSTRA (2007-2012) and the discussion below, disputes in this regard can involve a large amount of money in absolute terms (given the scale of Sirius XM’s business) and take a very long time to resolve. It is our great desire to minimize the room for future such disputes.

¹³ The increase in 2014 is due, at least in large part, to the DMX transaction described above, and the increase in 2015 is due, at least in large part, to having the DMX transaction affect a full year of royalty payments.

In addition, it appears that Sirius XM commonly grants free trials that are longer than the periods for which royalty-free free trials are permitted in marketplace transactions involving interactive services. Under the current percentage of revenue rate structure, Sirius XM can give away music for an arbitrarily long period without incurring any royalty expense. When that happens, artists and copyright owners are not compensated for use of their recordings by Sirius XM that would be compensable under marketplace agreements with interactive services.

Accordingly, SoundExchange proposes that the SDARS statutory royalty rate be structured as the greater of a per-subscriber rate and 23% percent of “Gross Revenues.” This structure would mirror royalty rate structures common in the marketplace.

The per-subscriber prong of the greater-of would increase over the rate period from \$2.48 per subscriber per month in 2018 to \$2.79 per subscriber per month in 2022. Adopting a per-subscriber component in the rate structure for SDARS would ensure that artists and copyright owners are compensated for the use of their recordings without the potential for accounting issues of the kinds shown in SoundExchange Exhibit 1, and also that they are compensated for the music Sirius XM transmits beyond the length of an industry-standard royalty-free free trial period. The particular per-subscriber rate we have proposed for 2018 is at about the midpoint of the range indicated in the testimony of Jonathan Orszag. For years subsequent to 2018, we have increased our proposed per-subscriber rate at 3% per year, which is approximately the rate of the historical increase in Sirius XM’s subscription price.

We have based the percentage of Gross Revenues prong of our proposed royalty rate structure on the current definition of Gross Revenues. However, as the dispute pending before the Judges concerning the *SDARS I* period and audit report provided as SoundExchange Exhibit 1 illustrate, this complicated definition has given rise to numerous disputes concerning

its application, which involve very substantial sums. To avoid some of those disputes during the coming rate period, in Section 382.20 of our proposed regulations, we propose to clarify a few aspects of the definition without making significant changes in what we understand the current definition to provide. Specifically, our modified version of the definition of Gross Revenues would provide as follows:

- The exclusions from revenue in paragraph (3) should apply only to the extent that the relevant revenue is included by paragraph (1) or (2). While this might seem like a self-evident point, Sirius XM has in the past [REDACTED]
[REDACTED]
[REDACTED]. See SoundExchange Exhibit 1, at 7-8, 9, Schedules 5 & 7. In our modified version of the definition of Gross Revenues, we do not propose to change the exclusion from the royalty base of categories of revenue such as equipment revenue. However, after narrowing the royalty base in that manner, there can be no justification for [REDACTED]
[REDACTED].
- Duplicative exclusions should be eliminated. Taxes and shipping and handling fees are presently excluded twice – once in paragraph (3)(i) specifically as they pertain to equipment revenue and again generally in paragraph (3)(iv). Because equipment appears to be the only thing for Sirius XM to ship and handle, the equipment provision seems to be the right place to exclude shipping and handling revenue. Because taxes are excluded generally in paragraph (3)(iv), there is no reason to say again in the equipment provision of paragraph (3)(i) that taxes are excluded.

- It should be clear which miscellaneous fees are included in or excluded from Gross Revenues. Sirius XM charges its subscribers various miscellaneous fees, including [REDACTED] [REDACTED]. SoundExchange Exhibit 1, at 4-5, 8, Schedules 2 & 6. Paragraph (3)(iv) of the current definition of Gross Revenues in 37 C.F.R. § 382.11 appears to permit exclusion of credit card fees and invoice billing fees. That paragraph also permits exclusion of something called “fulfillment service fees.” It is not entirely clear what those are, although the *SDARS II* determination suggests that they may be activation fees, swap fees and early termination fees. 78 Fed. Reg. at 23,072. We propose replacing the vague reference to fulfillment service fees with specific references to the miscellaneous fees referred to in the *SDARS II* determination. In any event, it should be clear which miscellaneous fees are in or out of the royalty base. Because we understand that the theory of excluding these fees from the royalty base is to enable Sirius XM to recover certain costs that may be perceived as unrelated to the use of sound recordings, rather than as an additional source of profit from providing an SDARS, we also propose clarifying that these fees can be excluded only when they are reasonably related to the Licensee’s expenses to which they pertain.
- Apart from bad debt, there should be no adjustments to revenue based on expenses incurred by Sirius XM. Also in connection with current paragraph (3)(iv), Sirius XM has previously [REDACTED] [REDACTED] [REDACTED]. SoundExchange Exhibit 1, at 8, Schedule 6. Thus,

Sirius XM not only has not paid royalties based on the revenue it generates from subscribers for equipment (as the regulations permit), but it has [REDACTED] [REDACTED] (which we do *not* believe the regulations permit). Accordingly, we propose clarifying that the fees that may be excluded under paragraph (3)(iv) (which we propose renumbering as paragraph (3)(v)) are ones charged to subscribers (which are revenue of Sirius XM) and not fees paid to third parties by Sirius XM (which are expenses of Sirius XM).

- The Judges should confirm again that revenue from subscription bundles is not to be allocated. Under current paragraphs (3)(vi)(A) and (B) (which we propose renumbering as paragraphs (3)(vii)(A) and (B)), Sirius XM’s revenue from certain non-music offerings can be excluded when “offered for a separate charge.” In SDARS II, the Judges specifically stressed that such exclusions require “a separate charge.” 78 Fed. Reg. at 23,072 n.45. However, the audit report provided as SoundExchange Exhibit 1 shows that throughout the SDARS I period at least, [REDACTED] [REDACTED] [REDACTED]. SoundExchange Exhibit 1, at 5-6, Schedule 3. We do not know whether Sirius XM has continued to take such deductions during the *SDARS II* rate period, but to provide further clarity concerning this point going forward, we propose language specifying that excluded services must be “provided on a standalone basis for a separate charge.”

Our modified version of the definition of Gross Revenues does not propose any change to current paragraph (3)(vi)(D) (which we propose renumbering as paragraphs (3)(vii)(D)). The

payment dispute presently pending before the Judges in Docket No. 2006-1 CRB DSTRA (2007-2012) raises (among other things) the question whether Sirius XM was entitled to take a deduction under that provision during the *SDARS I* rate period based on its asserted use of pre-1972 sound recordings. We understand the Judges to have answered that question in the negative when they created a separate mechanism for a pre-1972 deduction in *SDARS II*. See 78 Fed. Reg. at 23,073. We also understand that the pending underpayment proceeding should resolve the historical dispute as to the *SDARS I* period. Accordingly, it does not seem necessary at this time to make any change to that provision. However, if the Judges conclude (contrary to their *SDARS II* determination) that current paragraph (3)(vi)(D) permits a pre-1972 deduction, then some change to the regulations would be required, because Sirius XM should not be allowed a double deduction based on its use of pre-1972 sound recordings (one under current paragraph (3)(vi)(D) of the definition of Gross Revenues and another under 37 C.F.R. § 382.12(e)).

B. Direct License and Pre-1972 Exclusions for SDARS

SoundExchange has incorporated in Subpart C of its proposed regulations royalty exclusions based on Sirius XM's use of directly licensed and pre-1972 recordings, which are based on the current SDARS rate regulations. These exclusions would apply regardless whether Sirius XM's royalty payment for a particular month is based on the per-subscriber or percentage of Gross Revenues rate. However, with several years' experience operating under the exclusions adopted in *SDARS II*, SoundExchange proposes several adjustments, which I describe further below.

First, and most importantly, it appears that Sirius XM's new generation of radios, which has been referred to as SXM17, will at some point during the coming rate period enable

collection of data concerning the actual relative listenership of channels or sound recordings on Sirius XM's satellite service. Sirius XM has announced that these radios will have the capability to communicate back to Sirius XM using the cellular network.¹⁴ Thus, they will fundamentally alter what Sirius XM has previously said is a "one way" service. *See* Comments of Sirius XM Radio Inc. in Docket No. 14-CRB-0005 (RM), at 6-7. From the publicly-available information about these radios, it appears that they will give Sirius XM the capability of collecting and reporting ATH or other relative usage information that Sirius XM is required to provide pursuant to 37 C.F.R. § 370.4(d)(2)(vii), but that Sirius XM has previously said it could not report. If reasonably reliable data of that nature becomes available, we propose using it to calculate the exclusions.

Currently, the exclusions are calculated based on a proxy for actual satellite listenership – Internet performances on the so-called "reference channels" of Sirius XM's webcasting service. In *SDARS II*, SoundExchange proposed that approach for the direct license exclusion, because it seemed (and still seems) to be the best available means of approximating satellite listenership given Sirius XM's then-current satellite radio technology. I want to be clear that I believe that these exclusions *should* be based on listenership (as opposed to spins), as the Judges found in *SDARS II*. *See* 78 Fed. Reg. at 23,073. An exclusion methodology based on spins would be more susceptible to gamesmanship than the current system.

However, Sirius XM's webcasts are not a perfect proxy for satellite listenership. First, there is not a perfect match between Sirius XM's webcast channels and satellite music channels.

¹⁴ SiriusXM Continues Hints at SXM 17, CE Outlook (Apr. 28, 2016), <http://www.ceoutlook.com/2016/04/28/siriusxm-continues-hints-at-sxm-17/>; SiriusXM Reveals Project SXM17, Inside Radio (Apr. 29, 2015), http://www.insideradio.com/free/siriusxm-reveals-project-sxm/article_a85d49d4-ee43-11e4-87a0-87d8a5c14610.html.

Indeed, the regulations anticipate that not all satellite music channels will be webcast. *See* 37 C.F.R. § 382.12(d)(3)(i), (e)(3)(i). One would also expect a mismatch between the webcast proxy and actual satellite listenership due to differences in listening habits between the car and home, office or other mobile environments. For example, I would expect Sirius XM's children's programming to have higher satellite listenership than webcast listenership, because children often ride in cars with their parents, but are probably less likely to listen to webcasts with their parents. In addition, and as described further below, if practicable the methodology for calculating the exclusions and the methodology used by SoundExchange for statutory royalty distributions would preferably be aligned, so artists and copyright owners would be credited with a similar share of Sirius XM's usage whether their works were covered by a direct license or paid for through SoundExchange. Using actual satellite usage data in making these calculations would be the best way of addressing all these issues.

Second, in the absence of actual satellite usage data for making these calculations, we believe there should be some limit on Sirius XM's ability to exploit differences between the methodology used to calculate the direct license deduction and the methodology SoundExchange is required to use to calculate distributions of statutory royalties. We have heard from some independent record companies that Sirius XM is using the mismatch between the exclusion and distribution methodologies as part of its sales pitch to entice indies with popular repertoire that does well on webcasting to enter into direct licenses. As demonstrated in the testimony of Dr. Thomas Lys, if this mismatch affected a sufficient amount of repertoire that is popular in Sirius XM's webcasts, it could have the effect of reducing SoundExchange's per-spin payments to artists and copyright owners whose works are used under the statutory license. This has not happened yet, but given Sirius XM's current efforts to exploit this mismatch, we believe there

needs to be some mechanism to mitigate Sirius XM's incentives to engage in such regulatory arbitrage to the detriment of artists and copyright owners whose works are used under the statutory license. As a simple way of addressing the issue, we have proposed capping the direct license share deduction based on spins on the satellite service until Sirius XM provides the actual satellite usage data required by the Judges' regulations.

Third, the regulations governing the pre-1972 deduction should expressly recognize that some pre-1972 recordings are subject to federal copyright protection, and statutory royalties should be payable for the ones that are. The Judges adopted the pre-1972 exclusion because sound recordings first fixed before February 15, 1972 are generally outside the federal copyright system. *See* 17 U.S.C. § 301(c), 78 Fed. Reg. 23,073 ("pre-1972 recordings are not licensed under the statutory royalty regime"). However, certain pre-1972 recordings of foreign origin *are* subject to federal copyright protection and the statutory license. *See* 17 U.S.C.

§ 104A(h)(6)(C)(ii) (treating certain pre-1972 recordings as restored works). Separate from the general question of whether Sirius XM was entitled to a deduction from Gross Revenues during the *SDARS I* period based on its use of pre-1972 recordings, the status of foreign pre-1972 recordings is an issue in the audit of Sirius XM that SoundExchange just concluded.

SoundExchange Exhibit 1, at 10-11, Schedule 11. Sirius XM also may be using remixed or remastered versions of pre-1972 sound recordings, which may be federally-protected and so subject to statutory licensing. Our proposed Section 382.20 includes changes to the definition of the term Pre-1972 Recording to clearly conform the definition to the scope of federal copyright protection.

Finally, SoundExchange proposes that it receive track-level usage information for the excluded tracks. Currently, Sirius XM is required to provide listings of the excluded tracks (*see*

37 C.F.R. § 382.13(h)), but it provides only aggregate data concerning the number of performances used in calculating the exclusions. Thus, when SoundExchange finds errors in the exclusions, it has no information about usage of the excluded tracks to assess the significance of those errors. In SDARS II, the Judges found that there should be “transparency” in the calculation of the exclusions. 78 Fed. Reg. at 23,073. Because millions of dollars of royalties are at stake, SoundExchange should have visibility into calculation of the exclusions at the track level.

C. Distribution Methodology for SDARS Royalties

As described above, it appears that Sirius XM’s new generation of SXM17 radios will enable collection of data concerning the actual relative listenership of channels or sound recordings on Sirius XM’s satellite service, and thus delivery to SoundExchange of the information concerning performances to individual listeners, or as an alternative, ATH and other information, that has been required by 37 C.F.R. § 370.4(d)(2)(vii). Through that provision, the Judges’ regulations have always contemplated that SDARS royalties would be distributed in a manner that takes into account actual satellite listenership. It has simply been impossible for SoundExchange to do that, because Sirius XM has not provided such data (and has said that such data cannot be collected given its current technology).

The Judges have repeatedly expressed a preference that statutory royalty payments “relate . . . to the value of the sound recording performance rights that give rise to the royalty obligation.” *E.g.*, 78 Fed. Reg. at 23,073. The principle that listening by a large audience is worth more than listening by a small audience applies to distribution of royalties by SoundExchange as well as to payments to SoundExchange. That is why most services, including SDARS, are required to report performances to individual listeners, or as an alternative, ATH

and other information that allows SoundExchange to weight distributions by listenership at the channel level. 37 C.F.R. § 370.4(d)(2)(vii). Section 382.22(a) of our proposed regulations confirms that if Sirius XM is capable of obtaining reliable data concerning actual performances, ATH or other relative listenership, it is required to report that information to SoundExchange in its reports of use, and SoundExchange will then use that data in its royalty distributions as has always been contemplated by the Judges' regulations.

In the meantime, Section 382.22(b) of our proposed regulations would permit (but not require) SoundExchange to incorporate into the distribution methodology for SDARS royalties usage data that may be available. Currently, copyright owners with repertoire that is relatively popular on Sirius XM's webcasting service get credited with a higher proportion of Sirius XM's usage under direct licenses than under the statutory license, because SoundExchange must distribute on the basis of spins on the SDARS. As a result, such copyright owners can get paid more by granting Sirius XM a direct license, even at a lower royalty rate. That condition undermines the statutory license system. It is not clear that there is a way to address that issue fairly with only the usage data currently used to calculate the direct license and pre-1972 exclusions.¹⁵ However, if SoundExchange's Board was able to agree on fair adjustments to the distribution methodology that would incorporate usage data to some extent, it should have the flexibility to do so.

¹⁵ Internet performances on reference channels seem to be a good enough proxy for satellite listenership to use them in determining the overall amount of the exclusions across Sirius XM's entire service in the absence of better usage data. However, the problems discussed above, including the mismatch between the reference channels and satellite channels, would not allow reliance on that data alone for the more granular purpose of royalty distribution to individual artists and record companies.

V. PSS Rates

SoundExchange also proposes changes in the rate structure applicable to PSS. The centerpiece of our PSS rate proposal is to adopt the per-subscriber rates for CABSAT services presently set forth in 37 C.F.R. Part 383 for 2018-2020 (and presently applicable to Sirius XM's CABSAT service). We also propose that the PSS be required to pay for any ancillary Internet streaming at the applicable rate for commercial subscription webcasters. We base this request on the testimony of Dr. Paul Wazzan, who canvassed the field for possible benchmarks to use in setting PSS rates and concluded that the CABSAT rates, supplemented by the webcasting rates where applicable, provide the best available approximation of a likely marketplace rate for services similar to the PSS.

As further explained in Dr. Wazzan's testimony, the core PSS service is the same type of service subject to Part 383, as defined in 37 C.F.R. § 383.2(f) – that is, a noninteractive, audio-only subscription service that transmits a large and broad selection of musical genre channels to residential subscribers of a cable or satellite television service using technology that is incapable of tracking the individual sound recordings received by any particular subscriber. The only difference is that the PSS were in operation in 1998 and the CABSAT services were not.

The CABSAT services are real services. Sirius XM is obviously known to the Judges. For its distribution through the Dish satellite television service, it consistently paid about [REDACTED] annually in CABSAT royalties during 2013-2015. Stingray Digital is a diversified, international provider of audio and video music services that calls itself “the world-leading provider of multiplatform music products and services.”¹⁶ Its CABSAT service has shown rapid growth over the last several years from [REDACTED] in CABSAT royalties in 2013 to

¹⁶ <http://www.stingray.com/>; *see also* http://music.stingray.com/en_US/about.

[REDACTED] in CABSAT royalties in 2015. As recently as 2013, the CABSAT services were paying SoundExchange more in overall royalties than the PSS ([REDACTED] in 2013 CABSAT royalties as compared to [REDACTED] in 2013 PSS royalties). It was only when DMX ceased paying royalties as a CABSAT on April 30, 2014, and Muzak purported to incorporate DMX's service into its PSS, that the balance flipped. Even so, in 2015, the CABSAT services paid almost as much in statutory royalties as the PSS ([REDACTED] in 2015 CABSAT royalties as compared to [REDACTED] in 2015 PSS royalties).

SoundExchange understands that at least Music Choice offers consumer subscribers the option of obtaining webcasts of its channels over the Internet as a supplement to its core television-based service. Music Choice takes the position that its webcasting is part of its PSS and so does not pay separate webcasting royalties for its webcasting. SoundExchange disagrees with that position as to the particular Music Choice offering available today, because the service Music Choice provides over the Internet (*see, e.g.*, <http://app.musicchoice.com/>) appears to include video programming and thus does not appear to us to be within the scope of its PSS as described in the relevant legislative history. *See, e.g.*, H.R. Conf. Rep. No. 105-796, at 89 (1998). However, we do not believe it is necessary to decide that question at this time, because even if the webcasting were part of a PSS, the Judges are permitted to distinguish among different types of transmissions made by a PSS. 17 U.S.C. § 114(f)(1)(A). If the provider of a CABSAT service also were to webcast (as Sirius XM does), it would need to pay additional webcasting royalties for its transmissions that are made over the Internet, rather than through cable or satellite television networks. *See* 37 C.F.R. § 383.2(f). The provider of a PSS should as well. Accordingly, we propose that the applicable commercial webcasting rates in Part 380 apply to any ancillary webcasting that may be part of a PSS.

After more than 20 years of operation at rates anchored in a decision to set a low rate based on the now-discredited musical works benchmark,¹⁷ the time has come for PSS rates to move into line with the rates paid by essentially identical competitor services. This is particularly appropriate given that Muzak has purported to take over the former DMX service, which previously was paying CABSAT rates. While we hope that the D.C. Circuit will agree with us that the DMX service is not the DishCD service, and so is not eligible for the PSS rates, the episode illustrates that whatever market conditions and expectancies might have justified a lower rate in 1998 have long since dissipated.

That leaves the question of what to do about 2021 and 2022, years for which CABSAT rates have not yet been established. While we would be satisfied to refer to Part 383, and thereby defer that question until the next CABSAT proceeding, we understand that the purpose of this proceeding is to set PSS rates through 2022. Accordingly, and without suggesting that this would be an appropriate outcome for the next CABSAT proceeding, we propose rates for the PSS television-based service that in effect continue to step up the CABSAT rates at the same increment of approximately 3% that applies throughout the current CABSAT rate period.

VI. Minimum Fees

SoundExchange proposes no substantive change in the statutorily-required minimum fees for SDARS or PSS, which are currently provided in 37 C.F.R. §§ 382.3(b) and 382.12(c). However, as discussed further below, the specific regulatory language in our proposed Sections 382.2(c), 382.11(b) and 382.21(b) is patterned on that adopted by the Judges in *Web IV*. In each case, the minimum fee would be \$100,000 per year, which would be creditable toward ephemeral royalties under Section 112(e).

¹⁷ See *PSS I*, 63 Fed. Reg. 25,394, 25,409-10 (May 8, 1998).

One rationale for the minimum fee that has been raised in past proceedings is that it should cover SoundExchange's administrative expenses even in the absence of royalties. *Web II*, 72 Fed. Reg. 24,084, 24,096 (May 1, 2007). Much like SoundExchange's position in prior proceedings, I agree that the minimum fee should ensure that every licensee makes an appropriate contribution to the costs of administering the statutory license, as well as a reasonable payment for the usage of sound recordings. This is a very significant issue in webcasting proceedings, where most licensees pay only the minimum fee. It is less of an issue in this proceeding. Most of our costs are effectively shared across services – including things like information technology, maintaining our Repertoire Database, costs of artist outreach, research of repertoire used by multiple services, and distributing royalties, as well as corporate overhead. All three of the services here pay more than a token amount of royalties and so contribute to those costs through their royalties. For that reason, the minimum fee has been noncontroversial in PSS/SDARS proceedings. SoundExchange asks the Judges to continue the current minimums.

VII. Ephemerals

SoundExchange likewise proposes no substantive change in the allocation of royalties between the two separate statutory licenses at issue in this proceeding, which is currently addressed in 37 C.F.R. §§ 382.3(c) and 382.12(b), although again, as above, the specific regulatory language in our proposed Sections 382.11(c) and 382.21(c) is patterned on that adopted by the Judges in *Web IV*. In each case, we assume that the Judges will set a bundled royalty covering both statutory licenses, and propose that it be allocated 95% to Section 114 and 5% to Section 112(e).

We believe that bundling the rights under the two statutory licenses makes sense because services need to make ephemeral copies under Section 112(e) to make performances under

Section 114. As I understand it, voluntary licenses typically convey a similar bundle of rights. However, if the rights and royalties are so bundled, the bundle must be allocated between the two statutory licenses, because Section 114 performance royalties are further allocated between artists and copyright owners as prescribed in Section 114(g), while reproduction royalties under Section 112(e) are payable only to the copyright owner. SoundExchange's Board – which is composed of representatives of both copyright owners and performing artists – previously adopted a resolution reflecting agreement that 5% of the royalties for the bundle of rights should be attributable to the Section 112(e) ephemeral royalties. Accordingly, SoundExchange reiterates that proposal in this proceeding.

VIII. License Terms and Regulatory Language

In the *Web IV* proceeding, the Judges undertook a major rewrite of the regulations embodying the webcasting rates and terms. This presented something of a quandary for SoundExchange as it contemplated its proposed terms and other regulatory language in this proceeding. On the one hand, SoundExchange has only targeted concerns with the terms and other regulatory language currently applicable to the SDARS and PSS. On the other hand, we agree that the “plain language” format ultimately adopted by the Judges is clearer in many respects than the predecessor regulations. *See* 81 Fed. Reg. 26,316, 26,316 n.1 (May 2, 2016). The SDARS regulations, and to a significant extent the PSS regulations, have tended to track the webcasting regulations, and there are significant operational advantages for both SoundExchange and licensees in having provisions that are relatively consistent across rate categories, unless there is good reason for inconsistency. *See SDARS II*, 78 Fed. Reg. at 23,073 (“In general, the Judges seek, where possible, consistency across licenses to promote efficiency and minimize costs in administering the licenses.”). Accordingly, SoundExchange used the regulations

adopted by the Judges in *Web IV* as the model for the regulations it is proposing in this proceeding.

We have included in our proposed regulations drafting notes explaining the origins of various provisions and highlighting instances in which we propose addressing an issue in a way more like the current PSS or SDARS regulations or making other changes. I elaborate on the more material points in this part of my testimony.

A. Unclaimed Funds

Our proposed regulations include in Section 382.4(b) an unclaimed funds provision based on current 37 C.F.R. § 382.8 and § 382.17 rather than the analogous provision of the webcasting regulations (37 C.F.R. § 380.4(b)). In *Web IV*, the Judges adopted changes to the webcasting unclaimed funds provision “in abundance of caution” based on Pandora’s suggestion that the terms of the federal statutory license must or should defer to state escheat law. 81 Fed. Reg. at 26,400. The thrust of these changes was to eliminate the clear direction to SoundExchange to apply unclaimed funds to offset deductible costs under 17 U.S.C. § 114(g)(3), and the clear statement that the regime adopted by the Judges applies “notwithstanding the common law or statutes of any State,” and replace those directions with a vague reference to other applicable law. SoundExchange opposes making any such change in the terms applicable to PSS and SDARS.

