

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In the Matter of

DETERMINATION OF RATES AND
TERMS FOR MAKING AND
DISTRIBUTING PHONORECORDS
(PHONORECORDS III)

)
) Docket No. 16–CRB–0003–PR (2018–
) 2022)
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WRITTEN DIRECT TESTIMONY OF PAUL VOGEL

(On behalf of Spotify USA Inc.)

Introduction

1. My name is Paul Vogel. I am Vice President, Head of Global Financial Planning and Analysis and Investor Relations at the Spotify group of companies (“Spotify”) and an employee of Spotify Limited. I have served in this role since I joined Spotify in June 2016. I graduated with a BA in Economics from the University of Pennsylvania in 1995 and am a Chartered Financial Analyst (“CFA”).
2. Before joining Spotify, I served as a Managing Director at Barclays PLC, where I was a Senior U.S. Internet Analyst and Head of the Internet and Media Research Team. I have held numerous other positions, including ten years as a Senior Vice President, Portfolio Manager, Analyst, and Global Sector Head of Consumer, Media, and Internet at AllianceBernstein L.P.
3. My testimony will primarily focus on four areas: (1) the mechanical royalties paid by Spotify; (2) the effect on Spotify’s financials of removing the per-user floor for

mechanical royalties; (3) the pricing risk Spotify faces as a result of the per-user floor; and (4) the importance of royalty rates to Spotify's business.

4. Unless otherwise noted, all calculations refer to fiscal year 2015—the most recent full year for which data is available.¹

**In 2015 Spotify Paid an Average of [REDACTED] of Revenue
for Mechanical Royalties, Driven by the Paid Subscription Service**

Background

5. Spotify offers two types of streaming music services: a free-to-users ad-supported service, which I will refer to as the “ad-supported” service, and a paid subscription service, which I will refer to as the “paid” service.²
6. Both services pay three types of royalties:
 - (1) royalties to record labels for the public performance of sound recordings;
 - (2) royalties to performing rights organizations (“PROs”)³ for the public performance of compositions, which I will refer to as “PRO royalties”; and
 - (3) mechanical royalties to the Harry Fox Agency (“HFA”).
7. Both PRO royalties and mechanical royalties flow to publishers and songwriters (through the PROs and HFA, respectively), and both are for the use of compositions. I will refer to the sum of these as “total composition royalties.”

¹ Spotify's fiscal year starts in January and ends in December.

² [REDACTED]

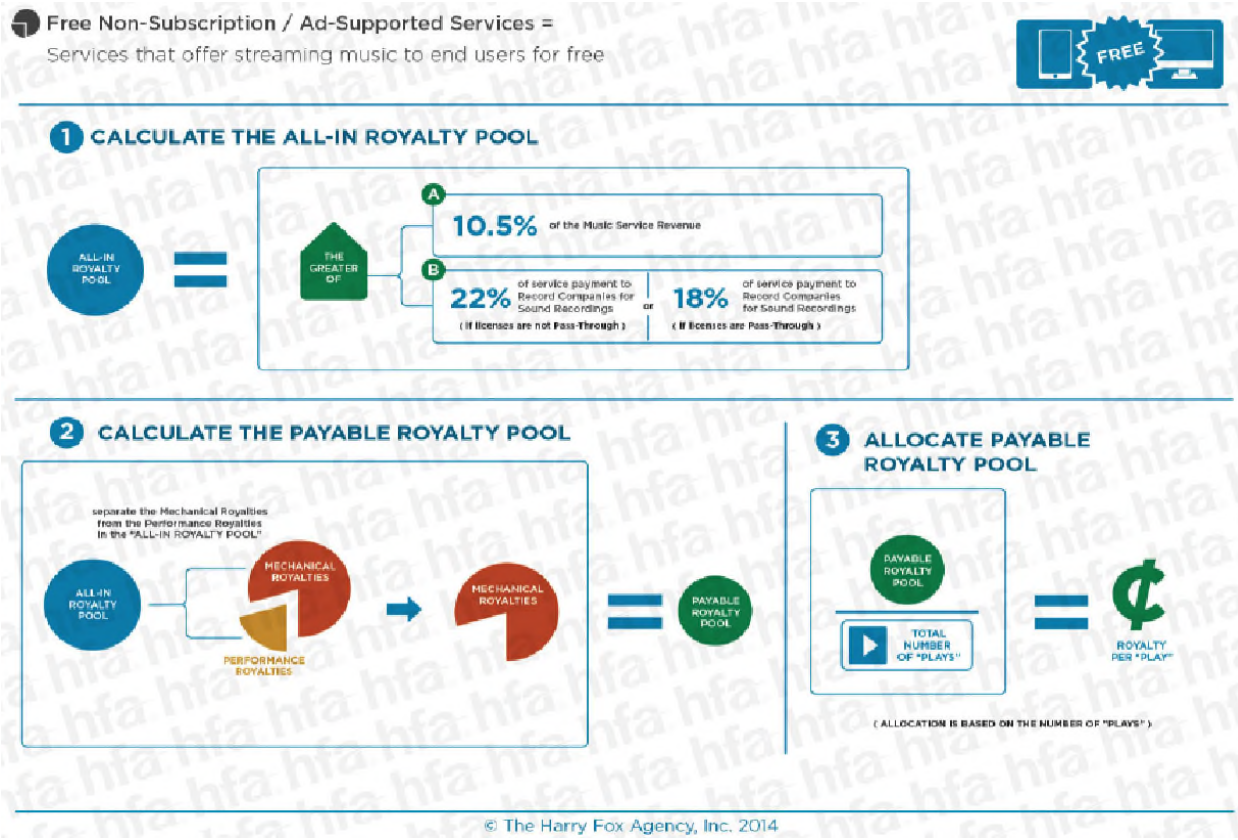
³ Spotify pays public performance royalties to four PROs: ASCAP, BMI, SESAC, and GMR.

Calculation of Spotify's Mechanical Royalties

8. We calculate mechanical royalties as follows: First, we calculate a so-called “all-in” royalty pool, which includes both PRO royalties and mechanical royalties. This calculation begins with a nominal “headline” rate of 10.5% of revenue, but is subject to minima which vary between the ad-supported service and the paid service. For the ad-supported service, the all-in royalty pool is the same as total composition royalties: all we do is subtract the PRO royalties—which are set separately—from the all-in rate to get the mechanical royalties we owe.
9. For the paid service, however, after we subtract the PRO royalties, if we would owe less than a certain per-user floor (50 cents per user), we owe that per-user floor instead, in which case total composition royalties will be greater than all-in royalties. I will refer to this as the “second step per-user floor.”
10. [REDACTED]
11. [REDACTED]

Mechanics for the Spotify’s Ad-supported Service Averaged [REDACTED]

12. The mechanical royalties formula for Spotify’s ad-supported service is illustrated below (see 35 C.F.R. 385.12–13):



13. In 2015, Spotify’s average all-in royalty rate for its ad-supported service was [REDACTED] of revenue. [REDACTED]