As an initial matter, there is no reason to harbor doubts as to whether the Judges are empowered to adopt a uniform national rule for disposition of unclaimed statutory royalties. The Judges have previously adopted current 37 C.F.R. § 382.8 and § 382.17, as well as analogous webcasting regulations, and the Register of Copyrights raised no issues whatsoever concerning their authority to do so. To the extent the Judges nonetheless have questions concerning their

authority to prescribe a uniform national rule for disposition of unclaimed statutory royalties, the Judges should resolve those doubts by referring the issue to the Register as other questions concerning the Judges' authority have been referred in the past. *See, e.g., Scope of the Copyright Royalty Judges Authority to Adopt Confidentiality Requirements upon Copyright Owners within a Voluntarily Negotiated License Agreement*, 78 Fed. Reg. 47,421 (Aug. 5, 2013).

Moreover, current 37 C.F.R. § 382.8 and § 382.17 embody an appropriate disposition of statutory royalties that cannot be distributed. The *Web IV* determination's discussion of the royalty distribution provisions suggests that unclaimed funds are subject to "retention" by SoundExchange. *See* 81 Fed. Reg. at 26,400. However, that reference reflects a misunderstanding of the organizational structure of SoundExchange and the unclaimed funds provisions that have historically applied under the statutory licenses – and continue to apply under current 37 C.F.R. § 382.8 and § 382.17. SoundExchange is a nonprofit organization operated on a breakeven basis. It does not retain profits from its administration of statutory royalties, and it has no stockholders that profits could be distributed to. When unclaimed statutory royalties are applied to SoundExchange's administrative expenses, as current 37 C.F.R. § 382.8 and § 382.17 provide, that reduces the administrative expense deductions taken from royalties distributed to artists and copyright owners, and results in a pro-rata distribution to all artists and copyright owners who were paid royalties for the relevant year. Current 37 C.F.R. § 382.8 and § 382.17 use unclaimed funds to benefit artists and copyright owners, not to benefit SoundExchange. There is no reason to change this arrangement. The Judges should continue the arrangement that has previously applied to PSS and SDARS.

B. Use of Copyright Office Records and Directories of Copyright Owners in SoundExchange's Efforts to Pay Artists and Copyright Owners

SoundExchange proposes royalty distribution provisions that generally track the analogous webcasting provisions in 37 C.F.R. § 380.4. However, in its proposed Section 382.4(a)(2), we propose clarifying that SoundExchange is only required to search Copyright Office records and directories of copyright owners when that is likely to be helpful. To be clear, SoundExchange does *not* propose any change to the requirement that it use its best efforts to identify and locate artists and copyright owners. As described above, SoundExchange has always made extensive efforts in that regard. In those efforts, our experience has been that finding contact information is not usually all that difficult. We devote much more effort to actually making contact with busy professionals who are frequently on the road and to convincing them to provide the tax and payment information necessary to pay them. When we do need to search for contact information, we have found the most useful resources for finding current contact information to be search engines, websites, social media, phone books, industry contacts and partner organizations. The Copyright Office records and directories of copyright owners referred to in the webcasting regulations are rarely authoritative sources of necessary information, and so should not be singled out as resources of first resort.

As the Copyright Office has recently explained, the Office did not start regularly providing contact information for copyright owners in its registration records until 2007. *Removal of Personally Identifiable Information from Registration Records*, 81 Fed. Reg. 63,440 (Sept. 15, 2016). When copyright owner contact information is included in registration records, that information is as of the time of registration, and so is frequently out of date.¹⁸ Moreover, it

¹⁸ By way of example, SoundExchange Exhibit 2 is a copy of the Office's online registration record for Alicia Keys' 2015 single "28 Thousand Days," showing an address for Sony Music

is typically more difficult to locate artists than record companies, and when the artist and copyright owner are different, contact information for the artist is not provided in the Office's registration records. Finally, the Office is now proposing to remove copyright owner contact information from the Office's online records on request. *Id.* If the Judges believe there is a reason to mention the Office's registration records as a possible source of contact information, SoundExchange is not opposed to doing so. However, the regulations should not suggest that they be a resource of first resort, because they are almost never the most useful resource available to us.

By the reference in the webcasting regulations to "published directories of sound recording copyright owners," I assume the Judges mean books like *Just The Facts: North American Record Company Directory*, a paperback listing of 97 record companies published in 2013.¹⁹ Publications like this would almost never be helpful to us, because record companies are typically easy to locate through an Internet search; printed publications go out of date quickly;²⁰ SoundExchange already has approximately 41,000 rights owner members (over 400 times as many as are included in this book); and SoundExchange has already registered many other non-member rights owners. If the Judges are aware of better resources for finding copyright owners, we would love to hear about them. However, the regulations should not suggest that books like this one be our resource of first resort, because they seem unlikely to provide us useful information.

Entertainment at 550 Madison Avenue in New York. Sony Music is obviously well known to us at SoundExchange, and it moved offices early in 2016. If Sony Music was not known to us, consulting this registration record would lead us to the wrong address.

¹⁹ See <https://www.amazon.com/Just-Facts-American-Company-Directory/dp/149092910X/>.

²⁰ Like the Office's registration records, this book reflects the former address for Sony Music Entertainment and its affiliated labels.

C. Confidentiality

The confidentiality provisions in Section 382.5 of our proposed regulations largely track the provisions adopted by the Judges in *Web IV* (37 C.F.R. § 380.5). The one substantive change we propose relates to an issue that the Judges addressed late in *Web IV*, but only partially – disclosure to outside counsel. There, the Judges recognized that attorneys are subject to professional obligations of confidentiality, and so deleted them from the list of parties required to sign nondisclosure agreements. They then added them to the provision allowing disclosure of confidential information to qualified auditors, who are under similar ethical obligations. 81 Fed. Reg. at 26,400-01. However, that provision (37 C.F.R. § 380.5(c)(2)) permits disclosure to qualified auditors and outside counsel only for purposes of audits. That is an appropriate limitation for auditors. However, outside counsel perform different roles than auditors, and thus require access to confidential information for different purposes. Accordingly, we have proposed as Section 385.5(c)(3) an additional provision permitting disclosure to outside counsel for other purposes relating to the collection and distribution of royalties.

D. Audit Regulations

The audit provisions in Section 382.6 of our proposed regulations largely track the provisions adopted by the Judges in *Web IV* (37 C.F.R. § 380.6). The one material difference we propose is in the audit fee shifting provision of 37 C.F.R. § 380.6(h). That provision provides for audit fee shifting only in the case of a 10% underpayment by a licensee. Currently, a 5% threshold applies to PSS under 37 C.F.R. § 382.6(f) and a 10% threshold applies to SDARS under 37 C.F.R. § 382.15(g).

We believe strongly that a 10% threshold for SDARS is too high given the amount of payments involved. We conduct audits for three-year periods, as contemplated by the Judges’

regulations (e.g., 37 C.F.R. § 382.15(b)). Sirius XM paid SoundExchange [REDACTED] in statutory royalties for 2015. Simply by way of illustration, multiplying Sirius XM's 2015 payment by three yields royalty payments of close to [REDACTED] over the course of an audit period. There can be no excuse for underpaying statutory royalties by [REDACTED] (10%) or even [REDACTED] (5%). The Judges should not signal that a [REDACTED] underpayment should be expected in the ordinary course or is in any way acceptable.

By contrast, our recently-concluded audit of Sirius XM cost us audit fees of [REDACTED]. See SoundExchange Exhibit 1, at 12. If Sirius XM were to underpay by \$50 million or so, Sirius XM, rather than artists and copyright owners, should pay the comparatively modest audit costs necessary to discover an underpayment of that magnitude. Likewise, the PSS pay royalties at a level higher than the vast majority of webcasters (who pay only the minimum fee). While a 10% fee-shifting threshold for webcasters could perhaps be justified as saving low-paying webcasters from payment of audit fees that may be high relative to an underpayment of a few thousand dollars, the same cannot be said of the services at issue in this proceeding. The 5% threshold currently applicable to PSS should also apply to SDARS.

E. Qualified Auditor

We have included one other audit-related change to the *Web IV* regulations in the definitions in Section 382.7 of our proposed regulations, a change to the definition of the term Qualified Auditor. Consistent with the current regulations for PSS and SDARS, including current 37 C.F.R. § 382.2 and § 382.11, we have proposed that a Qualified Auditor be an independent Certified Public Accountant.²¹

²¹ As the Judges did in *Web IV*, we have proposed moving the requirement of auditor independence from the audit provisions themselves (37 C.F.R. §§ 382.6(f), 382.15(c)) to the definition of the term Qualified Auditor.

In *Web IV*, the Judges added a further requirement suggested by NAB and NRBNMLC that a CPA conducting a royalty audit be licensed in the jurisdiction in which the audit is to take place. The decision to impose this requirement seems to have been based primarily on a “significant” concern that CPAs performing royalty audits be subject to the jurisdiction of the local state authorities. 81 Fed. Reg. at 26,404. SoundExchange believes that this addition is based on a misunderstanding of applicable state law regulating the field of public accounting.

According to the American Institute of CPAs, every American state except Hawaii has adopted “CPA mobility” legislation that generally allows CPAs in good standing in one state to practice outside their home state without getting an additional license in the state where they will be serving a client or an employer.²² As a result, public accounting clients generally are permitted to hire “the CPA best suited to the job, regardless of location, without the hindrances of unnecessary filings, forms, and increased costs.”²³

Under the Uniform Accountancy Act, CPAs availing themselves of this CPA mobility privilege *are* subject to the jurisdiction of the local authorities, without the requirement of obtaining an additional license.²⁴ Thus, the concerns expressed by the Judges in their *Web IV* determination as justification for the new licensing requirement have already been addressed by the states that regulate CPAs. The Judges should allow the states to regulate CPAs as they see fit, and not burden the statutory royalty audit process with CPA licensing requirements that the states themselves have chosen to eliminate.


²² See AICPA CPA Mobility Resources,
<http://www.aicpa.org/ADVOCACY/STATE/MOBILITY/Pages/default.aspx>;
http://www.aicpa.org/Advocacy/State/DownloadableDocuments/SumCPAMobility_05192014.pdf.

²³ AICPA, History of CPA Mobility,
<http://www.aicpa.org/Advocacy/State/Pages/SubstantialEquivalencyandPracticeMobility.aspx>.

²⁴ Uniform Accountancy Act, § 23(a)(3) (7th ed. 2014), available at
<http://www.aicpa.org/Advocacy/State/DownloadableDocuments/UAASeventhEdition.pdf>.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: Oct 14, 2016


Jonathan Bender

Exhibits Sponsored by Jonathan Bender

Exhibit No.	Description	Designation*
SX Ex. 001	Royalty Examination of Sirius XM, Inc. on Behalf of SoundExchange, Inc., dated June 15, 2016	Restricted
SX Ex. 002	Copyright Office Online Registration Record for Alicia Keys' "28 Thousand Days"	Public
SX Ex. 014	Statement of Account for a Preexisting Satellite Digital Audio Radio Service (SDARS) – 2015 Monthly Liability, dated February 16, 2016	Restricted
SX Ex. 015	Statement of Account for a New Subscription Service (CABSAT) – 2015 Monthly Liability, dated February 16, 2016	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Jason Gallien

**Senior Vice President, Finance
Universal Music Group**

October, 2016

I. Qualifications

My name is Jason Gallien. I am the Senior Vice President of Finance for Universal Music Group (“UMG”), a position I have held since May 2012. As Senior Vice President of Finance, I oversee all of UMG’s financial reporting and accounting matters for UMG’s recorded music operations in the United States. The departments under my direct supervision include: Central Accounting Services, Financial Services, North American Finance, as well as other administrative and operational departments. These departments cover the full range of financial activities in the US including strategic planning, budgeting and financial reporting, internal and external audit compliance, accounts payable, and cash management. As a result, I have personal knowledge of and regularly review UMG’s finances, including its revenues, costs, investments and profitability. As a member of UMG’s Global Finance team, I report to UMG’s global CFO. During more than nineteen years with UMG, I have held a number of other positions. From May 2009 to May 2012, I was the Senior Vice President of Finance for North America, and from April 2005 to May 2009, I was the Vice President and Group Controller for UMG in the United States. I have also previously worked as Vice President of Finance in Universal’s Music Publishing Group, and as Senior Director of Finance for UMG.

I earned my Certified Public Accountant (CPA) in the State of California (currently inactive) and received a Bachelor’s degree in Business Economics from the University of California Los Angeles.

II. Overview

The market for recorded music in the United States has changed dramatically in recent years. Historically, UMG and other record companies relied on the sale of physical audio products to generate the vast majority of their revenue. However, in today’s market, UMG

cannot and does not rely on the sale of CDs or other physical products as its primary source of revenue. Indeed, in 2015, sales of physical products represented only [REDACTED] of UMG's U.S. total net sales. Instead, as I discuss in this written testimony, UMG relies on a wide variety of revenue streams. In such an environment, it is more critical than ever that we are fairly compensated when our recordings are performed on Sirius XM's satellite radio service and Music Choice and Muzak's pre-existing subscription services. In this testimony I also explain that fair compensation for content usage is critical to UMG because we bear significant financial risks and make significant investments to create, produce, market, manufacture, distribute and license the sound recordings that provide Sirius XM, Music Choice and Muzak with the music content for their services.

III. Universal Music Group

By investing in artists and acquiring music catalogs, UMG has developed into the largest record company in the world. Our share of the US domestic recorded music market in 2015 was approximately [REDACTED], including market share of approximately [REDACTED] of domestic CD album sales, [REDACTED] of domestic digital sales, and an estimated [REDACTED] of domestic streaming. We are home to some of the most popular record labels in the world: Motown Records, Interscope Records, Island Records, Def Jam Records, Geffen Records, A&M Records, Capitol Records, Virgin Records, Mercury Nashville, Universal Music Latino, Verve Records, Republic Records, Universal Music Classics, and many more. Our labels produce music from a wide variety of genres, including: rock, hip-hop, country, Latin, pop, jazz, classical and others. In addition, UMG's record labels and central catalog company, Universal Music Enterprises, import and market music from around the world for the US consumers and broadcasters. The UMG catalog includes some of the most important recordings in history, including recordings by greats

like The Beatles, Ella Fitzgerald, Louis Armstrong, James Brown, Judy Garland, The Beach Boys, The Who, Stevie Wonder, Patsy Cline and Frank Sinatra. UMG's labels continue to sign, record and market some of today's most successful acts, including Katy Perry, Rihanna, Kanye West, Lady Gaga, Luke Bryan, Imagine Dragons, Ariana Grande, Eminem, Andrea Bocelli and The Weeknd.

IV. The Transformation of the Music Industry Has Reduced UMG's Revenues.

The music industry has experienced significant changes over the past fifteen years or so. Since 2000, music sales in the United States have declined by approximately 50%, falling from a high of \$14.3 billion to \$7 billion in 2015. It's no coincidence that UMG employs roughly [REDACTED] in the U.S. today compared to 2000. This steep decline in sales can be traced to a number of factors, including online piracy and new music services that have changed the way people listen to and purchase music.

These trends affect the entire music industry. Their negative impact on physical sales has been dramatic and irrevocable. According to data reported by the RIAA, in 2000 record companies shipped 1.1 billion physical product units across all formats with a retail value of approximately \$14.3 billion. By 2015, record companies shipped 144 million physical product units across all formats with a retail value of approximately \$2 billion.

UMG's experience has tracked the industry trend. Our domestic revenue from physical sales has decreased from [REDACTED] in 2000 to [REDACTED] in 2015. During the last decade, as our revenues fell precipitously, we have had to undertake repeated rounds of restructuring and downsizing in order to preserve capital to continue investing in new artists and their creative vision. Unfortunately, despite our cost saving initiatives, [REDACTED].

As revenue from physical sales has plummeted, it has become clear that revenue from digital and licensed uses is where the future of the business lies. At UMG, we have adapted our business to focus on maximizing digital and licensing exploitation. Revenues from digital exploitation of our recorded works are now primary sources of revenues. Despite a decade and a half of continued cost cuts, we have made substantial investments in the infrastructure and personnel needed to operate a business that relies on digital products and licensed uses. As I discuss in greater detail below, in Section V.E, UMG has invested over [REDACTED] in our digital business since the early 2000s.

Virtually none of the music industry's retail revenue was attributable to digital distribution in 2000. But according to RIAA data, by 2015 digital exploitation generated 70% of industry revenues. [REDACTED] Table 1 below shows our physical and digital domestic revenues at three points in time. In 2000, UMG had virtually no digital revenue. But by 2010, digital formats generated [REDACTED] in revenue, comprising about [REDACTED] of total revenue. In 2015, UMG's digital income increased to [REDACTED] and comprised [REDACTED] of total digital and physical revenue.

Table 1: UMG's Domestic Physical and Digital Revenue

Year	Physical Revenue	Digital Revenue
2000	[REDACTED]	N/A
2010	[REDACTED]	[REDACTED]
2015	[REDACTED]	[REDACTED]

Although digital revenues have steadily increased and now constitute the majority of our business, they have not offset the decline in physical revenues. As Table 1 makes clear, [REDACTED]

[REDACTED]

As all of these financial figures demonstrate, UMG in particular and the music industry as a whole are increasingly dependent on the digital sales and licensed exploitations of sound recordings. While we were able, years ago, to rely largely on a single revenue stream, like the sale of CDs, those days are over. Today, we rely on a variety of revenue streams, most of them digital. Table 2, which depicts the amount of revenue UMG derived from various sources in fiscal year 2015, makes this abundantly clear.

Table 2: UMG's Domestic Revenue Sources in 2015

Physical Product Sales	[REDACTED]
Digital Download Sales	[REDACTED]
Digital Subscriptions Sales	[REDACTED]
Ad Supported Audio Streaming Sales	[REDACTED]
Ad Supported Video streaming Sales	[REDACTED]
Ring Tone & Other Mobile	[REDACTED]
Other Digital Revenues	[REDACTED]
Broadcast Licensing Income	[REDACTED]
Synchronization & Other License Income	[REDACTED]
Foreign License Income	[REDACTED]
Non Recorded Income	[REDACTED]
Manufacturing & Distribution Service	[REDACTED]

UMG now depends on revenue from digital sources, including downloads, subscriptions, streaming, video streaming, and licensed sources such as Sirius XM. Because our business now depends on generating numerous revenue streams, it is imperative that we receive fair

compensation for the use of our recordings by digital and licensed service providers, whether that service is provided over fiber optic cables, cellular networks, or via orbiting satellites.

The digital music marketplace itself has undergone significant changes over time. In the past decade, most of UMG's digital revenue was from the sale of downloads. But the marketplace is rapidly shifting from a model based on ownership to a model based on access. In 2013, UMG's revenues from digital downloads peaked at [REDACTED]. By 2015, UMG's download revenues [REDACTED] in UMG's most significant revenue stream in just two years. The decline in digital downloads has occurred because consumers are increasingly embracing services that provide them with access to a wide range of music rather than purchasing music for their personal collections. Some services, like Apple Music, Google Play, and Spotify, offer a mix of interactive and non-interactive features. Others, like Sirius XM, do not yet offer interactive features. Whether consumers subscribe to Spotify or to Sirius XM, or use a non-subscription service like Pandora's free tier, they increasingly want to access music they want to hear without having to purchase a permanent copy of a recording.

Because services that offer access to sound recordings are already significant and represent the future of the music business, the revenue they generate is rapidly becoming the core revenue that UMG and the record industry will depend on for its commercial viability. The royalties we receive from SoundExchange are a significant and important part of the industry's current and future revenue base. UMG received approximately [REDACTED] in statutory license royalties from SoundExchange in 2010 and approximately [REDACTED] in 2015. Those 2015 royalties included [REDACTED] from satellite radio and [REDACTED] from pre-existing services.

Because the revenues and royalties that we earn from access services are more and more important to our bottom line, it is imperative that we are fairly compensated by each service. Earning fair returns from each access service, including Sirius XM, is important for another reason: consumers have a limited amount of time to listen to music. When subscribers tune in to Sirius XM, they forego other direct revenue generating services, like Apple Music or Spotify. It stands to reason that our return from Sirius XM should be commensurate with the returns we receive from such services. In addition, subscribers also may feel that they no longer need to purchase CDs or downloads to hear the music they like through their satellite subscription.

V. UMG's Investments in and Contributions to the Creation, Marketing, and Distribution of Sound Recordings

Like other record companies, UMG makes substantial investments in and contributions to the creation, marketing and distribution of sound recordings. Our investments fuel artists' careers and fund their creative efforts. Our investments ensure the world's music fans have the opportunity to hear and discover new artists and new music, thereby increasing the number of performers able to release sound recordings to a mass audience, allowing fans to discover their next favorite artist. We are involved in every step of music creation and distribution. We work to discover artists, to help create and refine their sound recordings, and to distribute and market those recordings to the public.

A. Artists & Repertoire (A&R)

The first step in the creative process is discovering, nurturing and developing new talent through our record labels A&R efforts. UMG's A&R departments search the country and globe for new artists. A&R staff go to clubs and concerts, listen to thousands of demonstration recordings ("demos"), and scour the Internet to identify emerging and undiscovered artists. Once new artists are identified, staff meet with them, as well as their managers and attorneys. Because finding musical talent is an art, not a science, it requires people with deep knowledge of and experience in the industry, all working relentlessly to identify performers likely to resonate with the public.

UMG's A&R representatives scout thousands of artists each year, but we end up signing only a small number of them to a recording contract. In 2015, UMG signed approximately [REDACTED] new artists through its U.S. based record labels. We invest a substantial amount of money, time and effort in every artist. When considering whether to sign a new artist, we assess whether the artist and his or her music is marketable. That determination can be difficult. Most new artists do not present themselves with a fully realized image. As a result, most new artists do not immediately possess broad appeal and are unlikely to gain it without tremendous work and effort. Part of our job is to help shape an artist's music and image in ways that maximize an artist's commercial appeal. Our efforts can include investing in dance and vocal lessons, personal stylists, makeup artists, trainers, media training, and the like.

Our A&R department incurs significant costs that represent an extensive investment in our future. In fiscal year 2015, we spent a total of [REDACTED] on gross A&R expenditures. These expenditures include: recording costs, mastering costs, producer and sampling fees, as well as royalty advances to artists and overhead funding to our A&R venture partners.

There is no guarantee that our investments in an artist will generate a profit for our company. Every new artist poses a risk. When an artist's music is not commercially successful, we are the ones that bear the loss. Music services like Sirius XM and Music Choice benefit from our investments in artists because they can pick and choose from among our most popular recordings for their services, but they suffer no financial exposure or loss if an artist's music is not commercially successful.

Even well-established artists pose financial risks for our business. In fact established artist contracts tend to be the most expensive contracts and are sometimes the most risky. When we invest in an artist, we need to do better than simply covering our costs. We need to earn a sufficient return on the investment to ensure that we sustain our ability to continue investing in other new artists. We cannot do that just by selling CDs or track and album downloads. As I noted above, our industry has shifted from a model focused primarily on physical sales, to one requiring reliance on a variety of different revenue streams. As a result, we need an artist to generate revenue across all of the available platforms.

By way of example, one of the music industry's biggest superstars is Eminem. He released his second album, the Marshall Mathers LP, in 2000. It sold over 10 million copies in the U.S. In 2013, he released his seventh studio album, the Marshall Mathers LP 2. It was also a huge success compared to other albums released that year, with several chart-topping singles. But it sold only about two million copies in the U.S. To be clear, that is not because of disinterest in the Marshall Mathers LP 2. In fact, in 2014 Spotify named Eminem the most streamed artist of all time – based significantly on the over one hundred million streams for hits like “The Monster” off of Marshall Mathers LP 2. The decline in physical sales for Eminem's

albums is attributable to the changing ways that people consume sound recordings. Music fans simply do not purchase music as much as they used to.

B. Business and Legal Affairs

After UMG decides that it would like to sign an artist to a recording contract, the Business and Legal Affairs department tries to negotiate a deal. There are often several record labels competing to sign the same artist, which can complicate negotiations and increase the cost of the deal. While we negotiate each contract individually, and each one is different, the contracts typically require that UMG front the cost of recording, mixing and mastering a record, and pay the artist an advance. Ordinarily, the artist also receives a share of the proceeds generated by exploitation of the artist's recordings in the form of royalties, which the artist receives only after the advance and recording costs have been recouped by the label (though an artist receives statutory royalties from SoundExchange without regard to recoupment). If the artist does not achieve a high level of success and does not generate enough revenue to recoup – as is often the case – then the record company absorbs the loss. UMG's 2015 income statement reflects [REDACTED] in advances and recording costs for new unproven artist signings and write offs of investments in established artists – net of recoveries.

C. The Production and Recording Process

UMG devotes substantial financial and human resources to recording an album. We can easily spend as much as [REDACTED] or more on recording costs, video production and advances on a new artist's album. In fact, most new artists' albums lose money. While we do everything we can to make each album a success, record companies operate on the principle that new releases generally lose money. For an established artist, the odds of success are greater, but so are the costs. For instance, the recording process for an established artist is often longer and

more expensive. UMG's pre-release costs for an established artist can be as much as [REDACTED]. [REDACTED]. Regardless of whether an artist is new or established, we bear all the risk associated with those expenditures. Recording costs are typically recoupable from artist royalties, but if an album does not generate enough revenue to cover its costs, then we suffer the loss of the upfront costs.

The A&R department oversees the process of creating and curating an album. Before production begins, A&R representatives work with artists to select the material to be recorded, and to match artists with producers and studios. For some hip hop and pop artists, A&R representatives may sift through thousands of rhythm tracks to find the perfect union of artist, producer and studio. The right combination of artist and producer can be invaluable in propelling an artist to stardom. A&R representatives also may have artists collaborate with other artists, which can help introduce one artist to another artist's fans. For example, Rihanna and Eminem recorded together for the first time on the hit "Love the Way You Lie." This collaboration exposed Rihanna's pop audience to Eminem, and Eminem's rap audience to Rihanna. The A&R department also handles an array of administrative logistics for a project: ensuring that the right session musicians, background musicians and vocalists are hired to work on the recordings; reserving and paying for studio time; covering and arranging travel expenses; and renting equipment.

In the process of recording an album, it is common to record more tracks than ultimately will be used on the album. The A&R representative and others at the label work with the artist to decide which tracks should be included on the album release. However, the other tracks may still be used in connection with an album (e.g., as bonus tracks in "special" or "deluxe" edition versions of the album). Finally, when the recording process concludes, the Art, Marketing and

Production departments work with the artist to design artwork and take photos to set the visual themes for the album.

A significant cost that we incur is for the production of music videos. Our video departments work with the artist and video directors to develop creative and exciting videos that help draw attention to the recording and the artist and attract an audience in their own right. While we used to view music videos as largely or purely promotional, we have for the last decade treated our videos as valuable assets to be monetized like our audio recordings.

D. Marketing

Once an album has been recorded, our marketing teams work with the artist to find the artist's best fit in the marketplace and to develop the artist's image so that the artist can communicate his or her message and music to the public. We also have promotional staff who work to identify opportunities to garner exposure for that artist. UMG tailors its plan to market and promote an artist based on the style and genre of the artist. We may focus on scheduling promotional events around a live tour for one artist, but on generating interest on social media platforms for another. The goal in marketing and promotion is to create awareness among consumers about the artist's music, and to increase interest and excitement surrounding the artist so that the album will generate as much revenue as possible.

Our artist development departments work with artists and their management teams to identify touring opportunities and coordinate marketing efforts on behalf of that artist while the artist is out on the road. UMG also has in-house publicity personnel who work with media outlets and supervise outside publicists. Each of UMG's labels and its central commercial services company have sales departments to ensure that our artists' products are available to the consumer and well positioned to succeed in the marketplace. We also have new media staff who

market artists on the Internet through social media and other tools. All of these various marketing and promotion professionals strive to put the artist in the best position to maximize revenues from an album.

Although there are many fewer brick and retail stores that sell records than there were in the past, UMG works with the remaining retail outlets to make sure that our records are prominently displayed. These efforts can include creating marketing materials like stand-ups, cardboard cutouts and posters featuring the artist, and ensuring that an artist's new release is featured on the "end caps" in the retail stores, the prime real estate at the end of an aisle where research shows customers are more likely to notice products.

UMG also collaborates with digital services to ensure that our artists are featured on their services' home pages or included in curated playlists. Every album and artist is unique. Each album requires a new, custom-tailored marketing plan to ensure that it gets noticed among the millions of sound recording tracks available on digital music services. In recent years, as playlists on digital music services have gained popularity, they have become an integral part of marketing and promoting an album. UMG has invested in the setup costs and personnel to establish a team dedicated to streaming marketing and playlisting efforts. Our marketing and sales departments develop playlists to feature on digital music services, encourage our artists to create playlists, and encourage tastemakers to feature our music on their playlists.

Marketing and promoting artist and albums is a time-consuming and expensive process. In fiscal year 2015, UMG spent [REDACTED] on gross marketing costs net of recoveries to third parties, as well as [REDACTED] on our marketing overhead for the various departments focused on this important work. UMG 2015 marketing costs included over [REDACTED] in advertising, [REDACTED] in press and TV appearances for our artists, over [REDACTED] in internet

marketing & advertising, over [REDACTED] in radio promotion, and over [REDACTED] in video production costs.

E. Manufacturing and Distribution

UMG also facilitates the manufacturing of records, and the distribution of music to retailers and digital platforms (for delivery to consumers). UMG's manufacturing and distribution operations have changed dramatically over the last 15 years. Due to declining physical product sales, UMG has been forced to close and sell off its manufacturing and physical distribution facilities, putting hundreds of employees out of work in the process. Today, we no longer own pressing plants or distribution warehouses. Instead, we engage third-party pressing plants. UMG's manufacturing costs for physical records, including costs we advance for pressing and distribution deals, were [REDACTED] in fiscal year 2015

There is a common misperception that digital distribution is cost-free for record companies. However, digital distribution is actually very complex, and UMG makes significant investments in digital distribution and digital revenue processing. Since the early 2000s, UMG has invested over [REDACTED] in IT infrastructure and operating costs, as well as the professionals that today distribute the thousands of digital files we provide to hundreds of music services and to handle the processing of billions of micro transactions related to recognizing digital revenues and calculating the associated royalty obligations.

Because of the changing landscape of digital services, our digital supply chain has evolved over time. It includes several interacting electronic database systems, some of which have been developed within the past few years. UMG operates Universal Mastering Studios, a division of the company that converts master sound recordings (or "masters") into digital audio files. We have massive systems that store our digital content/assets, including the artwork and

digital audio and video files that will eventually comprise our digital releases. Yet another database controls the scheduling of our digital releases. While digital releases are often simultaneous with physical releases, that is not always the case. Our digital scheduling system ensures that product is released at the appropriate time. UMG uses a global repertoire system to track data associated with each recording, a global pricing mechanism that we can use to determine price, and a global rights system that tracks how we are permitted to use the recording. In addition, UMG has two systems that work in concert to finalize and prepare the product for delivery to digital services. One system maintains the services' profiles and determines which content goes to which service, while the other system ensures that each service receives the artwork and digital audio files that meet their particular specifications.

Before we release a recording digitally, a group within our Digital Supply Chain department reviews the metadata that is supplied with the digital audio file to ensure its accuracy, and confirms that it contains the correct categories of information and is ready for public dissemination. The group also reviews the metadata related to the artwork, artist information and track information in order to enable the digital music service to identify the recording in its system.

In 2015, UMG coordinated and delivered over [REDACTED] new digital assets and first time metadata updates to North American digital service providers and platforms. This doesn't include the millions of additional pricing and metadata updates UMG manages across its existing catalog of digitally available music and videos. The vast array of IT systems underpinning our digital supply chain and revenues processing capabilities require constant maintenance and ongoing development to keep pace with the evolution of the music business. In 2016 and

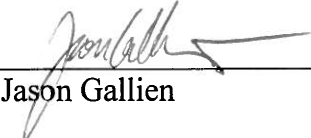
throughout 2017, UMG will be investing in its 3rd generation of digital supply systems and digital revenue processing systems at an estimated cost of over [REDACTED].

VI. SoundExchange

As consumers have used statutory services more and the royalties from those services have grown, the work that SoundExchange does to collect and distribute royalties has become more important than ever. SoundExchange has repeatedly been designated as the sole collective for statutory royalties. Through years of experience, SoundExchange has demonstrated an ability to carry out its responsibilities efficiently and fairly. SoundExchange has developed systems to keep pace with the rapid growth of data that it must process, and has served the interests of copyright owners and artists well. UMG supports designating SoundExchange as the sole collective once again in this proceeding.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10/17/2016



Jason Gallien

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Raymond M. Hair, Jr.

**International President
of the American Federation of Musicians
of the United States and Canada**

October, 2016

WRITTEN DIRECT STATEMENT OF RAYMOND M. HAIR, Jr.

BACKGROUND AND QUALIFICATIONS

My name is Ray Hair, and I am a professional musician and the International President of the American Federation of Musicians of the United States and Canada, AFL-CIO (AFM). I have spent my entire life playing, studying, and teaching music, representing musicians, and working to improve the livelihood of professional musicians.

I began playing the drum set professionally as a youngster in Mississippi nightclubs before liquor was legal and before I could drive a car. At one time or another, I've performed every style of popular music. I was 13 years old when I performed my first professional engagement, and I became engaged as a recording musician while I was in high school. In the early 1970's, I performed and recorded with Tommy Stuart and his group, the "Rubberband." Our hit, "Your Man Done Gone," moved up the Billboard charts during the summer of 1970. Over the next few years, I recorded dozens of tracks, mostly demos, in Jackson, Mississippi.

Throughout those years in Mississippi and later in Texas, I earned my way through college by performing professionally. I received an undergraduate degree in music from the University of Southern Mississippi. In 1975, I left Mississippi for Texas, where I earned a graduate degree in jazz studies from North Texas State University (now the University of North Texas). I eventually taught drum set full-time at UNT and I enjoyed teaching music to undergraduate and graduate students. I never stopped performing, though. I started my own group, Yazoo, which performed in many states of the United States and experienced the many forms of exploitation that musicians endure when they work night after night a week in dance lounges, nightclubs, showrooms and concert halls in city after city. I spent time in Dallas recording studios in those years, too, doing sound recording and jingle session work.

I learned a lot of things in the studios and on the road, but the most important thing I learned was the value of the union to a professional musician. The AFM set standards for live performances to protect us from being ripped off, and stood by us if we had disputes with purchasers. The AFM negotiated industry-wide rates and terms for recording musicians that improved conditions considerably, whether recording records, television or movie soundtracks, or commercial announcements.

Ultimately, I became very involved in the union, and in 1983 I relinquished my teaching position and greatly reduced my performing career in order to become the President and Secretary of the Fort Worth Professional Musicians Association, which was Local 72 of the AFM. Later, I guided the merger of the Dallas and Fort Worth locals, and served as the President of the merged Local 72-147 continually until 2010. At various points through those years, I also served on the AFM's International Executive Board, which supervises the affairs of the entire AFM. In 2010, I was elected to my current full-time position as International President of the AFM. As the AFM International President, I also serve as a Co-Chair of the AFM & SAG-AFTRA Intellectual Property Rights Distribution Fund ("AFM & SAG-AFTRA Fund") and the AFM and Employers' Pension Fund, and as a Director on the Board of SoundExchange, and of the Alliance of Artists and Recording Companies.

As a Local and International AFM officer, I've represented every kind of professional musician. I've led or participated in negotiations for local collective bargaining agreements covering symphony, opera and ballet orchestras and theaters, and I pioneered the free-to-attend, continuous, multi-stage music festival format in North Texas. On the national level, I have led negotiations in the commercial announcements, television, motion picture, and sound recording industries.

SUMMARY

I understand that this proceeding is for the purpose of setting the rates and terms for the statutory license that the Copyright Act grants to Sirius XM for its satellite radio service and to Music Choice and Muzak for their pre-existing subscription services. I am submitting this testimony to emphasize the importance of the statutory royalties to performing artists. I also want to express the AFM's support for the designation of SoundExchange as the sole Collective to collect and distribute the royalties at issue in this proceeding.

DISCUSSION

I. AFM

The AFM is an international labor organization representing over 80,000 professional musician members in the United States and Canada through a network of more than 200 local unions. The AFM was founded in 1896 and is the oldest and largest union of musicians in the world. AFM members record music for sound recordings, film scores, radio, television and commercial announcements, as well as perform music of every genre in every sort of venue from small jazz clubs to symphony orchestra halls to Broadway and local theaters. The AFM negotiates industry-wide agreements that set standard working conditions for all musicians who record under it. AFM members span the full range of professional musicians, from featured recording artists who are well-known celebrities to non-featured artists who work as session musicians in the recording industry.

The traditional area of activity for labor organizations is collective bargaining, and the AFM has been negotiating an industry-wide collective bargaining agreement, the Sound Recording Labor Agreement ("SLRA"), which governs terms and conditions for the major recording companies and hundreds of independent companies, for sixty years. But, the AFM has long served as an advocate for musicians' interests in various other contexts, too, including

specifically serving as a strong proponent of performers' rights and copyright protection for performers.

For example, the AFM and the American Federation of Television and Radio Artists ("AFTRA") were critically important supporters of the Digital Performance Right in Sound Recordings Act of 1995, which created the rights at issue in this proceeding. The unions' joint efforts contributed to the current structure of the Act, which requires that 50% of the royalties from the statutory license for digital performances shall go to performers, and shall be paid by SoundExchange directly to them. I am proud that AFM and AFTRA helped secure the performance right and ensured that SoundExchange will pay 45% of the royalties from this proceeding directly to featured artists, and that it will pay 5% to the AFM & SAG-AFTRA Fund for further distribution to session musicians and vocalists.

II. The Importance of Statutory Royalties

I cannot overstate the importance of the revenue stream from the statutory licenses to recording artists and musicians. In my experience as a musician and a labor leader, I know that 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 are all necessary to earn a decent living that allows you to continue to make music. Every income stream is important to a working musician, but statutory 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 services like Sirius XM satellite radio and, to a lesser degree, Music Choice and Muzak.

Traditionally, CD sales (and later, digital sales) have been a cornerstone of compensation to featured artists and session musicians. They support the industry which provides investment for artists and employment for session performers. They provide royalties

to featured artists, and for session musicians, they provide payments from the union-negotiated Special Payments Fund (“SPF”) under the SRLA. But I know from experience that sales have declined, and as a result, we see less employment under the SRLA across the country, less investment in artists (which means reduced opportunities for them) and reduced SPF payments to musicians. In fact, in the last ten years, SPF collections (and subsequent distributions to session musicians) have declined by more than fifty percent.

Digital performance royalties are an increasingly important source of revenue to industry, artists and musicians. SoundExchange has reported that it paid out \$803 million in royalties in 2015, with half of that amount – about \$400 million – going directly to performers. It is impossible to overstate the value of these SoundExchange payments to thousands of featured artists who are struggling to start or maintain their careers (or to survive after their touring days are over) and to provide for their families.

The royalties that artists receive from SoundExchange are particularly critical because they come to artists directly, without regard to whether any advances against royalties received from a record label have been “recouped.” And the statutory royalties are incredibly meaningful for session musicians and vocalists, too. To date, the AFM & SAG-AFTRA Fund has distributed over \$127 million to non-featured performers.

Experience tells us that digital performance royalties are important because patterns of music consumption are changing, so that “listening” is replacing “purchasing.” That is certainly true. But from a musician’s perspective, these royalties have a more fundamental importance. The truth is that we musicians make great 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. Our work is valuable. We believe that the use of sound recordings should

command a fair price, and we believe that wherever and whenever our music adds financial value to a business, we ought to share in that value.

III. Designation of SoundExchange as the Sole Collective

In prior proceedings, the AFM has supported SoundExchange as the best entity to act on behalf of performers and copyright owners as the sole Collective for the collection and distribution of statutory royalties. For the reasons I explain below, the AFM renews its support for SoundExchange to serve as the sole designated Collective for the statutory license fees at issue in this proceeding.

A. SoundExchange Is Controlled by, and Has Earned the Trust of, Performers and Copyright Owners.

SoundExchange is governed by a Board of Directors that is composed of performer and copyright owner representatives. Thus, the very constituencies that are served by SoundExchange are also in control of its policies and operations. SoundExchange's officers and staff are answerable to the demands of copyright owners and performers for honest, fair and efficient distributions, and for vigorous efforts to achieve fair rates that recognize the value of our music.

The nine performer representatives include artists, artists' attorneys and managers, individuals affiliated with artist manager organizations such as the Music Manager Forum, and representatives of the performers' unions — the AFM and SAG-AFTRA— which together represent tens of thousands of performers. They bring the views and concerns of a broad range of performers to the decision-making process at SoundExchange.

I think that the level of control that performer representatives have over SoundExchange has ensured that SoundExchange is committed to serving our interests as well as the interests of copyright owners. SoundExchange has demonstrated this commitment by engaging in

extensive efforts to make performers aware of the royalties they are owed, to find and enroll them, and to get royalties into their hands. These 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. SoundExchange also serves performers' interests by advocating for fair royalty rates, working for reporting requirements that will help get the money into the hands of as many performers as possible, and building the computer and service systems that enable it to distribute directly to performers.

Through all of its efforts, SoundExchange has earned the trust of performers and copyright owners alike. Perhaps the best evidence of SoundExchange's commitment to the fair representation of artists and copyright owners is that tens of thousands of artists and copyright owners have not only registered with SoundExchange but have become members.

B. SoundExchange Is a Non-Profit Organization.

The AFM firmly believes that the digital performance right was created to benefit performers and copyright owners, not to provide business opportunities for agents. It also believes that performers should receive the fullest possible benefit from the royalties, and not see their royalties reduced to pay a commission to an agent. And finally, AFM believes that the Collective's decisions should be guided by the needs of performers and copyright owners, and not by an agent's business needs.

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 a non-profit organization, SoundExchange's incentives are properly aligned with the interests of royalty recipients.

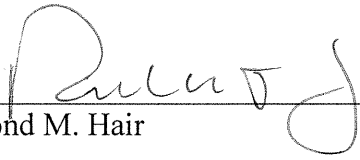
C. SoundExchange Has Substantial and Unparalleled Experience.

I understand that in prior proceedings, it has consistently been decided that the appropriate way to administer the statutory license is through a single Collective. The AFM has always advocated for this conclusion, and remains convinced that it is the best system for performers. I also firmly believe that SoundExchange should be that single Collective.

SoundExchange has a demonstrated record 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). 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. Renewing SoundExchange as the Collective will serve the best interests of the performers and copyright owners that depend on statutory performance royalties for their livelihood.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10/17/13



Raymond M. Hair

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Aaron Harrison

**Senior Vice President, Business & Legal Affairs
UMG Recordings, Inc.**

October, 2016

Introduction

1. I am Senior Vice President, Digital Business & Legal Affairs, UMG Recordings, Inc., a position I have held since 2013. UMG Recordings, Inc. is the primary recorded music company in the United States for the Universal Music Group (“UMG”), the colloquial name for a group of music-related companies owned by Vivendi S.A. Together, these companies comprise the world’s largest recorded music company. Along with other members of the Digital Business & Legal Affairs team, I negotiate deals with various digital music service providers that use the sound recording repertoire of UMG and its digitally distributed indies. Such services include on-demand and customized streaming services, download and ringtone stores, and locker services. I have negotiated deals on UMG’s behalf for the past eleven years. During that time, I have negotiated more than 100 significant agreements with digital music services.

2. Prior to assuming my current position, I was Vice President, Business & Legal Affairs, eLabs, UMG. I began my employment with UMG in 2005 as a Director, Business & Legal Affairs, eLabs. Before joining UMG, I was an attorney with the law firm Manatt, Phelps & Phillips, LLP, where my practice focused primarily on talent representation and advising companies in the acquisition of intellectual property and branded entertainment rights. I started my career as an attorney at Munger, Tolles & Olson, LLP in 1999. I received a J.D. from Yale Law School and a B.A. in Economics from Pomona College. I am licensed to practice law in California.

3. I previously testified before the Copyright Royalty Judges in 2012 in the *SDARS II* proceeding, and in 2015 in the *Web IV* proceeding.

4. I have included a copy of my resume as Appendix 1.

UMG's Position in the Music Industry

5. In 2015, UMG's share of the U.S. recorded music market, measured by ownership volume, was approximately 26.7%. UMG's share of the market by distribution was 38.5%.¹

6. UMG's recorded music holdings span an extensive and diverse collection of record labels, including A&M Records, Blue Note Records, Capitol Records, Capitol Christian Music Group, Decca, Def Jam Recordings, Deutsche Grammophon, Geffen Records, Interscope Records, Island Records, MCA Nashville, Motown Records, Republic Records, Universal Music Latin Entertainment, Verve Music Group, and Virgin Records. The artists who record for UMG labels include some of the best known and most popular recording artists in the world, including, among others, U2, Maroon 5, Katy Perry, The Weeknd, Drake, Bon Jovi, Mariah Carey, Ariana Grande, Dr. Dre, Kanye West, Alan Jackson, Tim McGraw, Keith Urban, Norah Jones, The Killers, Lady Gaga, Madonna, Lorde, Sting, and George Strait. UMG's catalog of sound recordings includes music by some of the most influential and legendary artists in the history of music, including Louis Armstrong, The Beach Boys, The Beatles, James Brown, Patsy Cline, Ella Fitzgerald, Marvin Gaye, Guns N' Roses, The Jackson Five, Lynyrd Skynyrd, Bob Marley, The Rolling Stones, Frank Sinatra, The Who, and Stevie Wonder.

7. UMG also has an extensive international presence, operating through affiliated companies, joint ventures, and other entities authorized to disseminate its content in more than 70 countries worldwide.

¹ Ed Christman, *U.S. Recording Industry 2015: Streams Double, Adele Dominates*, Billboard (Jan. 5, 2016), available at <http://www.billboard.com/articles/business/6835216/us-recording-industry-2015-streams-double-adele-dominates-nielsen-music> (showing market share by units).

**The Changing Market for Sound Recordings
and the Shift from Ownership to Access**

8. The market for recorded music continues to change rapidly. The shift away from sales of physical products such as CDs has been happening for many years. More recently, and most relevant here, we began a transition from the traditionally dominant “ownership” model of consumers buying recorded music to a model that is focused on “access” to recorded music without ownership of it.

9. Under the ownership model, the consumer buys a copy of a particular piece of recorded music, traditionally an album (whether on vinyl, cassette, or CD) or, in more recent times, a permanent download through an online retailer such as the iTunes Store. Once purchased, the copy resides in the consumer’s music library, either in a record collection, on a hardware device (such as an iPod), in a cloud collection on a locker service’s remote servers (such as iTunes Match), or some combination of the three. By contrast, under the access model, consumers do not obtain permanent copies of sound recordings. Instead, they use services that play recordings for listeners.

10. Over the last decade, numerous services that digitally stream music to consumers have launched and gained popularity. These services provide various materially different types of access to musical content. A number of these services are “on-demand,” meaning that, among other things, they allow users (or subscribers) to choose whatever recording they want to hear and to create playlists of recordings in the order in which they want to listen to them. Some well-known on-demand services are Spotify, Napster, and Apple Music. Other services—Pandora, Slacker, Sirius XM, and iHeartRadio—offer programmed, customized, or personal webcasting.

11. The increasing popularity of streaming services coincides with a decline in sales of digital downloads (not to mention CDs, sales of which have been dropping for years). For example, while January is typically our biggest month for download sales because iTunes gift

cards are a common holiday gift, in January 2016, the recorded music industry saw a 23.9% decline in download sales from the prior January.² Over the same period, the number of listener hours on customized and on-demand streaming services rose substantially.

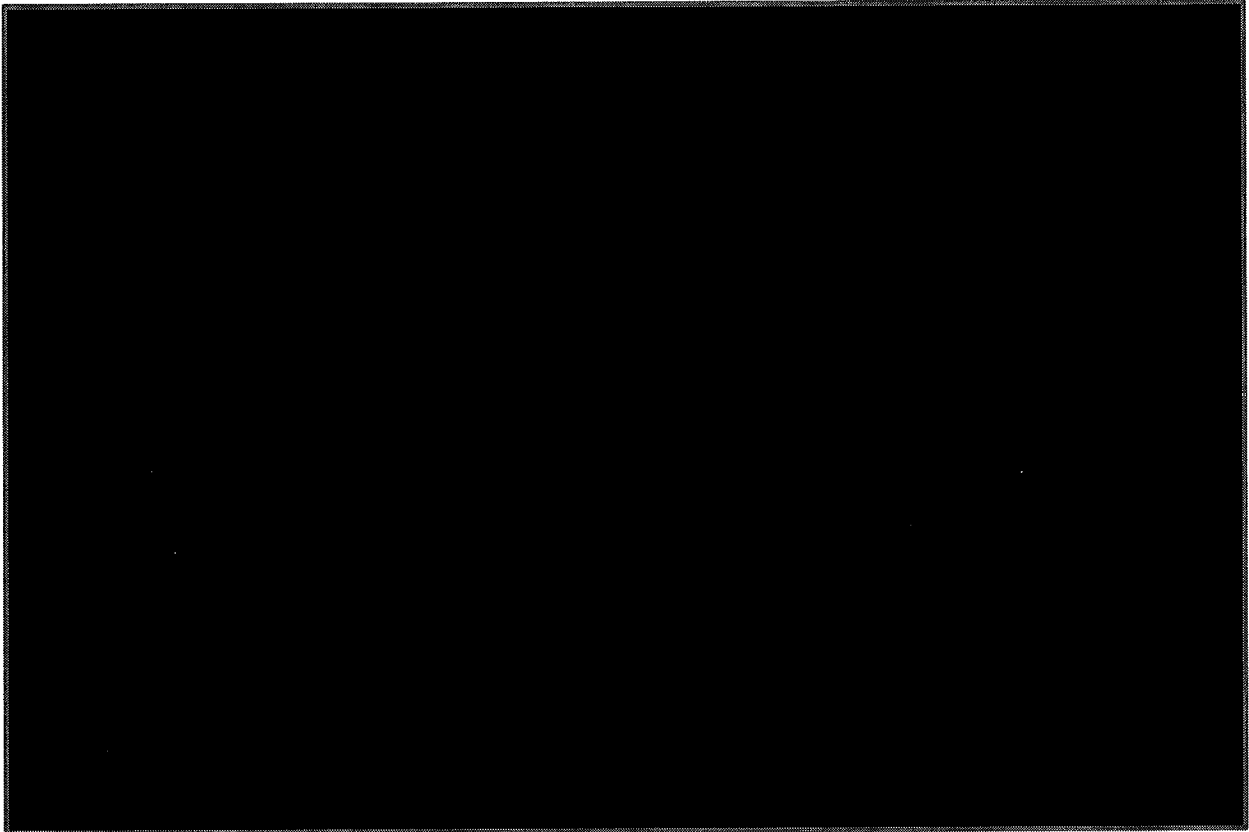
12. The industry-wide picture is reflected in UMG's experience. The graphic below, taken from a UMG internal "year in review" summary for 2015, makes the point. [REDACTED]

[REDACTED]

² Paul Resnikoff, *Music Downloads Post Their Worst Decline EVER*, Digital Music News (July 7, 2016), available at <http://www.digitalmusicnews.com/2016/07/07/music-downloads-worse-decline/>.

Figure 1 - Restricted

[



]

13. The prevailing industry view is that the increase in streaming and the decrease in download sales are related phenomena – the former is causing the latter, just as in the case of other recorded music format migrations in the past (*e.g.*, vinyl to tape, tape to CD, CD to download). Whether consumers stream music on-demand, listen to streamed music customized to their tastes by computer algorithms, or select from dozens of pre-programmed channels offering narrow niches of music, consumers now have more ability to hear something they like without having to select a recording from a music collection that they own. And the near-ubiquitous availability of mobile devices and broadband connectivity means they can do so anytime and virtually anywhere.

14. While the combination of physical products and digital download sales still represents more than [REDACTED] [REDACTED].] We expect these trends to continue, even accelerate, so that UMG will become ever more dependent on the revenues it can generate from streaming in the near term. To put it another way, the market almost certainly will continue to move away from music purchasing towards music streaming, [REDACTED] [REDACTED],] as we look to the future we must have a business plan that effectively monetizes streaming services.

15. The market evolution towards streaming as the dominant mode of music consumption poses substantial challenges for record companies. We can sell downloads, CDs and vinyl albums at a market price. But the royalties we can obtain from licensing streaming services are regulated in significant part, and in other respects indirectly affected by regulation. Terrestrial radio, of course, has long been exempt from paying sound recording performance royalties. That was originally the result of the recording industry not being a significant factor as the 1909 Copyright Act was moving through Congress, and later was perpetuated based on broadcasters' arguments that they promoted sales of sound recordings (an increasingly irrelevant premise in a world losing interest in owning sound recordings). Noninteractive webcasters and satellite radio services pay royalties at rates established by the Judges, and although we can (and sometimes do) negotiate direct licenses with such services, we do so constrained by the fact that the services have a statutory right to use our content and can always default to the statutory rates. YouTube presents a similar problem. Its user-uploaded content often violates our copyrights, but policing such infringement is very difficult and only moderately effective. Further, YouTube claims protection

under the Digital Millennium Copyright Act (DMCA) safe harbor, leaving us little practical option other than to license YouTube at the low rates we have been able to obtain.

16. All of that said, streaming also offers opportunities to UMG and the recording industry more generally. Several streaming services have developed successful business models that appeal to a growing segment of the market and pay significant royalties to record companies. In particular, subscription on-demand services such as those offered by Spotify and Apple pay sound recording royalties of approximately [REDACTED] to the recording industry per subscriber per year. The revenue that record companies earn from these services [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].]

17. In this environment, UMG obviously would like to shift consumers towards the on-demand subscription services [REDACTED], and UMG wants streaming services to incentivize consumers to make this move. This is so even though such services may substitute for sales of digital downloads. For reasons I explain below, we believe that subscribers use on-demand streaming services to discover new music, and not just to listen to music with which they are already familiar. But streaming services on the whole – whether they are on-demand internet services, noninteractive internet services, SDARS or preexisting subscription services (“PSS”) – are causing consumers to purchase less music. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[REDACTED]

18. For this reason, in the current market climate, we recognize that regardless of whether the Spotify on-demand subscription service or the Apple Music on-demand subscription service are promotional or substitutional of sales, they are now the digital platforms that best monetize our sound recordings and pay the highest royalties. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

19. While UMG wants premium on-demand services to succeed, many consumers do not care enough about the on-demand functionality of a premium subscription service to pay the (typically) \$9.99/month subscription price. UMG therefore sees value in new “mid-tier” or “radio-plus” services, such as the recently launched Pandora Plus service or the soon-to-be launched iHeartRadio Plus service. These new services offer more functionality than pure noninteractive streaming. For example, they may offer the subscriber the unlimited ability to skip recordings, a limited right to replay a recording just heard, or similar functionality that takes these services out of the statutory license but stops well short of on-demand. The Pandora and iHeart “radio-plus” services will be offered as subscription-only services priced at \$4.99/month. We hope that consumers who want only a “lean-back” listening experience and are unwilling to pay \$9.99/month

will consider these services a better option than free streaming services that are burdened with ads and offer more limited functionality.

20. Even if mid-tier subscription services succeed in drawing some consumers away from poorly-monetized free ad-supported streaming services, there is also a danger that they could to a degree cannibalize the premium on-demand subscription services. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].]

21. Of course, when UMG negotiates rates with mid-tier services, it faces the possibility that such services will simply drop any non-DMCA compliant functionality and pay the statutory rate. As a result, UMG's bargaining leverage is constrained. This is not merely a theoretical issue; services do in fact explicitly make the threat to default to a DMCA compliant service and statutory rates in negotiations with UMG. [REDACTED]

[REDACTED].] Below, I will describe two contracts that involve mid-tier services recently negotiated by UMG with Pandora and iHeart Radio.

The Pandora Agreement

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

C.

[REDACTED]

³ UMG's share includes UMG-owned content as well as indie content distributed digitally by UMG. [REDACTED]

The iHeart Agreement

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

24. The agreements I have described above are complex, and the summary above certainly does not capture all of their elements. Generally, however, these agreements show [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Sirius XM

25. My discussion of marketplace trends and UMG's approach to licensing streaming services is intended to assist the Judges in understanding how UMG views Sirius XM and the rates that UMG believes would be appropriate statutory rates in this case.

26. If the statutory license did not exist and Sirius XM were to approach UMG today to negotiate a license for the use of UMG content, I can confidently say that we would not accept anything like the current rates. The current rate of 10.5 percent (increasing to 11 percent in 2017) of a limited pool of revenue is far below anything we would agree to in a market not constrained by a statutory license and other regulation. [REDACTED]

[REDACTED]

27. At the current rates, Sirius XM pays the record companies only \$12 to \$14 per year per subscriber; [REDACTED]

[REDACTED].] All of those alternative methods for consuming music are available in the car, where Sirius XM is most used by its subscribers. Most cars have

CD players; downloads can be played through smartphones or tablets, often through the car's entertainment system; and mobile streaming is now the norm, and often can utilize the in-car entertainment system. Subscribers to Sirius XM would naturally tend to buy more of these other, higher-revenue options if they did not subscribe to Sirius XM.

28. Moreover, all of these services offer the sort of "lean-back" listening characteristic of in-car entertainment. With respect to premium interactive services, an important part of their growing appeal is the availability of playlists. According to data provided to UMG by the services, [REDACTED] percent of plays on Spotify and [REDACTED] percent of the plays on Apple are playlist plays from user-created playlists, service created playlists, third-party created playlists, or other pre-programmed streams. Listening to a playlist is particularly suited to in-car listening – the subscriber is not actively searching for individual on-demand plays, but instead simply plays a playlist of her own or someone else's creation.

29. Sirius XM subscribers have demonstrated a willingness to pay for music. UMG would far rather have them pay to consume music by buying it or by subscribing to streaming platforms that pay higher royalties. We consider the opportunity costs of every deal we contemplate. We would not willingly give Sirius XM the competitive advantage it now enjoys in the form of below market rates. In a marketplace transaction, it would be foolish for us to agree to license Sirius XM at \$12 to \$14 per year [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].]

30. The PSS are even more significantly under-monetized. They deliver our recordings into the homes of tens of millions of subscribers, but pay only pennies per subscriber per year. For Muzak, a PSS may be a good way to generate a little extra revenue from programming they create for their business services. Music Choice may be a good vehicle for its cable company owners to acquire music inexpensively for inclusion as a feature of their subscription packages. However, the pricing makes no sense for a record company in the current environment that I have described above.

31. In addition, as I mentioned above, we negotiate in our agreements with streaming services a variety of benefits absent from the statutory license. These include:

A. [REDACTED]

B. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].]

C.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].]

D.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].]

E.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

F.

[REDACTED]

32. The statutory rates currently paid by Sirius XM are not near the level we could negotiate in the marketplace, and the statutory license does not contain any of the valuable additional terms we would obtain in a negotiated agreement. To the extent that marketplace considerations are relevant to the statutory standard in this case, UMG believes those considerations suggest a substantial rate increase.

**Factors That Constrain UMG's
Rate Negotiations with Interactive Services**

33. I understand that in the *Web IV* case the Judges concluded that the market for licensing sound recordings to on-demand streaming services is not effectively competitive due to the alleged complementary oligopoly power of the major record companies. I am not an economist, but I negotiate digital license agreements with on-demand services, and in my experience there are important practical constraints on our ability to obtain high rates from on-demand services.

34. First, UMG is keenly aware that its best hope of increasing its revenues lies with subscription on-demand services. [REDACTED]
[REDACTED].] We will not likely go back to a world where record companies thrive selling downloads and CDs. Our future is streaming, and we need those subscription on-demand services to grow their subscriber base (and thus our revenues). But we know that subscription on-demand services face intense competition – from free ad-supported services, from mid-tier services, and from satellite radio and terrestrial radio, among others. We know that these on-demand services must see a path to profitability, or else they will either lose their investors (and possibly exit the music streaming business entirely) or abandon their on-demand service tiers in favor of their lower priced subscription or ad-supported services. Either way, if they abandon their on-demand service tiers, that will materially impact our revenues. Moreover, we know that the path to profitability for the subscription on-demand services cannot come yet from raising subscription prices substantially, given the existence of free and less expensive subscription alternatives. Forcing the on-demand services to increase their subscription prices may well have the effect – contrary to UMG's interests – of reducing their market share and our revenues.

35. The services we negotiate with regularly invoke this logic in rate negotiations. That is particularly so for the biggest services. [REDACTED] generate approximately [REDACTED] percent of our premium on-demand revenue, and [REDACTED] generate nearly the same percentage of our overall digital revenue. They are among the biggest distributors of our recordings, and have considerable clout in our negotiations. For these reasons, UMG understands that the rates it seeks from the services are constrained by the importance of these services to UMG and the highly competitive nature of the market in which they operate.

36. Second, the Judges concluded in *Web IV* that a service's ability to steer in favor of one record company's sound recordings and away from the sound recordings of its competitors, based on the price charged for those sound recordings, created the possibility of price competition. Increasingly, such steering would be feasible for on-demand services. That is because, more and more, subscribers to on-demand services are listening to playlists. Rather than search for a particular recording or artist to play (although subscribers certainly continue to do that), subscribers listen to playlists that they or others have created. Of course, to the extent that a subscriber elects to listen to a playlist that he or she created, the music is chosen based on the listener's preferences instead of price. But subscribers also listen to service-generated playlists, and the use of such playlists is growing. According to data supplied to UMG by Apple and Spotify, Spotify's top playlist reached [REDACTED] percent of its users and Apple's top playlist reached [REDACTED] percent of its users. These services offer multiple service-generated playlists. Overall, for Spotify as much as [REDACTED] percent of plays come from playlists and algorithmic streams that the service controls. The services do, of course, have the ability to choose which sound recordings to include in those streams based on price.

37. The effect of service-generated playlists extends well beyond the percentage of a record company's plays that result directly from those playlists. Some subscribers use service-generated playlists to discover new music. People have access to so much music that it is very difficult for them to discover music they like on their own, so they often listen to playlists created by others in order to hear new music. As I noted above, for Spotify approximately [■] percent of streams are generated by the service through playlists (rather than selected by the subscriber), but close to [■] percent of Spotify's streams of our frontline releases were programmed by the service. In other words, UMG finds that its new releases represent a much higher percentage of plays in the service playlists, compared to UMG's overall catalogue. This indicates to us that service playlists are important to music discovery for subscribers. New music discovered on service playlists is added by subscribers to their own playlists, and shared with their friends on the service, who likewise add music to their playlists.

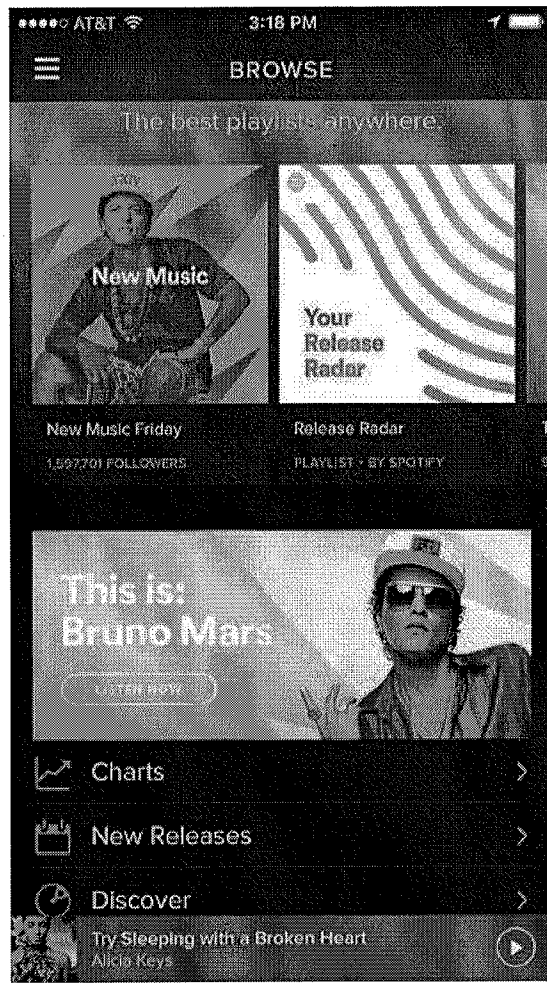
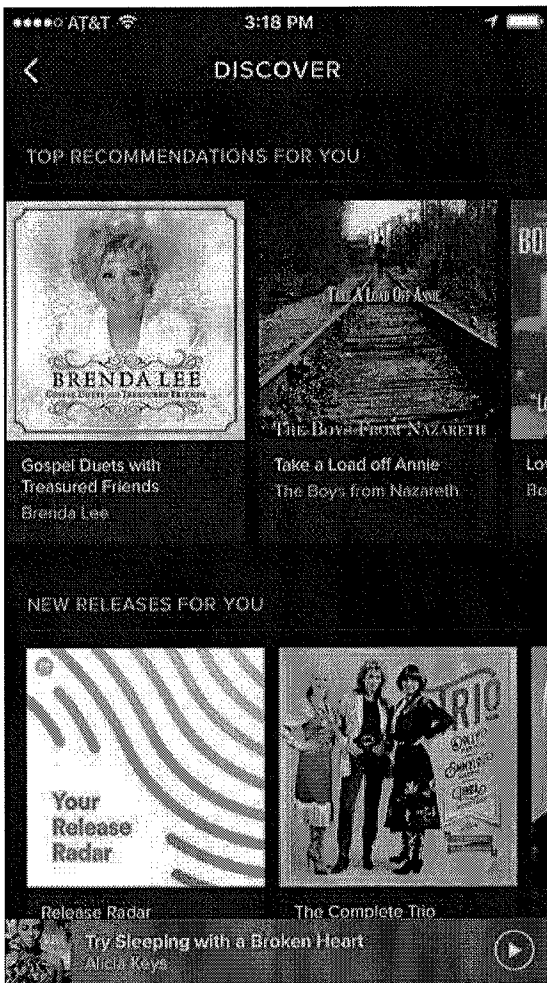
38. All of these plays generate revenue for UMG, if they are UMG sound recordings. More play of UMG music increases UMG's market share on the service, which in turn increases UMG's pro rata share of the percentage of revenue or per subscriber payment by the service. And this impact lasts over time. Once subscribers discover new music on playlists and add it to their own playlists, those recordings tend to be played repeatedly for months or sometimes years. UMG has found that the practice of including its music on playlists generates an overall steadier stream of revenue over a longer period of time than do sales.

39. In short, it is important to UMG to have its sound recordings included in on-demand service playlists, not only because of the revenue directly generated by those plays, but because they help drive consumption on the service more broadly and therefore UMG's share of the service's total royalty payment in the long term. In this sense, services do have the ability to steer.

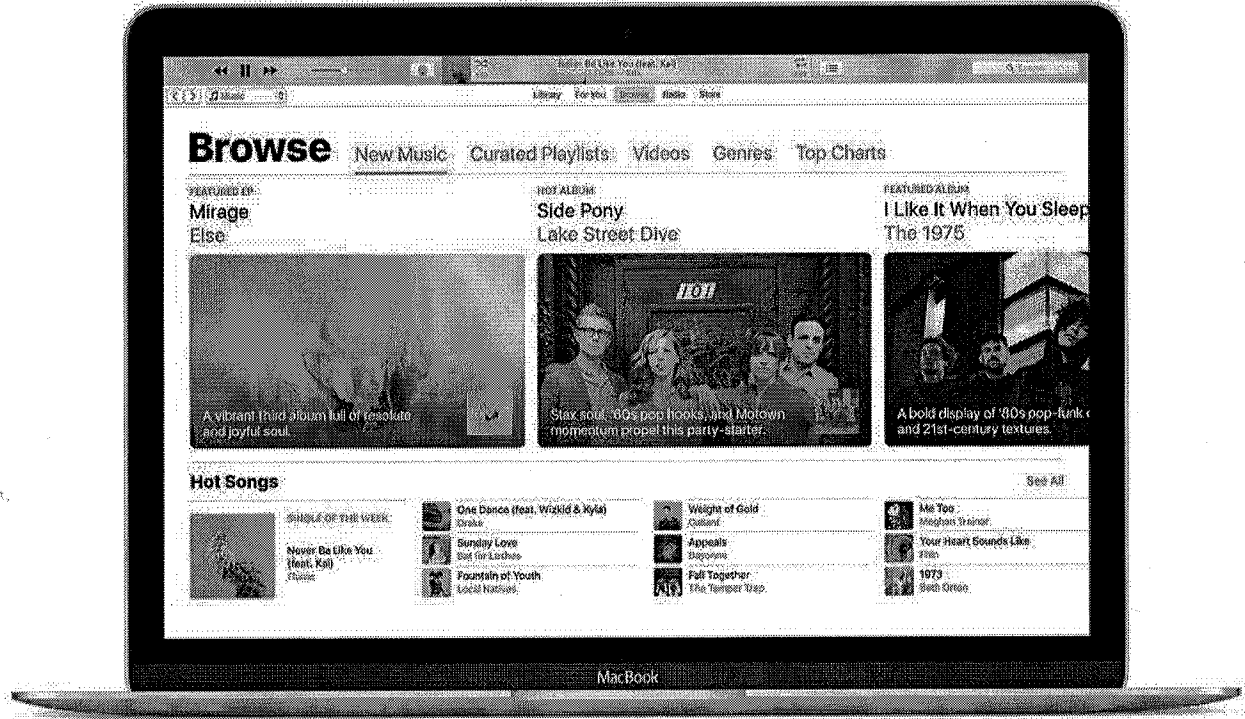
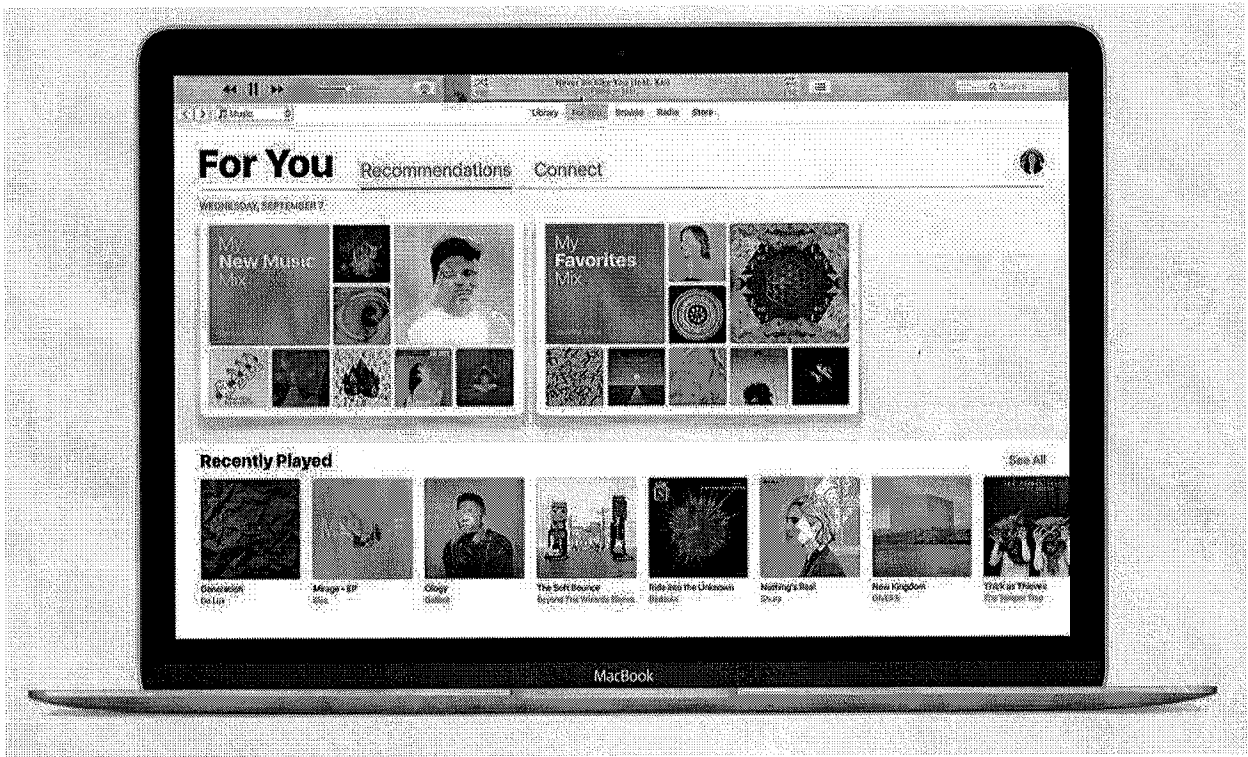
While the on-demand service directly controls less of the choice of which music to play, compared to a noninteractive streaming service, the on-demand service's choice of which music to include on playlists has a significant influence on subscriber choices and therefore record company revenues. For this reason, record companies compete to place their music on service playlists.

40. Apart from playlisting, on-demand services have other ways to shift revenues between record companies. On-demand services recognize that their users want more than the ability to select the next track. They want features that editorialize, curate, and recommend the next track or playlist the user will hear.

41. For example, Spotify has a "Browse" option, which steers listeners to music on select charts and certain new releases. The "Browse" option also includes a "Discover" tab, which includes "top recommendations for you," "new releases for you," and "suggested for you based on" artists to which you have recently listened. Spotify also has a "Discover Weekly" playlist that features thirty recordings each week, and is popular with subscribers as a music discovery tool. Labels vie not only to have their music featured on this playlist but also to have their music appear earlier in the order on this playlist, given that some users do not make it through the playlist in its entirety. Placement on the Discovery Weekly playlist is important because it often informs Spotify users' listening habits for the rest of the week; they listen to not only the particular tracks on the playlist but also other music by the artists on the playlists. If UMG's artists are on Discover Weekly and other playlists like it, that placement will accordingly increase the amount of revenue that UMG derives from the service. Screenshots of these Spotify features appear below.



42. Similarly, Apple offers a “my new music mix” and a “my favorites mix,” in addition to several features that users can browse, including selected new music and curated music. Screenshots of these features appear below. Again, it is important to UMG that its artists are featured in these parts of the service because it is a way that services can introduce UMG artists and tracks to users. Introducing users to UMG artists and tracks in turn increases demand for those artists and tracks, increasing revenues to UMG and its artists from playlisting.



43. For all of the reasons I describe above, on-demand services are not simply passive recipients of subscriber requests for on-demand plays of music the subscribers have discovered elsewhere. When on-demand services first were offered, they were focused on simply allowing a subscriber to request a song on-demand. But the services have evolved to offer their subscribers far more in the way of guidance and suggestions in the selection of music. Now, on-demand services actively influence subscribers' requests in a variety of ways that in turn directly affect the relative shares of royalty payments that are split among the record companies. The services therefore have the ability to play one record company off against another in catalogue license negotiations, and they do so. Generally, services argue that other labels are on board with any contentious point, including economic points, to pressure us to acquiesce.

44. There is one additional fact that, in my experience, affects UMG's ability to negotiate with on-demand services. Some of these services are part of companies that dwarf UMG and dominate digital markets – Amazon, Apple and Google, for example. They do not hesitate to use their economic clout in our negotiations. By way of example, [REDACTED]
[REDACTED]
[REDACTED].] This type of negotiating tactic is increasingly common.

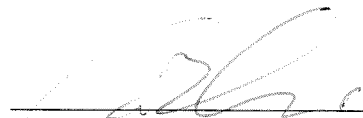
Conclusion

45. UMG now operates in a market that is shifting to consumption of music through streaming rather than purchase. UMG sees opportunity in this shift, but only if it treats streaming services as the principal way it monetizes sound recordings and not as a nice but less important ancillary revenue source that might or might not promote sales of downloads and CDs. In this context, Sirius XM is an anomaly. Sirius XM is the biggest music service in terms of total

subscribers in the United States but does not rank among the top 10 royalty payors to UMG in the United States. Sirius XM reaps substantial revenues and profits from subscribers who demonstrably are willing to pay for our music, but pays us royalties that are dramatically lower than other subscription services. UMG believes that the statutory rates applicable to Sirius XM should increase substantially.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10-13-16



Aaron Harrison

Exhibits Sponsored by Aaron Harrison

Exhibit No.	Description	Designation*
SX Ex. 010	Bain & Company: U.S. Music Consumer Insights Discussion, dated August 27, 2014	Restricted
SX Ex. 012	[Redacted]	Restricted
SX Ex. 013	[Redacted]	Restricted
SX Ex. 017	CD Containing Recently Executed Universal Music Group Agreements with Pandora and iHeart Radio, Relied on in Orszag Testimony	Restricted
SX Ex. 031	CD Containing Agreements Between Subscription Interactive Services and Universal Music Group, Relied on in Orszag Testimony	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Bruce Iglauer

**President
Alligator Records**

October, 2016

Testimony of Bruce Iglauer

BACKGROUND AND QUALIFICATIONS

I am the founder and President of Alligator Records, the world's largest independent contemporary blues label. Because of the depth of Alligator's catalog, the success of its artists, and its 45-year-long history, Alligator is considered one of the top blues and roots rock record labels in the world. Our catalog contains almost 300 albums. Three Alligator recordings have won Grammy Awards, and forty-one titles have been nominated. The label and its artists have received well over 100 Blues Music Awards and more than seventy *Living Blues* Awards.

Alligator Records exists because, as a young college student, I fell in love with the blues. In 1966, while studying at Lawrence University in Appleton, Wisconsin, I saw a live performance by an incredible musician – Mississippi Fred McDowell. The performance resonated deeply with me and it sparked what became a lifelong passion for the blues. After seeing Fred, I pored over the history of the blues and began hosting a college radio show. I also began making regular pilgrimages to Chicago so that I could see greats like Muddy Waters, Junior Wells, Otis Rush, and others.

A few years after first encountering the blues, I decided to make it my life. I moved to Chicago and found work as a shipping clerk at Delmark Records, a small but well-established blues and jazz label. Shortly after starting, I tried to convince the label to record my favorite band, "Hound Dog Taylor and the Houserockers." They were a trio of middle-aged African-American musicians who played entirely in the small clubs in the black community in Chicago. They had no national or international reputation. I'm fortunate that Delmark said no. It was 1971 and I was only 23, but I decided to start my own label. Alligator Records was born in my one-room apartment to ensure that Hound Dog Taylor could make his first record.

Public Version

I used an inheritance of about \$2,500 to record, manufacture and promote the Hound Dog Taylor record. It was all the money I had, so I had to make that first record at least a modest success or my new label would fail. We recorded the album live in the studio, mixing it as it was recorded. We managed to record in just two nights, but the studio time cost \$900 and I gave the band another \$900 as an advance payment against what I hoped would be future royalties. Pressing 1,000 copies of the album ate up the rest of my inheritance, but with 1,000 copies of the album, I packed up my Chevy, and hit the road to do promotion, visiting radio stations and distributors and often sleeping in my car. I managed to get quite a bit of radio play and to find distributors around the country. Before long, I was also acting as Hound Dog's booking agent, road manager, business manager, driver, and publicist. Money was short but I did everything I could to make Hound Dog's album and performing career a success.

In Alligator's early days, the label remained a one-man operation run from my apartment. I was eager to share my passion for the blues and to increase the public's familiarity with its talented artists. But running Alligator was a struggle. Each record had to make enough money to finance the next one, so I was only able to release about one album each year. Still, the new releases were successful enough to keep the company above water. Slowly, Alligator became more profitable, I moved into a two-room apartment and I was able to record more blues artists.

In 1975, I hired Alligator's first employee and moved the label (and myself) into a small house in Chicago. My office was a bedroom and I warehoused and shipped albums from my basement. Although the operation wasn't fancy, the label had expanded and that felt like momentum. I tried to extend the label's reach outside of the community of traditional blues fans and to reach an audience of rock fans of my own generation. Sure enough, Alligator's expanding roster of recording artists started to receive greater attention, including, for example, reviews in

Rolling Stone magazine. Between 1975 and 1981, our recording artists received eleven Grammy nominations.

In the early 1980s, Alligator won its first Grammy award, and subsequently signed several blues-rock artists with more mainstream recognition and appeal. These artists included musicians like Johnny Winter, who recorded the first Alligator album that landed on Billboard's "Top 200" chart. These artists gave the label radio, press, and retail credibility that it never had before. The publicity allowed Alligator to expand and, by 1985, my staff of seven and I were releasing about 10 new albums each year, up from one album a year back in the 1970s. By 1991, Alligator had 125 recordings in its catalog and had become the most successful contemporary blues label worldwide, giving traditional artists a wider audience and bringing public attention to new, younger blues artists.

Over four and a half decades, Alligator has managed to record and produce some of the most talented and prominent blues musicians in the history of the genre, including: Albert Collins, the first blues artist to come to the label with a national reputation; Johnny Winter, the first Alligator artist with mainstream rock radio name recognition; and several blues rock guitar heroes, like Lonnie Mack and Roy Buchanan. One of the most successful artists to join Alligator Records was the Queen of Blues – Koko Taylor. Her debut album, "I Got What It Takes," won the label its first Grammy nomination, and she remained with Alligator Records until her passing more than 30 years later.

Alligator continues to record and produce some of the very best blues you'll hear. Our recordings frequently top critics' "Best of" lists and readers' polls. The New York Times has said that "Alligator is the leading record label for the blues." The Washington Post has called Alligator "the premiere blues label," and the Chicago Sun-Times has said that "Alligator is

numero uno among indie blues labels, with artists representing the best in contemporary blues.” Alligator has also continued to nurture young new stars, such as Grammy-nominated Shemekia Copeland, International Blues Challenge winner Selwyn Birchwood and blues visionary Jarekus Singleton.

I am a founder and board member of the Blues Community Foundation, a charitable organization that helps musicians in need and their families. I previously served on the Board of the National Association of Independent Record Distributors and Manufacturers and on the Board of The American Association of Independent Music (A2IM). Over the years, I have been honored to receive several awards for my work at Alligator. This year, I received the *Blues Blast* Magazine Lifetime Achievement Award. I was inducted into the Blues Foundation’s Hall of Fame in 1997. I’ve previously received the A2IM Lifetime Achievement Award, Chicago Magazine’s Chicagoan of the Year award, and two “Keeping the Blues Alive” awards from the Blues Foundation.

SUMMARY

The purpose of my testimony is to provide the Copyright Royalty Judges with information about the important role that an independent label like Alligator Records plays in making sound recordings available to the public, including its costs and contributions. My testimony also discusses the importance of SoundExchange royalties to Alligator and to our artists, many of whom struggle to make ends meet. In a very real sense, Alligator is increasingly dependent on these royalties to stay afloat.

I am incredibly proud of what Alligator has accomplished and hope that we can continue to give musicians a chance to record their music and share it with the public. As I’ve said on Alligator’s web site: “Alligator should be the label that’s exposing the next generation of blues

artists and bringing their music to the next generation of blues fans. I want the future of the blues and the future of Alligator Records to be one and the same. I want to keep bringing blues and roots music to new fans and getting them as excited about the music as I am.” These sentiments remain as true as ever. But to meet these goals, it is essential that we earn a fair return for the use of our sound recordings by services like Sirius XM and Music Choice.

DISCUSSION

A. Challenges Facing Alligator Records

Alligator Records produces and records blues and roots rock, which has a smaller market than genres like top 40, country, or hip-hop. Although blues and roots rock may not have broad commercial appeal, they attract passionate, engaged fans who appreciate that the blues has a unique place in American history. Our music feeds the interests of long-time listeners and helps grow the next generation of blues fans. Alligator helps preserve and nurture one of the most important traditional American musical genres.

I did not found Alligator Record to become rich. Rather, I am dedicated to producing and recording emotionally rich and culturally important music that I love, and to sharing it with an audience that shares my passion for the blues, as well as inspiring new listeners to become fans of the music. Nonetheless, Alligator Records is a business, and it can only survive and release music if its sound recordings generate enough revenue to cover its costs and to provide profits that we can use to develop our artists.

Changes in the marketplace for recorded music have made it increasingly difficult for smaller independent labels like Alligator to survive. Several years ago, Alligator was one of several independent labels releasing blues albums. Other blues labels included Blind Pig, Arhoolie and Delta Groove. But to my knowledge, none of those labels has any plans to release

new albums. Last year, Blind Pig shut its doors after thirty-eight years in business, and sold its catalog to The Orchard. Earlier this year it was announced that after being in business since 1960, Arhoolie Records had sold its catalog to Smithsonian Folkways Recordings, which is a nonprofit label associated with the Smithsonian Institute. While that transaction will preserve the Arhoolie catalog of over 350 albums, I am not aware of any plans to release new Arhoolie albums. And last year, the founder of Delta Groove passed away. It is unclear whether the label will continue to release new albums. I am concerned that as the number of blues labels dwindles, there are fewer opportunities for blues artists to share their music with the public.

While artists today sometimes produce and release their own albums, producing a quality recording is beyond the financial reach of many blues artists. Even if they are able to produce their own CDs, it is virtually impossible for blues artists to generate media attention, distribute their recordings and gain visibility in the marketplace. A label like Alligator not only funds recordings, but also provides the staff and experience to produce, manufacture, market and distribute an artist's recordings in a way that creates demand for the recordings. Many artists who have joined Alligator Records have moved from performing locally and regionally to becoming national and international touring artists with established life-long performing careers that have given them and their families financial security.

Alligator Records is not immune to market forces. We operate on thin margins and we are sensitive to changes in sales. Over the past two decades, our sales have decreased dramatically. For example, I estimate that in the first few years of this century, our best-selling new releases each sold approximately [REDACTED] physical units in the United States and [REDACTED] abroad. Today, our best-selling new releases sell approximately [REDACTED] physical units in the United States (including CDs and LPs) and [REDACTED] abroad, and most of our releases sell

significantly less – approximately [REDACTED] physical units in the U.S. and [REDACTED] abroad. Alligator's gross revenue from physical sales (before returns) has [REDACTED] [REDACTED].

Part of the reason for the decline in physical sales was the growth of digital downloads. But even at their peak, digital sales did not offset the loss of physical sales. Digital sales have been [REDACTED] and generated [REDACTED] in revenue in 2015, as compared to [REDACTED] in 2012 and [REDACTED] in 2013. Alligator is hardly unique in this respect. It has been widely reported in the press and by groups like the Recording Industry Association of America that digital download revenue has been decreasing across the U.S. music industry since 2012, with no signs of a reversal.

As the marketplace has shifted over time, we have of course adjusted our business to keep pace. In the 1980s, we were the first blues company to produce CDs, and in the 1990s we were among the first labels to market our catalog on the internet. Today, we update our web site and social media sites regularly. Our web site provides visitors with updated news, lets them listen to our music and read bios of our artists, offers free downloads and enables them to buy CDs and merchandise. And as streaming services have grown over the years, we have made sure that our tracks are available to them. Our increased revenue from streaming services, however, has not been sufficient to make up for decreased sales, as I note below.

These trends have made it more difficult for Alligator to release new recordings to the public. I rely on sales of past and current albums to finance the recording and production of future albums. When profits decrease, so does the pool of money that Alligator can invest in recording and releasing new music. As a result, we can afford to take fewer risks in signing, recording and promoting new artists, and new artists have fewer opportunities to release their

And if an album does not perform well enough to recoup these costs, Alligator alone suffers the financial loss.

1. A&R and Recording Costs

The most critical element of a successful release, of course, is good music. Alligator Records therefore devotes considerable resources to identifying artists, signing them to our label, and producing high-quality sound recordings. Alligator bears all of the costs associated with this process. We identify artists in a variety of ways. Some of them are artists with whom we have worked in the past or who have recorded for other labels, but others are new artists. To identify new artists, we attend a number of live performances throughout the country. We also listen to a significant volume of material submitted by hopeful artists.

When Alligator finds an artist that we may be interested in recording, we try to see the artist perform live, and meet with the artist and his or her manager (if there is one). This sometimes means spending a considerable amount of money on plane tickets, hotels, and meals in order to scout and sign artists. Sometimes those artists ultimately sign with Alligator. Other times they do not. Either way, the label must pay for the effort.

When we sign an artist, we usually create an "all-in" budget for an album, which means that we give the artist and/or producer a budgeted amount and to cover the costs of recording and producing the album. These costs include renting a recording studio, hiring a sound engineer, paying musicians to play with the featured artist, preparing a final mix of tracks to create a master recording, mastering the recording to make it ready to manufacture, and often hiring a producer to coordinate the project. Alligator's "all-in" budgets typically range from about [REDACTED], though these figures can vary. For example, Alligator spent approximately

[REDACTED] on a project earlier this year, which we hoped would generate significant revenue. The artist keeps any money left after those expenses have been paid.

Less frequently, Alligator Records pays a separate advance to the artist. The most recent advance that Alligator Records paid was for [REDACTED] and the one before that was for [REDACTED]. This is money that an artist keeps even if he or she never sells a single album. When an artist receives an advance, Alligator will cover the cost of recording and producing the artist's album. If possible, I produce these albums myself, as I am an experienced and successful producer, and it saves Alligator the expense of an outside producer. Once we have finished mastering an album, which costs about [REDACTED], we pay outside photographers and create cover art. In recent years, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

2. Manufacturing Costs

Alligator Records relies on third-parties to manufacture our physical units, which include CDs and vinyl records. We use CDA of Charlotte, North Carolina to manufacture our CDs. It costs us between [REDACTED] per CD to manufacture a large run of CDs, including the physical discs, packaging, plastic jewel boxes or cardboard sleeves, plastic shrink wrap and promotional stickers, and as much as [REDACTED] per CD for a small run of 300 or fewer CDs. The number of CDs we manufacture varies depending on how many CDs we expect to sell. For our six most recent new releases, we manufactured between about [REDACTED] CDs per release, with an average of about [REDACTED] CDs per release. This does not include copies that we

manufacture to provide free to radio, press, and retail outlets. For each of those six releases, we manufactured an average of about [REDACTED] promotional copies.

Over the past few years, Alligator has made an effort to capitalize on the resurgent market for vinyl records. Although the market for vinyl is still small, we make every effort to develop viable revenue streams. The cost of pressing vinyl albums can vary, because different weights of vinyl are available and packaging may be simple or complex. On average, it costs Alligator approximately [REDACTED] to press and package 1,000 vinyl copies of an album.

3. Distribution and Delivery Costs

Alligator relies on several third-parties to handle our distribution and delivery. For distribution of our physical units, we use Alternative Distribution Alliance (ADA), a distributor owned by Warner Music Group. We pay ADA a percentage of the wholesale price of each compact disc or record to solicit sales and deliver the disc or record to stores across the country. ADA operates on consignment. Alligator owns the CDs until they are sold to retailers and not returned. Alligator thus bears the financial risk for any unsold CDs. Approximately [REDACTED] of the CDs we sell to retail outlets are returned unsold. When this occurs, we make no money on the sale, and we are obligated to issue a credit ADA, even though we have already incurred manufacturing costs.

We rely on Consolidated Independent for much of our digital delivery to music services. In order to provide our recordings to Consolidated Independent, Alligator uploads our recordings to an FTP site. Consolidated Independent then ensures that our recordings and associated metadata are delivered to the various digital music services in the digital format specified by the

music services. It costs Alligator more than [REDACTED] to deliver our catalog of recordings to a digital music service through Consolidated Independent.

Because of this cost, it is sometimes not economical for Alligator to use Consolidated Independent for digital delivery to a particular music service. That is, if we expect that Alligator will earn less than [REDACTED] in revenue from a particular music service, it does not make sense for us to pay Consolidated Independent to deliver our recordings to that service. In such instances, Alligator uses an aggregator called State 51 Conspiracy, which charges Alligator [REDACTED] [REDACTED] Alligator earns from each music service, instead of the [REDACTED] charged by Consolidated Independent.

In either case, we benefit from these companies' economies of scale and their familiarity with digital music services' technical specifications. Every digital music service has its own technical specifications for the formatting and delivery of data. Delivery services and aggregators are familiar with these requirements. By relying on them to deliver our content, we avoid the time and cost that would be associated with handling delivery on our own. In fact, Alligator is not able to prepare files for delivery because some of the specifications exceed our technical capabilities. We use delivery services and aggregators for the simple reason that we lack the required technical capabilities and it is cheaper to rely on them than to develop those capabilities ourselves.

Aggregators also negotiate agreements directly with digital music services, which enables Alligator to avoid the time and cost we would otherwise have to devote to negotiating those agreements ourselves. While Alligator has sixteen employees including me, some of the digital music services are large companies with more financial resources and personnel than we have. Digital music services sometimes offer novel functionalities or complicated revenue calculations

that require close analysis to understand and assess fully. The direct negotiation of a licensing agreement with a digital music service can be time consuming and a serious strain on our limited resources. If we were to negotiate with each service directly, it would inevitably interfere with our ability to perform the other functions necessary to run our label, or we would have to hire additional employees to handle negotiations.

Alligator, like many independent record labels, is also a member of Merlin, the digital rights licensing agency for the independent label sector. This membership entitles Alligator to opt into agreements that Merlin negotiates with digital music services. Alligator has opted into a number of Merlin's agreements. Merlin charges Alligator a membership fee and takes a small percentage of our revenue from each agreement we opt into. Merlin manages all accounting, payments and administrative aspects of the deals, but does not deliver our sound recordings to the digital music services. As is the case with our reliance on delivery services and aggregators, Alligator benefits from Merlin's economies of scale. As a relatively small label, Alligator might not be able to get the attention of a larger digital music service to enter into negotiations in the first place. But Merlin is more likely to have access to initiate negotiations. The resources that Merlin can devote to negotiations with digital music services exceed Alligator's resources, and Merlin enters negotiations with the leverage of representing thousands of independent labels. By essentially pooling our catalog with other independent labels' catalogs, Merlin, like digital aggregators, negotiates with digital music services from a position of strength.

4. Marketing and Promotion Costs

To ensure that consumers are aware of Alligator's new releases, we engage in advertising and promotional campaigns like those of other record companies. Before a new album is released to the public, we send promotional copies of the CD, along with posters/biographical

information about the artist, to radio stations, retail outlets, tastemakers, journalists, and publications. We also may purchase advertising in several publications, including the two leading blues publications, *Living Blues* and *Blues Music Magazine*, and smaller blues publications.

We focus much of our advertising and promotion around live shows that our artists perform. For example, if our artist is going to perform in New York, we might purchase advertising on radio stations with dedicated blues shows or that play blues along with other music. Over the years, we have also developed an electronic mailing list, comprised of about 40,000 of our fans' e-mail addresses. The list can be sorted by zip code and, as a result, when one of our recording artists is set to perform in a particular city, we will send a targeted e-mail notifying fans in that area. We also maintain a data base of media contacts to whom we email press releases in connection with live shows by our artists.

We also engage in retail marketing programs with record stores. As many record stores have disappeared over the years, these marketing programs have of course dwindled. Nonetheless, we may pay to have a CD or record included in in-store displays or at listening stations at chains like Barnes & Noble or smaller chains or independent retailers. We also might arrange in-store appearances by an artist, for which we will buy advertising and often pay for the artist's accompanying band.

Promoting and publicizing an album can require a lot of time and persistence. Alligator's staff includes several people who work on promoting and marketing our sound recordings, including two publicists, two radio/television promotional people, a new media staffer, someone who focuses on ex-U.S. promotion and publicity, and a sales manager. They call radio stations to urge them to listen to and play an album. They call record stores to urge them to stock an

album. They call digital music services about our participation in promotional campaigns. And they call journalists to urge them to write about an album. Because Sirius XM 's Bluesville channel plays blues recordings, our efforts often include reaching out to Sirius XM's programmers to encourage them to play our recordings (which of course generate royalties), or to arrange for live performances (which are outside the statutory license) by Alligators' artists on Sirius XM. In addition, we sometimes hire third parties to assist us with promotion. These services typically are paid by the week or month and can cost thousands of dollars.

5. Royalties

Alligator is responsible for paying two types of royalties. First, we pay mechanical royalties to song publishers. In 2015, we paid [REDACTED] in mechanical royalties. Second, we pay royalties to our artists whose advances are recouped. In 2015, we paid [REDACTED] in artist royalties.

6. Overhead Costs

Our overhead costs are significant. Alligator paid [REDACTED] in employee salaries last year. Our rent is [REDACTED] per year, and we contribute the vast majority of the cost of health insurance for employees and their families, which cost Alligator approximately [REDACTED] in 2015 and is increasing. Of course, Alligator also has typical office and administrative costs: everything from computers, to freight charges, to necessary equipment. We pay market rates for these goods and services.

C. Revenue

Alligator Records generates revenue from a number of sources. Our largest source of income is still physical sales, though our revenue from physical sales has decreased dramatically during the last ten years or so. In 2015, physical sales generated approximately [REDACTED] in

gross revenue for the label. In addition, in 2015 we generated revenue from digital sales ([REDACTED]); internet agreements, which are primarily with streaming services ([REDACTED]); synchronization agreements ([REDACTED]); mechanical royalties for the use of our musical works ([REDACTED]); other royalties ([REDACTED]); and a small amount of other revenue from merchandise sales. And of course we receive income from SoundExchange —last year, we received approximately [REDACTED] in statutory royalties from SoundExchange. Of that amount, approximately [REDACTED] was for the performance of our recordings on Sirius XM’s satellite radio service and [REDACTED] was for the performance of our recordings on Music Choice and Muzak’s PSS services.

D. Financial Summary

For 2015 our total costs, revenue, and profit were as follows:

Total Costs: [REDACTED]
Total Revenue: [REDACTED]
Profit: [REDACTED]

In other words, [REDACTED] in 2015. In 2014, Alligator Records [REDACTED] This year, I expect that Alligator Records will [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

E. The Importance of Royalties from Sirius XM and Music Choice

The music industry has evolved significantly during Alligator’s more than 45 years in business. The label has always recognized that new technologies are critical to the success of our recording artists. We have worked hard to adapt as different ways to consume music have

emerged. For example, in the 1970s, we made records, cassettes and 8-tracks. In the 1980s, we became the first blues label to make CDs. And in the 1990s, we were one of the first labels to market its catalog online. Alligator also embraced the digital format in the first part of this century, making our sound recordings available as downloads and for streaming.

As the music industry has undergone these transformations, one thing has remained the same in the industry – the need for great music. I am proud that through all these years, Alligator has continued to release some of the best blues recordings around. In order to continue making sound recordings available to the public, we need a fair return for our contributions. The survival of labels such as Alligator Records and the preservation of American music like the blues depends on our ability to capture new revenue streams.

Alligator provides valuable content for Sirius XM. In fact, Sirius XM has a dedicated blues channel called BB King's Bluesville. The channel is excellent and plays a variety of blues music, including many of Alligator's recordings. Sirius XM's web site promises listeners that the Bluesville channel offers "authentic blues from the past to the present," and identifies some of the artists that listeners can expect to hear on the channel, including at least one artist, Johnny Winter, whose recordings are part of Alligator's catalog.

I do not know for certain whether having Alligator's recordings performed on Sirius XM, or any other service, promotes the sale of our recordings or whether it substitutes for sales. For a niche genre like the blues, a station like Bluesville may well satisfy the listening needs of many fans and cause them to stop buying CDs and downloads. While I am aware of the argument that performance of our recordings on Sirius XM or other services could help promote the sale of our CDs and downloads, I have seen no evidence that it actually does so. What I do know, however, is that as the number of Sirius XM's subscribers has grown, Alligator's CD and download sales

have decreased; that revenue from streaming services has not made up for lost sales; and that as Sirius XM's revenue and profits have been growing dramatically, Alligator's have been shrinking. In today's market, it is important that we generate a fair return from every revenue stream.

1. Statutory Royalties Are Important to Alligator.

As the ways in which people consume music have changed, our revenue from other sources has diminished, and the statutory royalties we receive from SoundExchange for the performance of our recordings on Sirius XM (and to a lesser extent, Music Choice and Muzak) have become a critically important source of revenue for Alligator.

Year	Total SoundExchange Royalties	SoundExchange Royalties from SDARS	SoundExchange Royalties from PSS
2013	██████████	██████████	██████████
2014	██████████	██████████	██████████
2015	██████████	██████████	██████████
2016 (through June)	██████████	██████████	██████████

In 2015, SoundExchange royalties were approximately [████] of Alligator's total revenue, and Sirius XM royalties in particular were [████] of Alligator's total revenue. By comparison, in 2004, Alligator received [██████████] in SoundExchange royalties, representing [██████████] of Alligator's revenue that year.

Alligator Records should receive a fair royalty rate that reflects the considerable value we provide to Sirius XM, Music Choice, and Muzak. Like many other record companies, Alligator Records provides Sirius XM and Music Choice with the music they need to operate their services. Without the music that Alligator, other record companies and artists create, Sirius XM

would have no content for dozens of their satellite radio channels. I want companies that play blues music, like Sirius XM and Music Choice, to succeed, but not at the expense of Alligator Records and our artists. We should not be forced to subsidize large and profitable companies who use our recordings. As I described above, Alligator devotes substantial resources to making new blues recordings available to the public, but our margins are thin and it is increasingly difficult for us to operate as a financially viable business. Several other blues labels have stopped releasing new recordings. The statutory royalties that we receive from Sirius XM, Music Choice and Muzak are critical to the viability of Alligator Records and, as a result, to ensuring the continued existence of labels devoted to the blues.

2. Statutory Royalties Are Important to Alligator's Artists.

Alligator's artists also depend on royalties received from Sirius XM, Music Choice, and Muzak. I am very proud of the fact that hundreds of musicians and their families have been able to survive and sometimes thrive because of the work that Alligator Records has done to deliver their music to audiences. After more than 45 years of dedication to the blues, Alligator has helped generate royalties that support our artists, as well as the children and grandchildren of deceased artists.


Many of these artists and their families rely on the royalties from their music. Most of the artists associated with Alligator work hard to make ends meet and are not wealthy. The revenue from a royalty check can be invaluable to an artist and her or his family. Although a few hundred dollars might not seem like a lot of money, a check for that amount can mean the difference between paying rent or being evicted. The royalty checks help artists with the basic necessities of life, such as buying groceries and making car payments. For many artists, every dollar counts.

* * *

I thank the Copyright Royalty Judges for the opportunity to testify in this proceeding. Alligator has been making blues recordings available to the public for over forty-five years. As the marketplace for music has changed, we can no longer rely on physical and digital sales to sustain our business. It has become more important than ever that we receive a fair return on our work from services like Sirius XM, Music Choice and Muzak. Those companies have built their business in large part on the strength of recordings from labels like Alligator. In order for us to continue to release new recordings and to provide these services with new content, we need royalty rates that reflect our contributions to making these recordings available to the public.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10/18/15



Bruce Iglauer

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Michael Kushner

**Executive Vice President, Business & Legal Affairs
Atlantic Recording Corporation**

October, 2016

BACKGROUND AND QUALIFICATIONS

1. My name is Michael Kushner, and I am Executive Vice President, Business and Legal Affairs of Atlantic Recording Corporation (“Atlantic”), which is part of Warner Music Group (“WMG”). Before joining Atlantic in 2001 in my current role, I had various roles in the record business, starting with PolyGram Records in 1987. Just prior to joining Atlantic, I was Senior Vice President, Legal & Business Affairs for The Island Def Jam Music Group, a division of Universal Music Group.

2. I am primarily responsible for running the Business & Legal Affairs Department of Atlantic. I work closely with the Co-Chairmen, Chief Financial Officer, and the Artist & Repertoire (“A&R”) and Marketing Departments. I am also responsible for A&R Administration, which is the department that administers recording projects.

SUMMARY

3. The purpose of my testimony is to describe the role of a record company in today’s music market. While record companies have always been in the business of finding talent, producing recordings, and helping artists connect with an audience, the details of how we do that have changed tremendously in recent years. In my testimony, I will first provide some background about Atlantic. Second, I will describe in general terms some of the major forces that have transformed the record business in recent years and provide an overview of the business in the rapidly changing music market. Finally, I will provide some details concerning the process of finding and signing talent and creating, promoting, and distributing recordings, highlighting the contributions made by record companies.

4. The recordings that our artists and we create constitute the core of the consumer offerings provided by the SDARS and preexisting subscription services (“PSS”). We make large

investments, at significant risk, to sign artists, create recordings, release them to the market, help them find an audience, and build a fan base for our artists. The SDARS and PSS bear none of these risks, and instead have the privilege of choosing from among all the most successful recordings to attract and retain subscribers who are fans of our artists. In the current music market, if we are to continue to achieve returns on our investments to find and support the artists and music of tomorrow, it is imperative that we receive returns from those services' use of our music that are commensurate with the value that we contribute to those services.

DISCUSSION

I. Atlantic's Position in the Recorded Music Industry

5. Atlantic is part of WMG, along with a number of other labels, including Warner Bros., Parlophone, Rhino, Warner Music Nashville, and Warner Classics. Atlantic was founded by industry legend Ahmet Ertegun in 1947, and was originally known primarily as a rhythm & blues and jazz label. Atlantic introduced such legendary artists as Ray Charles, Aretha Franklin, and Bobby Darin. Atlantic was acquired by WMG in 1967. In the late 1960s, the label emerged as one of the leaders in the rock genre, with artists such as Led Zeppelin. In 2004, Elektra Records, which had a long and important history of its own, first as an independent label and then as part of WMG, was merged into Atlantic. Atlantic is also now the home of a number of smaller labels which are either wholly owned or affiliated with the company, including Fueled By Ramen, Roadrunner Records, and Artist Partner Group.

6. Our artists today represent a broad array of musical genres, including pop, rock, hip-hop, and alternative. Some of the current artists on the Atlantic label include Bruno Mars, Twenty One Pilots, Paramore, Wiz Khalifa, and Slipknot. For the week ending October 6, 2016,

Nielsen Music Connect reported that WMG had an overall U.S. market share of about 18% for albums (including track and streaming equivalents),¹ and Atlantic represented about half of that.

7. Atlantic is a well-managed company with a strong artist roster, a track record of helping our artists release great music, and a lot of resources to help that music find an audience. Like our sister labels and industry competitors, however, we have had to confront and adapt to a changing business landscape. We face new challenges brought by the digital market, the decline of physical retail, as well as retail and terrestrial radio consolidation, and competition and pricing pressures from other forms of entertainment (such as video games and streaming of television and movies). Nonetheless, we have experienced growth in recent years, due to huge investments in talent, as well as new lines of business and infrastructure.

II. The Changing Music Market

8. The market for music has changed tremendously in recent years.² Historically, technological constraints and limited federal copyright protection meant that revenue of the recording industry derived almost entirely from the sale of physical products – first vinyl records, then tapes, and then CDs – with a small share of revenue from licensing recordings for use in motion pictures, television shows and advertisements (so-called “synchronization” licensing). Terrestrial radio has always been permitted to use our recordings for free because that is what federal law has dictated, and so of necessity, we viewed terrestrial radio solely as a means to promote sales of the physical products (which was just about the only way we could make money from recordings).

¹ This does not include market share of independent labels distributed by WMG.

² Throughout my testimony, I describe conditions in the U.S. only, unless otherwise specified.

9. That model does not exist any longer. Technology has enabled a much wider range of delivery means and business models, which consumers have slowly come to embrace, and in the process reshaped the entire market for music. The Digital Performance Right in Sound Recordings Act of 1995 (“DPRA”) has allowed us to realize revenue from services that deliver performances as well as from the sale of copies, leaving terrestrial radio as the only use of our recordings that we cannot monetize. At the same time, consolidation in the terrestrial radio industry has made radio a less useful promotional vehicle for many genres of music than might once have been the case. Most terrestrial radio stations are now focused on a limited selection of genres of music; locally owned independent radio stations that were generally more willing to take risks on new artists are disappearing; and decisions on what stations will play are made more and more often in national corporate offices rather than DJ booths. In the current environment, the recording industry, and with it the entire process of creating recordings and making them available to the public, is now dependent on monetizing recordings through every outlet that the law allows. No outlet that can be monetized should be viewed as promotional of any other, nor should the fact that a particular outlet may have the potential of helping to promote a recording affect the fair compensation that such outlet pays for its use.

10. While as recently as 2003 the recording industry derived almost all its revenue from the sale of physical products, sales of physical products have fallen steadily since their high in 1999. This decline is the result of numerous factors. Initially, the primary driver was the massive online piracy unleashed with the launch of the infringing Napster service in 1999. While that service was shut down in 2001, its progeny continue to eat into the recording industry’s sales revenue. More recently, the decline of physical products has been driven in significant part by advances in technology, competition from other forms of entertainment (such

as streaming television and movies and video games), and consumers' preference for first downloads and then streaming.³ Data collected and reported by RIAA show the dramatic decline in the recording industry's physical product revenue. The retail value of physical music products distributed in the U.S. in 2015 was barely over \$2 billion.⁴ This was down an astonishing 86% from \$14.5 billion in 1999. Physical product sales still represented about 28.8% of the U.S. recording industry's retail revenue in 2015, but that share continues to decline steadily.

11. The declining physical business caused tremendous dislocation. Many music specialty retailers closed, including Tower Records in 2006. Big box retailers devoted much less shelf space to music. The large music distributor Handleman shut down in 2008. During the last decade, record companies went through a period of cutting costs to the bone, slashing artist rosters, signing fewer artists, and reducing internal headcount. In 1999, Atlantic and Elektra released a combined total of 86 new albums. By the middle of the last decade, that had fallen to 30 to 40 new albums per year. The aggregate workforce of Atlantic and Elektra, which at its peak in 1996 was over [REDACTED] people, has been reduced to [REDACTED] employees today. WMG got out of the business of manufacturing and distributing physical products, and now has its products made and distributed by contract manufacturers.

12. Initially, physical product sales were partially replaced by download sales, which began to find consumer acceptance after the launch of the iTunes store in 2003, although at levels nowhere near sufficient to close the gap caused by plummeting physical sales. Download

³ In this testimony, I use the term "streaming" to refer to all delivery of public performances by means of digital audio transmissions, including on-demand streaming, noninteractive Internet streaming, and transmissions by the SDARS and PSS.

⁴ SoundExchange Exhibit 3 is RIAA's analysis of its 2015 shipment and revenue statistics.

sales increased steadily until 2012, when the retail value of downloads distributed in the U.S. was just over \$3 billion, according to RIAA data. While the emergence of a major new revenue source was obviously good news for the recording industry, the sale of downloads produced its own dislocation due to the unbundling of albums. We previously oriented our business, and artists oriented their careers, around cycles of producing and releasing a body of work in album form, promoting the album, and touring in connection with the album. While many consumers buy albums in download form, many more buy only selected tracks, an option that has been available since the launch of iTunes in 2003. This phenomenon itself led to the sale of fewer tracks than was the case when only albums were available, and ultimately a reorientation of the business around more frequent product releases.

13. The transition from physical sales to digital sales not only led to dramatic revenue reductions, but also required that record companies make substantial new investments and incur new categories of cost. There is a popular misconception that the shift from physical to digital distribution entails dramatic cost savings for a record company. In fact, most of our costs are not associated with distribution at all, and are driven by the process of creating and promoting recordings and the need to account to our artists and other royalty recipients. Those costs, along with corporate overhead, must be recovered from all the uses we can monetize. In addition to those costs, Atlantic has added an entire new department solely addressing digital marketing, while we continue to maintain our radio promotion staff, video production and promotion staff, and sales staff. Digital distribution requires complex negotiations with digital service providers, infrastructure to manage and deliver various versions of recordings to each service, development

and delivery of extensive data about each recording, and employees to carry out these processes, while we also still maintain the staff and infrastructure necessary for physical distribution.⁵

14. As overall recording industry revenue plummeted and it became clear that neither artists nor record companies could continue to prosper on the basis of sales alone, record companies adopted a more holistic view of their relationship with their artists. They became increasingly involved in supporting and monetizing their artists' touring, merchandising, and branding. To do those things effectively, companies like WMG invested heavily in building out or acquiring infrastructure to support those lines of business. For example, WMG bought a merchandising company and a ticketing business, and continues to grow its direct-to-consumer operations.

15. We are currently in the midst of another major transformation of music distribution – from a digital model based on “ownership” of music to a new model of “access” to digital music, including both on-demand services and listening on services like Sirius XM and Pandora. After U.S. download sales peaked in 2012 at about \$3 billion, they too have been steadily declining. By 2015, the retail value of downloads distributed in the U.S. had fallen to a bit less than \$2.4 billion, and downloads represented only about 34% of total U.S. music revenue, according to RIAA. Streaming and other performance licensing is now the largest segment of the U.S recording industry's revenue, at 34.3% as reported by RIAA.

16. The emergence of streaming services has been a very long and slow process, but it has greatly accelerated recently. There have been digital music services in the market since the PSS launched their consumer services in the early 1990s. However, while many American

⁵ As described further below, for Atlantic these negotiation and distribution functions are carried out in other parts of WMG.

homes have access to the PSS as part of their cable or satellite television packages, the PSS do not ever seem to have generated a lot of consumer excitement, and we at Atlantic have never viewed them as a major outlet for our music. Noninteractive Internet webcasting (mostly ad-supported) first became available in the mid-1990s, but took a long time to reach commercial scale. The SDARS commenced operation in 2001 and 2002, but also took years to build their subscriber base. Record companies were very hopeful about the launch of subscription-based on-demand services delivered over the Internet, which happened in a commercially significant way in 2002. However, those services took many years to reach even a million subscribers. As a result, RIAA data show that all such services combined represented less than 10% of U.S. recording industry revenue as recently as 2011.

17. However, streaming services then began to take off quickly. That segment represented 15% of U.S. recording industry revenue in 2012, 21% in 2013, and 27% in 2014, before exceeding downloads as the largest source of U.S. recording industry revenue in 2015. Streaming is our future. While there may always be a role for copies of recordings as a memento or for serious audiophiles, it seems inevitable that physical and download sales will continue to decline for a long time, and that streaming services will be increasingly predominant in the coming years. Already, we sometimes release certain recordings in digital format only, and forego producing a physical album. That will certainly become more common in the future.

18. A number of factors have accounted for the increasing popularity of streaming services, including the widespread availability of broadband Internet connections, smartphones and other handheld mobile devices that enable Internet access from almost any location, and the growth in the installed base of satellite radio receivers. Consumers who once bought physical products, or more recently downloads, now have virtually unlimited access to music through

streaming smartphone apps, home and office computers, SDARS receivers in their cars, and cable or satellite television packages.

19. Despite all the dislocation over the last 15 years, the rise of streaming services has the potential to be good for our business. However, a music market in which streaming services predominate is very different from the one that prevailed even 10 years ago, including in the ways identified below.

20. First, our industry has shifted from a model that was focused almost exclusively on selling records to one in which we actively seek to cultivate multiple revenue streams, and in which every revenue stream matters. In order to recover our significant costs of releasing a recording, we must try to make our artists successful across all available platforms – and not just in sales of records. Unlike when law and technology forced us to view sales as revenue-generating and terrestrial radio as promotional, we now view as revenue-generating every outlet for our recordings that the law permits us to monetize. Revenue from the public performance of sound recordings is core revenue.

21. Second, we have to view use of our music in every type of streaming service as competing to some extent with every other such use of our music. We view none of them as promotional of any other, and indeed, we view each as potentially cannibalizing others. Thus, we are focused on growing the lines of business that generate the highest revenue per user, and need to generate an appropriate level of revenue from each of them.

22. Third, for a record company, our success depends significantly on maximizing our market share on each streaming service. It used to be that each new release had the potential to grow the revenue pie due to sales that would not have been made without the release. When we had a hit record, we would enjoy a bump in revenue from a few months of sales following the

release. In a streaming environment, each service's overall royalty expense in a particular month is largely a function of its number of subscribers (in the case of subscription services) or audience and ad sales (in the case of ad-supported services). We increase our revenue, and hence our profits, from streaming services by getting the highest proportion of listens possible on each service each month. But it's a zero-sum game. If we get a higher proportion of a service's market share in a particular month with a hot new release, other record companies will get a smaller share and smaller royalty payments.

23. Fourth, to remain competitive in a quest for market share, it is more important than ever for us to release great recordings, and lots of them. After shrinking our artist roster by close to half around the time of the 2004 merger of Atlantic and Elektra, we are now increasing the pace of our artist signings. With the breakdown of the album and the traditional album release cycle, we are also increasing the pace of releases, with many artists frequently releasing singles, "mixtapes," EPs, and other small bundles. We also typically create many more related products in association with a release. It used to be that when we released an album, we produced only a handful of products – the album itself, possibly a few singles, and a video. Today, an album release is accompanied by single versions of every track in different formats, multiple videos, and various extra tracks such as live or acoustic versions. And while we used to create videos solely in connection with singles that we promoted to terrestrial radio and MTV, the advent of YouTube has required that we make videos of many more tracks to both promote and monetize our releases. Even a single or EP is usually accompanied by such related products. Having more new product in the market every month increases the chance that our music will find an audience and capture a larger share of the plays on services.

24. Fifth, the quest for a higher proportion of the plays on each service shapes our promotional efforts. We promote to some extent to all commercially significant services, because we want to maximize our share of plays on the service to maximize our revenue from the service. We also still promote to terrestrial radio, and it remains a very important way for us to get attention for our recordings in the limited range of genres that are well represented on terrestrial radio – particularly pop and hip-hop. However, our desire to have our recordings on terrestrial radio should not be confused with a desire to have our recordings used for free. Free use on terrestrial radio is the result of a historical accident perpetuated in federal law, and does not suggest that we voluntarily discount uses that are in some way promotional. Every service we work with outside of terrestrial radio has a promotional element, and yet every such service whose rates are not set by the Copyright Royalty Judges negotiates with us to use our recordings on a fair market basis. And while we promote to such services in much the same way we promote to terrestrial radio and to Sirius XM, in an attempt to get crucial positioning on playlists and thus greater market share, those services do not presume to get discounts from us just because there are aspects of their service that serve a promotional function.

25. Finally, successful recordings generate (and must generate) significant revenue for us for a long time. It used to be that most of the revenue we received from a release was realized in the first few months after release. We had little insight (and little economic stake) in what consumers actually listened to, and we would make a fixed amount of money for each unit sold, regardless of whether the consumer ended up listening to it once or a thousand times. Now, our economics increasingly depend on listens rather than sales, and it turns out that hit recordings stay active on streaming services for much longer than they ever remained active on terrestrial radio. If we succeed in making great music and finding an audience for it, we can expect it to

generate material revenue from that music for years, and the economics of our business depend on our doing so.

26. Through all these changes, we at Atlantic are still focused on the fundamentals of finding great artists, helping them reach their potential, and connecting them to fans. I turn next to some details of how we do those things in the current environment.

III. The Role of Artists and Record Companies in Creating, Promoting and Distributing Recordings

27. It is obvious that recorded music depends upon the talent of artists. However, when a record company does its job very well, its contribution is invisible. It is nonetheless critically important. Record companies are the creative and economic engine of the music industry. Our role in finding the artists with the most potential, helping them both creatively and economically to create great music, and then helping them find an audience for their music in an environment where it is challenging for even the best artists and recordings to get noticed has never been more important than today. And, when the music is not commercially successful, we are the ones that bear the financial risk.

28. In this part of my testimony I describe in some detail the creative process of a record label's business, the significant investment involved in developing new music, as well as the risks of our business. Although the record company's process may vary somewhat from one company and record to the next, it is generally quite similar at each record label. My goal in this testimony is to describe a typical path from discovery to release.

A. Discovering Talent

29. There are multitudes of performing artists in the U.S., and even more abroad. At the most basic level, what record companies work hard to do is to find those artists who are most deserving of public attention and then help them develop their art, create the best possible

expression of their art, and connect with an audience to have a successful career as a recording artist. In this way, we act as a “filter,” assisting the music-consuming public and distributors such as digital music services in finding truly exceptional artists worthy of their scarce time and attention.

30. Before any sound recording can be created, we need to identify the artists in which we are prepared to invest our money and other resources. Our A&R Department is similar to the “research and development” departments of other consumer product companies. It searches the world for performers who are most likely to have successful careers as artists if provided with the kind of investment and platform that a major label like Atlantic can provide.

31. At Atlantic, we sign about [] new artists each year, as the result of exhaustive and expensive, ongoing efforts to identify the artists with the best potential to create great music and connect with fans. The A&R function is incredibly important to success as a record company in the current market, so we work hard to identify great artists by every means available, and evaluate thousands of artists each year. We review demonstration (so-called “demo”) recordings and releases by smaller independent record companies, meet with managers, and, in the rock genre, try to identify bands that are beginning to develop a touring base. These days, we often sign artists who have already developed some kind of professional profile, which often is manifested by views of their videos on YouTube, streams of their recordings on SoundCloud, or Instagram and Snapchat followings. By way of example, my teenage daughter recently mentioned to me a particular hip-hop artist whose music she had heard on social media, even though the artist had never been signed. She said that all her friends were listening to this artist’s recordings and recommended that Atlantic sign him. In fact, we were already in discussions with the artist about a possible relationship, and ultimately signed the artist.

B. Signing Artists

32. If we decide that we would like to sign an artist, our Business & Legal Affairs department tries to negotiate a contract with the artist. Most of the time (perhaps as much as three quarters of the time) our negotiations are competitive. That is, we understand that the artist is also talking with another record company about a potential deal as an alternative to signing with us. Because record companies compete in the marketplace for recordings based on the popularity of our artists and the strength of our repertoire, we compete intensely to sign the best, most promising artists and are frequently bid up by our competitors. The hip-hop artist I referred to in the prior paragraph was known to every relevant label, and they all wanted to sign him. Social media has provided artists with the ability to achieve a significant measure of awareness without a record company's help, but for artists with the potential to take their careers to the next level, that has also brought increased competitiveness, signing cost, and need for immediate reaction. That takes additional resources that were not necessary even five years ago.

33. In signing artists, Atlantic routinely competes with other major record companies, and sometimes with independent record companies ("indies") as well. Larger indie labels are often well-resourced with A&R and promotions staff, and while indies are not generally prepared to take the same financial risks on an artist that a major label will, they may, for example, provide the artist more flexibility by entering into shorter deals or seeking to participate financially in fewer aspects of the artist's business than majors typically do. The nature of the competition we face varies depending on the profile of the artist and by genre. In the pop and hip-hop genres, the promotional resources available through a major label platform give us an advantage over all but the largest indies in trying to sign the most promising artists. In rock and other genres for which radio hits are less relevant, independent labels are often able to provide

artists deals competitive with what the majors can do, although our greater level of investment and staffing provides artists in those genres who do sign with us resources that could not be provided by an independent label. What is clear is that the cost of competitive deals has generally continued to increase even in periods of industry decline, and even with the future looking brighter, the cost of deals continues to outpace the rate of growth.

34. The relationship between record company and artist is a complicated business partnership. The terms of our deals are highly individualized. Numerous factors influence the terms of each agreement, including the scope of the deal, the type of artist being signed, the competitiveness of the deal, whether the artist is already signed to another production company or small label, and our assessment of the market for the artist's work. For example, deal terms tend to reflect that rock albums typically cost less to produce than pop albums. However, most of our deals, like those of most other labels (major and indie), tend to take the same basic form that is pretty standard in the industry. In the most basic terms, the record company tends to absorb all the risk associated with creating a recording by fronting the costs and then sharing the rewards with the artist only if the artist finds commercial success. This type of arrangement is reflected in Atlantic's standard form of recording contract, which I have provided as SoundExchange Exhibit 4.

35. The terms of recording contracts tend to include payment to the artist of a substantial up-front advance. For a new artist, our advance would typically range from [REDACTED] to [REDACTED], depending on competition. For an established artist with a track record of success, we may pay advances of many millions of dollars.

36. The record company also typically pays all the costs of producing the artist's recordings, including costs such as producer fees, studio fees, engineering costs, wages of

session musicians, and costs of producing accompanying videos. In the case of a first album from a new artist, recording costs typically range from [REDACTED] to [REDACTED]. For an established artist, we sometimes pay recording costs for an album [REDACTED].

37. We also typically have to make other financial commitments to artists, such as to provide a certain level of support for videos, independent marketing, and touring.

38. A key term in any recording deal is the artist's royalty. These days, with respect to product that is sold either in physical form or as downloads, that is typically expressed as a percentage of the record company's wholesale price. For Atlantic's front-line artist roster, that percentage is typically in the range of [REDACTED]. In rare instances we might sign a new artist at a rate as low as [REDACTED] or a star artist at a rate as high as [REDACTED]. I estimate that our average royalty rate for active front-line artists is approximately [REDACTED] of the selling price of a CD or download.

39. Prior to the last decade, licensing of products to third parties was viewed as ancillary to our core business (which was then selling physical records), and we typically paid artists 50% of our licensing receipts in connection with such exploitation. This 50/50 split of licensing receipts was a very common practice in the industry at the time of the DPRA, and it probably inspired the statutory 50/50 split for Section 114 performance licensing royalties distributed by SoundExchange. *See* 17 U.S.C. 114(g)(2). While streaming is also based on a license model, we need to preserve our operating margins in the context of this new business model. Accordingly, we created a separate category of royalties to address the fact that streaming is directly substitutional for our physical product and download business. While the rate for so-called "ancillary" licensing (such as synchronization licensing) typically remains at 50% of our receipts, streaming royalty rates in new contracts are in the same range as physical and digital product royalty rates (typically [REDACTED]).

40. With the exceptions for statutory licensing I describe below, it is standard in the industry that the record company is entitled to recover the costs it has fronted before it pays royalties to artists. This is a process generally referred to as “recoupment.” In this arrangement, the record company is entitled to apply the royalties that the artist would otherwise earn from exploitation of the artist’s recordings to recoupment of the advances, recording costs, promotional costs described below and other amounts paid by the record company. Somewhat confusingly (since it is the record company that is recovering its costs), the artist is commonly said to be “recouped” when the artist’s recordings have enjoyed a level of commercial success sufficient to allow the record company to have recovered its costs through application of the artist’s royalties. Across the industry, it is generally only when the artist is recouped that the record company will begin issuing royalty checks to the artist.

41. Sadly, most artists and albums do not recoup. That is, the record company incurs costs associated with the artist’s releases that are greater than the amounts it receives through recoupment. Research by a Harvard Business School professor has found that across the industry, record companies “recovered their investments in only one out of every five or six new albums.”⁶ Although we believe Atlantic’s “batting average” is better than the average across the industry, our experience at Atlantic has been roughly similar, and, as far as I know, no record company has had more hits than misses over the course of time.

42. Because of recoupment, many artist lawyers and managers seem to prioritize getting a large advance when they are negotiating with record companies. The idea is that because there is a good chance that the artist will never receive any royalties from the record

⁶ Anita Elberse, *Blockbusters: Hit-making, Risk-taking, and the Big Business of Entertainment* 74 (2013).

company (because the artist will not recoup), the artist's best chance of making money from a recording lies in taking cash up front. Payment of a higher advance, of course, heightens the record company's risk of the success or failure of a recording.

43. I noted above that there are exceptions to the industry's usual recoupment model in the case of statutory licensing. There are two distinct issues. The first is statutory. Under Section 114(g)(2), statutory royalties paid through SoundExchange are to be distributed directly to featured artists and the union funds for background musicians and vocalists. Furthermore, I understand that as a matter of policy, SoundExchange will not accept a letter of direction from an artist asking SoundExchange to pay the artist's royalties to a record company. Because record companies never touch the artist's share of royalties flowing through SoundExchange, we cannot recoup our costs from those royalties. I understand that this was a key principle in the negotiations between the record companies and the musicians unions that eventually cleared the way for Congress to enact the DPRA.

44. The second issue involves direct licensing by the major record companies of services eligible for statutory licensing. As a matter of statute, except where SoundExchange distributions are involved, featured artists are generally to be paid "in accordance with the terms of the artist's contract." 17 U.S.C. § 114(g)(1)(A). As described above, those terms generally would involve the record company's recoupment of its costs from artist royalties. That is, if a record company directly licensed a service, rather than the service's using its recordings under the statutory license, the record company would be entitled to recoup from the artist's royalties (based on the contractual percentage rather than the statutory percentage). However, to ensure that direct licensing by the major record companies did not undermine the financial viability of SoundExchange, in 2010, the major record companies entered into an agreement with the

musicians' unions requiring the statutory artist share of direct-license royalties from services otherwise subject to statutory licensing to be paid through SoundExchange. A copy of this agreement is provided as SoundExchange Exhibit 5. As a result of this agreement, in the case of artists signed to major labels, the treatment of the artist share of performance royalties paid by statutory services is the same whether the service relies upon the statutory license or a direct license from a major record company. However, no independent record company is a party to this agreement, and I am not aware of any similar agreement that would prevent an indie from paying an artist for direct license royalties in accordance with the artist's contract as contemplated by the statute (including paying at the bargained-for royalty rate and subject to provisions concerning recoupment).

45. In short, if an artist is very successful, then both the record label and the artist reap the benefits. But if the artist does not achieve a high level of success, then the record company must absorb the loss. Moreover, in the most typical situation, where the artist does not achieve a high level of success, the record company may lose more where that artist was paid under the statutory license than it would if the record company had granted direct licenses for the relevant usage (if the record company is not subject to the majors' 2010 union agreement). This is so for two reasons. First, under the statutory license, the artist share is 50%, while under our contracts (like those of many other labels) the artist royalty is typically in the [REDACTED] range, so the statutory license causes the record company to give up [REDACTED] of revenue that it might otherwise be permitted to keep (if the record company is not subject to the 2010 agreement). Second, quite apart from the difference in royalty rates, with a direct license, a record company that was not subject to the majors' union agreement could use 100% of the artist royalties to recoup its costs before paying anything to the artist.

C. **Artist Development and the Creation of Recordings**

46. After an artist is signed, we begin a process of developing the artist and making recordings. We succeed by developing the strongest artist brands, and the most in-demand recordings, that will attract and capture large audiences across platforms. Indeed, in the current marketplace, it is more important than ever that we make great recordings. With the unbundling of albums and a constant push to maintain and grow market share on streaming services, we want every one of our recordings to represent the best possible expression of the artist's artistry. Doing that requires the collaborative efforts of a large team of professionals (both inside and outside the company), and is very expensive.

47. Particularly when we sign artists early in their careers, our A&R Department works with them as necessary to develop the complete package of skills necessary for a successful career. This may involve working on the branding and image that the artist will use to launch his or her career or honing the artist's performance skills. We may, for example, secure vocal or dance coaches, stylists, and assistance with maintaining a website and social media presence.

48. The A&R Department also usually works with the artist and the artist's management in the selection or writing of the songs to be recorded and assembling the necessary creative team. What this involves depends on the genre and the artist's own preferences and skills. Some artists are fairly self-sufficient, leaving us in a more supervisory role, while others require us to take a much more active role in shepherding the creative process. The process of creation of recordings in the rock genre tends to be fairly self-contained, although we work with the band to select a producer (usually one producer for an album, if an album is released), and we may help identify one or more outside songwriters to work with the artist to develop the songs to

be performed. Pop releases generally tend to involve more collaboration, particularly if the artist is not also a songwriter. Sometimes, we arrange collaborations with other featured artists. In the case of electronic dance music (“EDM”), artists who are DJs need to be matched with appropriate vocalists, which typically requires significant involvement by our A&R Department.

49. Hip-hop is an inherently collaborative genre. There, the artist and our A&R Department may review hundreds of instrumental “beats” suggested by different producers to find the right ones for the artist’s vocals. The selected producers then typically serve both as the songwriter of the instrumental portion of the track and in a traditional record producer role of shaping the sound of the finished recording. We often need to bring in additional songwriters who specialize in writing “top lines” or “hooks” that constitute the melody of song. Hip-hop albums tend to be fairly expensive to record, due to the cost of hiring top producers, the competitive landscape for tracks, and the cost of adding featured vocalists.

50. The A&R Department is also usually responsible for arranging for studio time, sound engineers, and background musicians and vocalists. Once the studio recording session is completed, the A&R Department will work with the artist and producer to complete production and mix and master the final recordings. Various edits of the recording may be completed, and the A&R Department will work with the artist to determine which edits to use.

51. Our audio releases are often accompanied by video releases. There, we work with the artist to select the most appropriate production companies, directors, and other essential components for the video. We also coordinate the production to ensure that it is consistent with the overall creative vision we are pursuing with the artist.

52. As I noted above, we no longer feel constrained by the need for an artist to produce an album-length body of work to release a product. Many artists will release multiple

singles or small bundles such as EPs before they release an album (*if they release an album*) and to bridge album cycles. Smaller releases are particularly common in the hip-hop genre (where albums are less and less critical for an artist's success and popularity) and the EDM genre (where singles are the norm, and the concept of an album is almost irrelevant). By way of example, Atlantic is in the process of releasing the fourth mixtape by popular Atlanta-based rapper Young Thug, who has yet to put out an "official" album.

D. Marketing and Promotion

53. While each of the recordings we release is a unique work of art that the artist, in collaboration with our A&R team, believes has the potential for commercial success (as measured within the context of the genre), producing great records is not sufficient to ensure that success. More music is created today than ever before with the proliferation of home recording studios, self-produced albums, and the flood of music on the Internet. With all that music available, an artist's creative works will not be known by the public in any meaningful way without a massive promotional effort to connect the artist and recording with an audience. In fact, for a record company, the largest part of the cost of releasing a recording typically lies in marketing it. Although this part of the process is the least understood and appreciated by the general public, the efficacy, efficiency, and creativity involved in marketing artists and their recordings can be as important as the quality of the music in trying to get attention for the artist and the artist's recordings and develop a fan base.

54. Digital music services demonstrate the fundamental problem for anyone who hopes to make money from music. Spotify offers more than 30 million tracks,⁷ and the iTunes

⁷ <https://news.spotify.com/us/2016/05/23/spotify-family-plan-gets-an-upgrade/>.

Store claims to have 43 million.⁸ No person could listen to more than a small fraction of them even once over the course of a lifetime. Record company marketing efforts are designed to cut through this clutter to reach an audience that can be monetized.

55. Marketing recordings is a creative process that varies widely based on the genre of music and the prominence of the artist involved. For example, for a new pop album, a high level of radio play combined with local promotional efforts is key, while touring is often essential for rock artists, and generating “street buzz” may be extremely important for a new hip-hop album. Whatever the focus for a particular artist, for a record to rise above its many competitors and become a success that will continue to attract an audience, there must be considerable and effective effort and investment in marketing the release.

56. Well before a release is complete, product managers in the Marketing Department work with the Finance Department to create a marketing budget and then create and implement marketing plans. Marketing plans define the market positioning and branding of an artist and target demographics, and are generally quite elaborate. The marketing of a release is designed to connect an artist and recording to an audience in multiple, coordinated ways, and may among other things include:

- Publicity to tell the artist’s story in as many media outlets as possible through interviews, television appearances, events, reviews and blogs.
- Touring, which may be the most important aspect of promotion for some artists (rock artists in particular).
- Digital Marketing, which is a core part of marketing both an artist’s brand and an artist’s recordings through the Internet, and particularly through social media.

⁸ <http://www.apple.com/itunes/music/>.

- Strategic Partnerships, through which we often partner with brands to promote our artists.
- Retail marketing, particularly for rock and pop recordings (which sell better than other genres as physical products), including special editions of products for particular retailers, product positioning and promotion in bricks-and-mortar and online stores, as well as artist appearances.
- In genres served by terrestrial radio (particularly pop and hip-hop), efforts to ensure that the artist's music has the chance to be heard on radio in coordination with other local marketing efforts (e.g., in-studio interviews, concert appearances and promotions).
- Promoting the recording to digital music services.

57. Our marketing involves carefully crafted promotional campaigns designed to create awareness among consumers about the artist's music, increase interest and excitement about the artist and the artist's music, and "break" the artist and new recording to specific demographics, or in the case of an established artist, to ensure that that artist maintains and grows their fan base. Promotion is not a scattershot matter, and not all plays by every service are promotion.

58. Our promotional efforts increasingly include promoting new recordings to streaming services that pay us royalties, because these services are, in effect, the new radio for their subscribers, and they are an outlet for music in genres that are not well served by terrestrial radio. We approach these services and influencers on these services in much the same way as we have long promoted our recordings to terrestrial radio, providing them plans and data to make a case for why a new recording will do well on the service, to get as much use as we can on each

platform to generate royalties from the service and to contribute to the overall “buzz” surrounding a new release.

59. On-demand services like Spotify are increasingly important to our promotional efforts and to the ultimate success of a recording. Much of the listening on such services is in a “lean back” mode, where the user does not select individual tracks one-by-one, but instead listens to programs or playlists that have been created by the service, by others, or previously by the user. In early 2015, WMG estimated that [REDACTED] of all plays on Spotify were playlist plays,⁹ and that percentage has likely grown since then. Service-generated and third-party generated playlists on these services are an effective way to introduce our recordings to the audience of subscribers to the service, and if users like a recording and add it to their own playlists, that will continue to drive royalties for us long into the future.

60. To illustrate the point, SoundExchange Exhibit 6 is an internal WMG strategy document called “Global Playlist Integration Update and Opportunities.” It notes that [REDACTED] of plays on Spotify come from non-personal playlists, and approximately [REDACTED] of those plays are newly discovered music (meaning music the subscriber has not played before on the service).¹⁰ We conclude that “playlisting is a critical driver to increasing consumption on streaming services” and “third-party playlisting is the most effective discovery feature on Spotify for getting users to add discovered tracks into their personal collections, exponentially increasing consumption.”¹¹

61. The point of this promotion is not simply or even principally to obtain exposure for the music so that consumers will buy copies of it. Instead, it is to encourage on-demand

⁹ SoundExchange Exhibit 7, at 10.

¹⁰ SoundExchange Exhibit 6, at 2.

¹¹ *Id.*

subscribers to add our music to their playlists, which then generate repeat plays and higher revenue from the service. As another internal strategy document put it, “playing the streaming game is all about continued engagement, getting people to play a track again and again,”¹² which maximizes our revenue from the service.

62. Accordingly, we strive to be included in services’ curated playlists, encourage tastemakers to feature our music on their playlists, create our own playlists and seek to have services offer them, and work with our artists to create and manage their own playlists. WMG has also purchased or invested in playlisting companies to help our artists secure spots on playlists on the on-demand services.

63. Similarly, Apple Music provides radio-like shows, including ones that are available only to subscribers, and have promotional characteristics similar to terrestrial radio and playlists on Spotify. Getting new music featured on such shows, particularly ones hosted by important influencers like the artist Drake, can be very effective in reaching an audience.

64. Promotion through on-demand services is particularly effective and important in genres like pop and hip-hop that are popular on the services and a good fit for the demographics of the services’ subscriber bases. It is probably not an overstatement to say that these days, in these genres, a record will not break (achieve commercial success) without being included in the most popular playlists on on-demand subscription services. Promotion through these services is less effective for rock music, which tends to have more of a fan base in the Midwest, where bricks-and-mortar retail is stronger than on the coasts, and for the moment at least, the penetration of on-demand services tends to be lower.

¹² SoundExchange Exhibit 7, at 7.

65. We promote our recordings to other kinds of services as well. For example, we try to get our artists featured on YouTube, and their videos listed on YouTube's charts.

66. We promote our recordings to Sirius XM. In genres that are not well-served by terrestrial radio and tend to have lower usage on on-demand streaming services, particularly rock and alternative, Sirius XM is a good platform for us to reach a broad audience. Moreover, we are paid when Sirius XM uses our recordings.

67. Many of our promotional efforts with Sirius XM involve studio appearances by our artists to promote live shows and give away tickets. It would be a mistake to view such promotions as a favor that Sirius XM is doing for us, because they provide benefits for Sirius XM as well as for Atlantic and our artist, and Sirius XM is often eager to feature our popular artists. It is in Sirius XM's interest to have appearances by popular artists, so that the artist's fans will associate Sirius XM with the artist, and Sirius XM can trade on the fans' loyalty to the artist to build and maintain their subscriber base. While we will [REDACTED]
[REDACTED]
[REDACTED], it is not our practice to waive the statutory royalties to which we are entitled. That is, Sirius XM pays statutory royalties for any subsequent use of the artist's recorded performance on Sirius XM, and we pay nothing to Sirius XM to get our artist on its service.

68. Carrying out a promotional campaign sufficient to give an artist a fair chance at commercial success is very expensive. These days, a typical initial U.S. marketing budget for an album cycle for a new artist is in the range of [REDACTED] to [REDACTED]. An initial U.S. marketing budget for an album by an established artist with a history of success will be several

times those numbers. In any case, if a record gathers momentum in the market, we will increase our marketing spend beyond the initial budget to propel it to greater success.

69. I must emphasize that we do not view any platform as uniquely promotional. In significant respects the various platforms are similar. For example, a genre-based playlist on Spotify or show on Apple Music will tend to include recordings in heavy rotation on a similar genre channel on Sirius XM or another service. We get paid by all of them, and we want our music to be well represented on all of them. Some platforms are better than others for particular genres of music and artists, depending on the service's focus and the demographics of its listeners. The services also tend to reach their subscribers in different places – *e.g.*, Sirius XM in the car and Spotify on a smartphone or a desktop computer. We want to use all appropriate platforms to reach an audience wherever we can.

70. Moreover, terrestrial radio, Sirius XM and other pre-programmed services, and creators of playlists on on-demand services are all motivated to use recordings that will appeal to their listeners, and to refrain from using recordings that will not appeal to their listeners. In the case of subscription services, that is how they attract and maintain subscribers and provide a service worth the subscription price. When we pitch an artist or new recording to a service or a playlisting company, and it decides to feature the artist or recording (whether by playing it as part of a program, including it on a playlist, or featuring it in other online “real estate”), that reflects agreement that there is a mutually beneficial fit between our artist or recording and the other party's programming or service that will satisfy its listeners, allowing it to monetize those listeners, and allowing us to receive royalties and develop an audience for the artist and recording.

71. While the details of our promotional efforts vary from release to release, for a record or recording to rise above its many competitors and become a success, there must be considerable and effective effort and investment in marketing.

E. Manufacturing and Distribution

72. The final steps in making recordings available to the public are manufacturing (in the case of physical products) and distribution (in the case of all products). Like almost all labels, Atlantic does not have its own manufacturing and distribution operation. Instead, it relies on Warner-Elektra-Atlantic Corporation (“WEA”), the shared services division of WMG, which functions as Atlantic’s distributor. WEA has specialized expertise in distribution and achieves economies of scale by distributing the recordings of many labels.

73. As Atlantic’s distributor, WEA is responsible for physical and digital distribution of our albums and other products. For physical products, WEA contracts for manufacturing and has an extensive distribution network that handles warehousing, shipping, and inventory control. It also has a large sales force, whose efforts are supplemented by Atlantic’s sales staff. WEA helps to manage account relationships with retailers and ensure that quality products are manufactured and shipped on a timely basis. WEA also handles reorders, ensures retail customers have adequate stock, and takes care of the billing and credit relationship with customers. In the case of digital distribution, WEA has account relationships with the major digital music services, as well as mobile carriers and ringtone providers. It is responsible for encoding and delivering the digital masters to these providers and administering the collection of revenue. For example, Atlantic does not itself negotiate for the distribution of its recordings by digital music services. That is a function performed at the WMG corporate level, and the deals WMG strikes cover substantially all of the recordings distributed by WMG, including Atlantic’s.

74. WEA typically collects from its customers after obtaining orders and distributing sound recordings on Atlantic's behalf. WEA receives a percentage of the wholesale price as a distribution fee.

CONCLUSION

75. It is unquestionable that record companies and artists make tremendous and indispensable creative and financial contributions at every stage of the process of creating and popularizing the recordings used by digital music services. It should also be clear that we are in a risky business.

76. Artists take personal risks with every new release. Even if an artist has previously had some commercial and critical success, that does not assure future success, and many artists only release one successful album. An unsuccessful release can significantly affect the arc of an artist's career.

77. A record company like Atlantic makes substantial investments to provide the threshold level of support that our artists need to have a fair chance to realize their potential, and to maximize our chances of having a profitable release. While Atlantic knows that in most cases we will not recover all the money spent on creating and marketing an album, let alone make a profit, if a record is to have a chance at succeeding, we must approach it as if it will succeed. Over time and across the industry, the investments made to create the catalog of recordings available to digital music services is staggering. According to a 2015 RIAA study, during the decade 2003-2012 (which was not a prosperous time in the industry), the major labels spent a


total of \$13.4 billion to find new artists and help them reach an audience, and \$20 billion on artist and songwriting royalties.¹³

78. Digital music services take no risks with respect to the recordings they use. Instead, they get to choose from among our most popular and commercially successful recordings to build an audience that they can monetize. Now that such services clearly represent the future of the music business, each such service must contribute fairly to providing record companies a reasonable return on the investments made to create and popularize the recordings they use, if record companies are going to be able to continue creating the music America loves. The statutory rates at issue in this proceeding, which have long been set intentionally below-market, should be increased to marketplace levels to compensate record companies and artists for their creative contributions, investment, costs and risks from which Sirius XM and the PSS benefit.

¹³ RIAA, Labels at Work: The Music Business in the Digital Age 1 (2015), available at <https://www.riaa.com/wp-content/uploads/2015/09/LabelsAtWork.pdf>.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10/18/2016



Michael Kushner

Exhibits Sponsored by Michael Kushner

Exhibit No.	Description	Designation*
SX Ex. 003	RIAA News and Notes on 2015 RIAA Shipment and Revenue Statistics	Public
SX Ex. 004	Atlantic Records Form Recording Contract	Restricted
SX Ex. 005	[Redacted]	Restricted
SX Ex. 006	Warner Music Group: Global Playlist Integration Update and Opportunities, dated January, 2015	Restricted
SX Ex. 007	Warner Music Group: Streaming Overview, dated January, 2015	Restricted
SX Ex. 011	Warner Music Group: Digital Strategy, dated November 15, 2012	Restricted
SX Ex. 040	Warner Music Group: Digital Strategy, dated September, 2014	Restricted
SX Ex. 041	Warner Music Group: Global Playlist Integration Plan, dated October/November, 2014	Restricted
SX Ex. 042	Warner Music Group: Viral 50 Impact	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Jason Pascal

**Vice President, Catalog Development
and Associate General Counsel
The Orchard**

October, 2016

I. Qualifications

My name is Jason Pascal. Since 2011, I have been the Vice President of Catalog Development and Associate General Counsel for The Orchard, a distributor of independent record labels now owned by Sony Music Entertainment (“Sony Music”). In this capacity, I manage relationships with record labels, artists, and other parties that bring content to The Orchard. I am familiar with The Orchard’s operations. I regularly work with our legal team, business development team, and finance team, and I report directly to our Chief Operating Officer.

From 2005-2010, I served as Senior Counsel for The Orchard. Before joining The Orchard, I held several other positions in the music industry, including positions at EverAd and at BMG Entertainment. I received a Bachelor’s degree in History from the University of Michigan and a law degree from Brooklyn Law School.

II. About The Orchard

The Orchard distributes sound recordings for [REDACTED]. Our catalog contains [REDACTED] tracks and spans a diverse collection of genres, including classic and indie rock, hip-hop, country, soul, folk, electronic, Americana, bluegrass, reggae, and more. Our distributed labels record and produce prominent, critically acclaimed, and commercially successful artists like Pitbull, Jimmy Page, Lil’ Jon, Journey, and Aventura. We also distribute for a significant number of recording artists who have a smaller but dedicated fan base, like Haley Reinhart, Butch Walker, Pete Rock, and Sharon Jones, as well as artists who are still working to find their audience. The Orchard has been partially owned by Sony Music since 2012, and became a wholly owned subsidiary of Sony Music in 2015.

III. The Orchard's Documents

I understand that documents from The Orchard's files are being submitted as part of an exhibit in this proceeding. I have reviewed The Orchard's documents, contained within SX Ex. 043. The documents from The Orchard's files are authentic, and I am prepared to appear at the hearing in this proceeding for purposes of providing any further foundation for their admission into evidence that the Copyright Royalty Judges deem necessary.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 10/18/2016

Jason Pascal

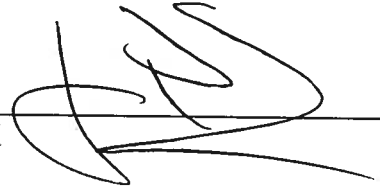
A handwritten signature in black ink, consisting of several overlapping loops and strokes, positioned above a horizontal line.

Exhibit Sponsored by Jason Pascal

Exhibit No.	Description	Designation*
SX Ex. 043	CD Containing Agreements Between Subscription Interactive Services and The Orchard, Relied on in Orszag Testimony	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Jeremy Sirota

**Senior Vice President and Head of Business and Legal Affairs
Alternative Distribution Alliance
and Warner-Elektra-Atlantic Corporation**

October, 2016

I. Qualifications

My name is Jeremy Sirota and I have worked at Warner Music Group (“Warner”) for almost eight years. I currently serve as Senior Vice President and Head of Business and Legal Affairs for two entities: Alternative Distribution Alliance (“ADA”), which is a Warner-owned distributor of independent music, and Warner-Elektra-Atlantic Corporation (“WEA”), which is the shared services division for Warner’s recorded music business.

I provide business and legal advice to the various departments within ADA and WEA, such as Finance and Credit, Physical Sales, Physical Supply Chain, Artist Services, Digital Account Management and Digital Operations. My position requires, among other things, regularly negotiating and helping to administer the vendor technology deals that underlie the services that WEA provides, including services related to digital supply chain, artist websites and e-commerce. It also requires negotiating ADA’s distribution deals with independent record labels, artists and management companies.

During my employment at Warner, I have had several other responsibilities. Until recently, I was responsible for managing a department called Revenue Assurance and Digital Compliance. This role involved overseeing catalog assurance with physical and digital retailers and audits of digital retailers. It also involved improving the processes we use to ensure digital service providers’ compliance with our digital agreements, including the marketing and promotion obligations in those agreements.

Prior to joining Warner, I worked for five years at a private law firm. At the firm, I was heavily involved in drafting and negotiating licensing, distribution and service agreements for a number of complex intellectual property transactions.

II. ADA

ADA is one of the largest distributors of independent music in the United States (as determined by market share). ADA distributes products via both physical and digital channels. The company was founded in 1993 as a joint venture between a Warner affiliate and two independent record labels, Sub Pop Records and Restless Records. It was established to help independent record labels and artists distribute their physical products into a broader marketplace. ADA is now wholly owned by Warner and has spent more than 20 years helping independent record labels and artists distribute, sell, market and promote their music. ADA continues to evolve to support independent record labels and artists, by meeting the needs associated with digital distribution in a global marketplace.

As of September 22, 2016 (measuring figures for year-to-date), ADA's distributed labels and artists represent approximately [REDACTED] of the aggregate physical/digital U.S. market for sound recordings (as measured by Nielsen SoundScan, inclusive of physical sales, digital sales and streaming activity), and [REDACTED] of the aggregate digital U.S. market for sound recordings (as measured by Nielsen SoundScan, inclusive of digital sales and streaming activity). In the U.S., ADA handles distribution for 100+ independent record labels, artists, and management companies spanning numerous genres, including Sub Pop Records, Epitaph Records, BMG, Nettwerk Music Group, New West Records, Beggars Group, Domino Records, Macklemore & Ryan Lewis, Q Prime, Bonnie Raitt, Defected, Milan, and Third Man Records.

III. WEA

WEA is the shared services division of Warner's recorded music business. WEA is responsible for many of the operational functions required to support Warner's wholly owned labels, global affiliates and ADA. WEA's departments include: Media Operations, Digital

Account Management, Physical Sales, Physical Supply Chain, Warehousing and Archiving, Research & Analysis, and Warner Music Artist Services. These are critical functions for Warner. The Media Operations department manages our digital supply chain, metadata management, storage of digital products, and more. The Physical Sales team houses a group responsible for working with retailers and oversees all aspects of our physical supply chain, including manufacturing, warehousing, and distribution. Warner Music Artist Services is responsible for many commercial and marketing responsibilities, including tour merchandise, retail sales, VIP and pre-sale ticketing, name/likeness licensing deals, developing and managing artist websites, e-commerce and artist marketing tools (e.g., email and mobile campaigns, fan engagement, etc.).

IV. Overview

I am testifying to provide the Copyright Royalty Judges with perspective on the significant benefits that independent record labels and artists obtain when their content is distributed through a major record company. In my testimony, I discuss several of these benefits.

First and foremost, an independent record label or artist that uses ADA as its distributor is distributed under the same streaming agreements, and according to the same terms, as a record label wholly owned by Warner. This means that streaming services pay the exact same revenue share for ADA-distributed content and Warner-owned content. Additionally this relationship means ADA's distributed labels and artists benefit from the same contract-based marketing and promotional opportunities as Warner's wholly owned labels.

Distributing through a major record company is also beneficial because we provide a number of services that require a substantial investment of time and capital. Digital distribution

and the related functions that ADA provides require extensive information technology and considerable expertise. It often does not make sense for an independent record label to spend its resources on the systems needed to ingest, host, and process the large volume of data associated with distributing content to and collecting royalties from an array of digital music services. By spreading costs across all of our distributed labels and artists, ADA can achieve substantial costs savings and efficiencies, from which our distributed labels and artists benefit.

V. Streaming Services Pay the Exact Same Rates for ADA's Independent Record Label Content and Warner's Owned Content.

ADA does not negotiate its own agreements with streaming services. Instead, independent record labels and artists that sign with ADA are distributed under the terms of Warner's agreements with streaming services. The agreements typically define Warner content to include all content that Warner owns or controls, either by virtue of ownership, a license deal, a distribution deal, or otherwise. In other words, Warner's agreements with these digital service providers do not draw distinctions between independent record label content and Warner's wholly owned content. As a result, streaming services pay the exact same revenue share for Warner's wholly owned content and distributed label content. This is true whether the service is interactive, non-interactive or offers some hybrid functionality. When ADA-distributed tracks are played on a streaming service, the service must compensate that performance at the same rate it compensates the performance of a Warner-owned track.

VI. Music Services and Retailers Provide the Same Non-Monetary Benefits to ADA's Independent Record Label Content and Warner's Owned Content.

As I have mentioned, ADA operates under Warner's streaming agreements, which do not distinguish between wholly owned and distributed label content. As a result, ADA's distributed labels and artists receive access to contract-based marketing and promotional benefits granted in

Warner's streaming agreements. The marketing and promotional needs of wholly owned and distributed labels and artists fluctuate over the course of a year. Demand for marketing and promotional opportunities usually arises when an owned or distributed label is set to release a new album. However, Warner attempts to allocate marketing and promotional benefits on a pro rata basis. Accordingly, ADA labels and artists receive a share of marketing and promotional benefits roughly proportionate to their market share on the relevant service. This enables independent record labels and artists distributed by ADA to find a broader audience, increasing reach and revenue.

VII. ADA Provides Independent Record Labels and Artists with Valuable Services.

In addition, ADA helps our distributed labels and artists reach a broader marketplace without incurring the significant costs associated with negotiating deals with physical and digital retailers, setting up their own digital and physical operations, and managing the credit and accounts receivables functions. The core services that ADA provides to our distributed labels and artists include sales, retail marketing, strategy, analysis, label/artist development, digital account management, and physical and digital supply chain management. Our ability to assume responsibility for complex but indispensable operations lowers barriers to entry and enables independent record labels and artists to focus their resources on acquiring rights and creating new sound recordings.

A. Digital Distribution

There is a popular misconception that digital distribution is costless and easy. In fact, it is expensive and complex. Although there has been consolidation in the marketplace for digital music – with companies like Apple, Google, and Spotify emerging as large players – there remain many digital service providers in the U.S. These digital service providers have

increasingly sophisticated business models and/or complex technical requirements. The differences between the technical requirements can be significant and many of the providers revise their requirements on a regular basis. As a result, delivering content to digital service providers in practice requires being up-to-date and nimble in handling such requirements.

ADA, and our distributed labels and artists, benefit from the role that WEA plays in assessing the technical requirements associated with digital distribution and in keeping up with any new specifications for each digital service provider. To do this, and to facilitate the formatting and transmission of digital content, is laborious and requires a substantial staff. In practice, labels and artists lacking experience with digital distribution are more likely to make technical errors when delivering content and metadata. These errors come at a significant cost: they can preclude labels and artists from getting placement on digital music services or getting paid. Accordingly, our ability to deliver content and metadata in a timely and accurate manner – no matter the technical specifications – is essential to the success of labels and artists. Moreover, by leveraging Warner’s resources, and spreading the price of operations across our wholly owned and distributed labels and artists, we reduce the effort and expense that would otherwise be imposed on independent record labels and artists, and help to reduce the barriers to entry for those labels and artists.

Distributing digital content also requires building powerful technical infrastructure that can process and store a significant amount of data, and which enables both formatting and delivery of voluminous files. WEA, on behalf of both ADA’s distributed labels and artists and Warner’s wholly owned labels, has made considerable investments in this very costly equipment, software, and technical expertise. Over the coming years, I expect that the amount of data that digital service providers deliver to us will continue to increase. As a result, I expect that WEA

will continue to reinvest in the systems used to store, process, and transfer data. The size of WEA's operation will allow it to generate economies of scale. Sparing each individual label from the cumbersome process of constructing and maintaining the IT necessary to distribute digital content – as well as the cost of hiring skilled staff to oversee digital operations – reduces redundancy and increases each individual label's ability to sink resources into content.

Of course, there is more to digital distribution than supplying content and data. We also monitor the various digital service providers to ensure that they pay and report accurately back to us, and to otherwise monitor and protect the intellectual property of our artists and labels. Warner, both in-house and via third-party relationships, monitors YouTube to issue takedown requests for infringing content and monitors other services (*e.g.*, Google, eBay, Amazon, P2P services) to take down any pirated or infringing content. For our distributed labels and artists, this service is important. Infringement imposes significant costs on labels and artists, many of whom lack the resources needed to police some or all of the sites through which unlawful content can be disseminated. Our distributed labels and artists benefit from the efforts and resources of our staff and our third-party relationships to protect their intellectual property.

B. Physical Distribution

Physical distribution is still important for many of our distributed labels and artists, despite the decline in CD sales. ADA has more than two decades of experience with physical distribution, including the support and experience of the WEA staff. ADA has developed the capacity to offer labels and artists comprehensive physical distribution services, including

assistance with manufacturing, distribution, sales, delivery, inventory control, and performance review. Some of this work is contracted out to third parties; the rest is managed in-house.

The investments that Warner and ADA make in our physical supply chain provide our distributed labels and artists with significant value. We offer the opportunity to leverage Warner's longstanding relationships with prominent retailers and our extensive distribution network. We also allow labels and artists to take advantage of an innovative platform that reduces costs by allowing physical retailers to order units directly from our warehouse. In sum, ADA enables distributed labels and artists to access the assets and services developed through decades of investment in physical distribution for Warner's wholly owned labels, rather than embarking on the painstaking process of developing the infrastructure needed to distribute physical units.

C. Collections, Payment Processing and Reporting; Data Visualization

Warner handles collections and payment processing for revenues from digital service providers (as well as the associated credit functions), with ADA providing reporting to its distributed labels. In the U.S., this means that we handle collections, payment processing, and reporting for more than 100 digital service providers, as well as numerous physical retailers. The amount of information that digital services provide to facilitate royalty allocations is often gigantic, and often presented in very different formats. But all of the reported data must be ingested, stored, analyzed, and synthesized to ensure that distributed labels and artists are paid on a monthly basis. To ensure that streaming usage is transparent, Warner has constructed a data visualization platform that allows labels and artists to view streaming usage data, including, for example, the total number of monthly performances of a label's and artists' sound recordings on relevant streaming services.

In short, we have created a sophisticated back-end operation to handle collections, payment processing and reporting, as well as data visualization, to save our distributed labels and artists a significant amount of time and money.

D. Marketing and Other Services

Part of helping labels and artists reach broader audiences and maximize profits is designing effective marketing and promotional campaigns. The right approach to marketing and promotion can increase the exposure of, and the revenue generated by, an album or track. To assist with this, ADA can offer a number of tailored services. Our digital marketing team can help to promote artists through online advertising, including asset premieres, unique features, and other initiatives, like promotional contests. Our press and publicity team can assist labels and artists by securing television opportunities, national, regional, and local print features, and online editorials. Additionally, ADA can provide labels and artists with services like synchronization licensing/brand licensing, merchandising (tour, wholesale, retail and licensing), e-commerce (including website design, product development and fulfillment), and VIP experiences, pre-sale ticketing and subscription clubs. Because these marketing and promotional efforts and services require significant headcount, many small and mid-sized labels and artists do not have the capacity to replicate this operation.

VIII. Conclusion

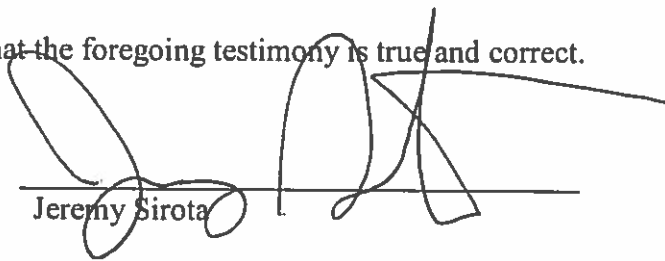
I appreciate the opportunity to offer the Copyright Royalty Judges testimony about the value our companies provide to independent record labels and artists. I am proud of the work that ADA and WEA do to assist independent record labels and artists to reach a broader audience and increase their commercial success.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date:

10/19/16

Jeremy Sirota

A handwritten signature in black ink, appearing to read 'Jeremy Sirota', written over a horizontal line. The signature is stylized and somewhat cursive.

Exhibits Sponsored by Jeremy Sirota

Exhibit No.	Description	Designation*
SX Ex. 018	CD Containing Recently Executed Warner Music Group Agreements with Pandora and iHeart Radio, Relied on in Orszag Testimony	Restricted
SX Ex. 032	CD Containing Agreements Between Subscription Interactive Services and Warner Music Group, Relied on in Orszag Testimony	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Darius Van Arman

**Co-Founder
Secretly Group**

October, 2016

I. Background and Qualifications

I am a co-founder and co-owner of a group of independent record labels called Secretly Group, which includes the four labels: Jagjaguwar, Dead Oceans, Secretly Canadian, and the Numero Group. I am also co-owner of a distribution company, Secretly Distribution, which distributes the four Secretly Group labels, as well as for about fifty seven (57) other independent record labels. Secretly Group is also affiliated with a music publishing company, Secretly Publishing, and an artist management company, Fort William Artist Management. Altogether, these affiliated music companies employ about one hundred people.

I am also actively involved in the independent record label community. I currently serve as the chairman of the Board of Directors of the American Association of Independent Music (“A2IM”), a not-for-profit trade organization representing over three hundred independently owned music labels in the United States. I am a member of the Board of the Music and Entertainment Rights Licensing Independent Network or “Merlin,” a global rights agency for the independent label sector. I am also a current council member of the Worldwide Independent Network (or “WIN”), the global representative organization founded in July 2006 to represent independent music companies and their national trade organizations. In addition, I am a member of the Board of Directors of SoundExchange, Inc., occupying one of the board seats reserved for independent labels.

I founded one of the Secretly Group record labels, Jagjaguwar, out of my bedroom in Charlottesville, Virginia, in 1996. Today, the Secretly Group record labels are home to prominent artists such as Bon Iver, a recording artist who won the Grammy Awards for both Best New Artist and Best Alternative Album; and Tig Notaro, a 2014 Grammy nominee for Best

Comedy Album. Our labels have rich and diverse rosters totaling approximately sixty active artists, including emerging, contemporary acts such as singer-songwriters Angel Olsen, Mitski and Kevin Morby, up and coming rock bands such as Whitney and Cherry Glazerr, as well as iconic artists like Dinosaur Jr., a band that has been releasing important records to the American public since 1984, and Yoko Ono, whose storied and classic back catalog, including recordings with John Lennon, is being reissued by Secretly Canadian. In addition to supporting these important artists, Secretly Group helps new generations of music consumers discover more rare but still classic musical gems through the efforts of the Numero Group, an archival label that creates compilations of previously released music from a variety of genres.

Secretly Group's experience highlights an important reality about the music industry: while there are three "major" record companies and many other "independent" labels, that major/indie distinction is a reflection of the size, but not the quality, of the companies' repertoires. By way of example, one of our most recent releases, Bon Iver's 22, *A Million*, opened as the number one best-selling album in the country and was also the number one best-selling album throughout the world when it was released on September 30, 2016. Similarly, other Secretly Group releases have become platinum and gold singles and albums, are regularly included in the Billboard Charts, and have received significant critical recognition, including multiple Grammy nominations and the Mercury Prize. We are not unique among independent labels in releasing popular music. Independent labels release some of the most commercially successful records, including those by artists like Adele, Major Lazer, Macklemore, Taylor Swift, and the Lumineers. Major Lazer in particular is an interesting case, as the band released gold singles on Secretly Canadian before releasing their follow-up album, *Peace is the Mission*,

on their own independent label, with the first single “Lean On” from that album becoming Spotify’s most streamed single of all time. In fact, independent labels and artists led the industry again at the 2016 Grammy Awards, winning more than half of the total of non-producer category nominations. In 15 of the Grammy categories, independents secured 100% of the nominations. At the same time, independent labels often support the release of sound recordings that would otherwise never be heard, either because the artists are undiscovered or the sound recordings appeal to devoted but niche audiences.

Independent record labels also have a significant commercial share of the market. According to publicly available figures for 2015, independently owned repertoire constituted 34.4% of the market for music sales. Nonetheless, it is also true that independent labels generally have a lower percentage of established artists on their rosters than major labels do. That is significant because established artists tend to release records that sell more physical products than newer artists, while newer artists tend to release records that earn more through digital products than established artists. As a result, independent labels as a group are more dependent on the digital market than the majors are. As the industry continues to shift away from physical sales and towards digital consumption, and streaming in particular, fair rates for digital usage are especially important for independent labels.

II. Distribution

Many independent record labels are distributed by one of the major record companies’ distribution companies. According to publicly reported data, the majors’ distribution companies distributed about 87% of the albums sold in the U.S. in 2015, including about 63% of independent labels’ albums. Other labels are distributed by independent distributors like

InGrooves, Red Eye Distribution or our Secretly Distribution. In either case, the vast majority of labels rely on distribution companies to handle the physical and digital distribution of their sound recordings to retailers and digital music services. Very few labels have the resources necessary to handle distribution on their own.

Until 2014, releases on just the three Secretly Group labels Dead Oceans, Jagjaguwar and Secretly Canadian were digitally distributed in the United States by Warner's ADA. At the same time, our company Secretly Distribution was handling digital distribution in the United States for the other labels it distributes. Since 2014, however, Secretly Distribution has served as the exclusive digital and physical distributor for all of the Secretly Group labels, as well as for the approximately 57 other premier independent record labels it currently distributes. I therefore have the experience and perspective of both an independent label that has been distributed by a major label, and of an independent distributor.

Record labels, of course, pay distributors for the services distributors provide. At Secretly Distribution, that fee is typically between [REDACTED] of the revenues generated from the usage or sale of the distributed recordings. In exchange for this fee, record labels receive a host of valuable services, which most labels would not be able to replicate if they were to try to operate without a distributor. Based on my experience, the distribution fee costs a label less than handling distribution on its own, because labels benefit from the economies of scale that a distributor can offer.

Negotiations with digital music services. Distribution companies often handle the negotiation of digital licensing agreements with music services (this service is also provided by Merlin, as I discuss later in this testimony). There are a number of major digital music services

in today's marketplace, including Spotify, Apple Music, Amazon, YouTube, Tidal, Pandora, Deezer, Rhapsody, Slacker, to name just a few. And there are dozens or hundreds of other smaller or start-up music services. The services offer a wide array of functionalities, and their agreements for the exploitation of sound recordings can be complex. The negotiation of digital licensing agreements with these music services requires both time and expertise – two resources that many record companies lack. In addition, many of the digital music services are large, established companies. I understand that music services like Pandora and Spotify have over 1,000 employees. They are often represented by teams of negotiators who are repeat players with a detailed understanding of how their services are structured and the functionalities they provide. By contrast, many independent record companies are small operations with a handful of employees, and it would not surprise me if the number of employees with licensing expertise is one or none. By signing on with a distributor, a record label can take advantage of the distributor's greater resources. Like the digital music services, a distributor is a repeat player with greater experience and knowledge of key negotiating points than most labels have.

A distribution company may also have an easier time getting to the negotiating table. Because there are a large number of independent labels, it may be impractical for a digital music service to negotiate with each one separately, even though a label's repertoire may be excellent. But a distribution company represents the catalogs of numerous record labels, and so a music service will likely have a greater interest in entering into negotiations in the first place.

Similarly, independent labels and independent distributors can take advantage of agreements negotiated by Merlin, a global rights agency that negotiates digital music licensing agreements on behalf of over 20,000 independent label members, but does not handle

distribution. Like a major distributor, Merlin has an aggregated catalog that is much bigger than any individual label's catalog. This puts Merlin in a strong position in negotiations with digital music services, which benefits all of the labels that opt into Merlin's agreements. When Merlin reaches an agreement with a digital music service, Merlin sends its members, including Secretly Distribution, an email describing the deal terms and giving each member label or distributor the opportunity to participate in the deal. Secretly Distribution, and by extension the labels it distributes including Secretly Group, has opted into a number of the agreements negotiated by Merlin.

Digital infrastructure. Whether negotiated by a distributor or by Merlin, once an agreement is executed, a robust technical infrastructure is needed to manage the large volume of data that is transferred to and from the music service. First, a record company must provide the music service with digital files of its sound recordings. Each music service has its own technical specifications for how it wants that data delivered to the service. Because distribution companies like Secretly Distribution handle delivery of sound recordings for multiple record labels, and because they may have negotiated the specifications, they are familiar with each music service's unique specifications. By using a distributor, a record label avoids the time and cost that it would otherwise have to spend in complying with those specifications.

Second, the music services every month provide the distribution companies with massive amounts of data about the recordings that were performed or sold by the services. Most labels do not have the capacity to ingest and process so much data. The creation, development, maintenance and upgrades of such sophisticated technical systems is an expense that is beyond the reach of many labels. However, distributors are able to handle this massive flow of data, and

they have powerful databases and infrastructure that enable them to analyze and organize the data. Because a distributor can spread these costs across numerous labels, the per-label cost is less and the labels benefit.

Other benefits. Also, a distributor has substantial marketing expertise, especially from the special perch of knowing how other comparable titles it has distributed have performed in the marketplace. The distributor can share this knowledge base with the labels it distributes, advising them on how effective or ineffective certain marketing programs were with comparable titles. A distributor also provides its distributed labels with logistical support (warehousing and shipping), as well as, financial support, providing cash advances to smooth out operating cash flow issues that the distributed labels may encounter from time to time.

III. The Artist's Share of Royalties under Direct Licenses

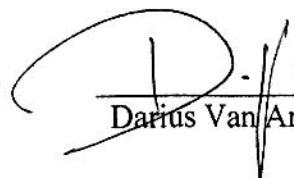
I understand that Sirius XM has engaged in a campaign to sign direct licenses with independent record labels in connection with this proceeding. Sirius XM has not contacted me about such a direct license. However, Music Reports, Inc. contacted our labels in 2011 on behalf of Sirius XM about a direct license in connection with the prior CRB proceeding. We did not accept that offer of a direct license. At that time, one of MRI's selling points to us was that the royalties paid to our labels under a direct license would include the artists' share of royalties, which would "afford[] labels the opportunity of making more than they have made from SoundExchange under statutory licenses." In other words, whereas a label receives 50% of the performance royalties under the statutory license (the label's share), MRI was suggesting that our labels would benefit by receiving 100% of the royalties (the label's share and the artists' share) under a direct license.

While our labels did not accept that offer of a direct license, I can understand why the prospect of receiving 100% of a slightly lower rate, instead of receiving 50% of the statutory rate, could be attractive to some record labels. I consider Secretly Group to be an artist-forward record company. We typically share [REDACTED] of royalties from digital licensing agreements with our artists. Based on my experience in the industry, I believe this is more generous to artists than the terms of many other record companies' artist agreements, which tend to share less than [REDACTED] of royalties with artists. Moreover, royalties are typically subject to recoupment. So, for example, if a label's agreement with an artist requires the label to pay the artist 15% of royalties, then under a direct license with Sirius XM, the label would retain 85% of the royalties, as opposed to 50% of statutory royalties. And if the artist's album had not yet recouped, 100% of the artist's share of the royalties would go to offsetting any unrecouped balance, instead of some portion flowing through to the artist.

Indeed, even under our labels' agreements, an artist receives its [REDACTED]
[REDACTED]
[REDACTED]. Accordingly, if our labels, or labels with similarly generous artist contracts, were to sign a direct license with Sirius XM, the labels would still benefit from receiving 100% instead of 50% – [REDACTED]
[REDACTED]
[REDACTED].

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: OCTOBER 18, 2016



Darius Van Arman

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Determination of Royalty Rates and Terms
for Transmission of Sound Recordings by
Satellite Radio and “Preexisting”
Subscription Services (SDARS III)

Docket No. 16-CRB-0001 SR/PSSR
(2018-2022)

WRITTEN DIRECT TESTIMONY OF

Jeff Walker

**Executive Vice President & Head of Business & Legal Affairs
Sony Music Entertainment**

October, 2016

I. Qualifications

My name is Jeff Walker. Since 2010, I have been the Executive Vice President & Head of Business & Legal Affairs for Global Digital Business at Sony Music Entertainment (“Sony Music”). My job responsibilities include negotiating agreements with digital music services that use Sony Music’s sound recordings. This requires familiarity with how digital music services perform in the marketplace and with Sony Music’s strategy for monetizing content, including on streaming and subscription services. Previously, I served as Executive Vice President of Business & Legal Affairs for the Columbia/Epic Label Group at Sony Music. I have previously held other positions in the music industry, including a position at RCA Records. I received a Bachelor’s degree from Dartmouth College and a law degree from Harvard Law School.

II. Sony

Sony Music is a recorded music company home to several well-known labels, including Arista Nashville, Columbia Nashville, Columbia Records, Epic Records, Kemosabe Records, Legacy Recordings, Masterworks, RCA Records, RCA Nashville, RCA Inspiration, Sony Classical, Sony Music Latin, and Syco Music. Our labels create and distribute music across every genre. Together, they boast a wide variety of artists, including domestic and international superstars like Adele, Aerosmith, Beyonce, Kenny Chesney, Kelly Clarkson, Bob Dylan, Billy Joel, Alicia Keys, Ricky Martin, Yo-Yo Ma, Carlos Santana, Bruce Springsteen, Barbara Streisand, Justin Timberlake, Usher and many more.

Sony’s deep catalog contains some of the most important sound recordings ever made. Miles Davis, John Denver, Carole King, Johnny Cash, Frank Sinatra, Rosemary Clooney, Bing Crosby, Benny Goodman, Janis Joplin, Louis Armstrong, Dolly Parton, Elvis Presley, Vladimir

Horowitz, Stevie Ray Vaughn, Glenn Miller, Whitney Houston, and Michael Jackson are just a few of the legendary artists represented within our catalog.

III. Sony Documents

I understand that documents from Sony Music's files are being submitted as exhibits in this proceeding. I have reviewed these exhibits, which include SX Exs. 016, 020-021, 024-026, 030, and 046. The Sony Music documents that comprise each exhibit are authentic and I am prepared to appear at the hearing in this proceeding for purposes of providing any foundation for their admission into evidence that the Copyright Royalty Judges deem necessary.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: October 18, 2016



Jeff Walker

Exhibits Sponsored by Jeff Walker

Exhibit No.	Description	Designation*
SX Ex. 016	CD Containing Recently Executed Sony Music Entertainment Agreements with Pandora and iHeart Radio, Relied on in Orszag Testimony	Restricted
SX Ex. 020	[Redacted]	Restricted
SX Ex. 021	[Redacted]	Restricted
SX Ex. 024	MusicWatch: Playlisting 2016 Report	Restricted
SX Ex. 025	MusicWatch: Playlisting 2016	Restricted
SX Ex. 026	MusicWatch: Annual Music Study 2015 Final Report to RIAA Research Committee, dated March, 2016	Restricted
SX Ex. 030	CD Containing Agreements Between Subscription Interactive Services and Sony Music Entertainment, Relied on in Orszag Testimony	Restricted
SX Ex. 046	Sony Music Entertainment: MRP Phase II Review, dated October 8, 2014	Restricted

*Exhibits designated Restricted are omitted from this public version in their entirety.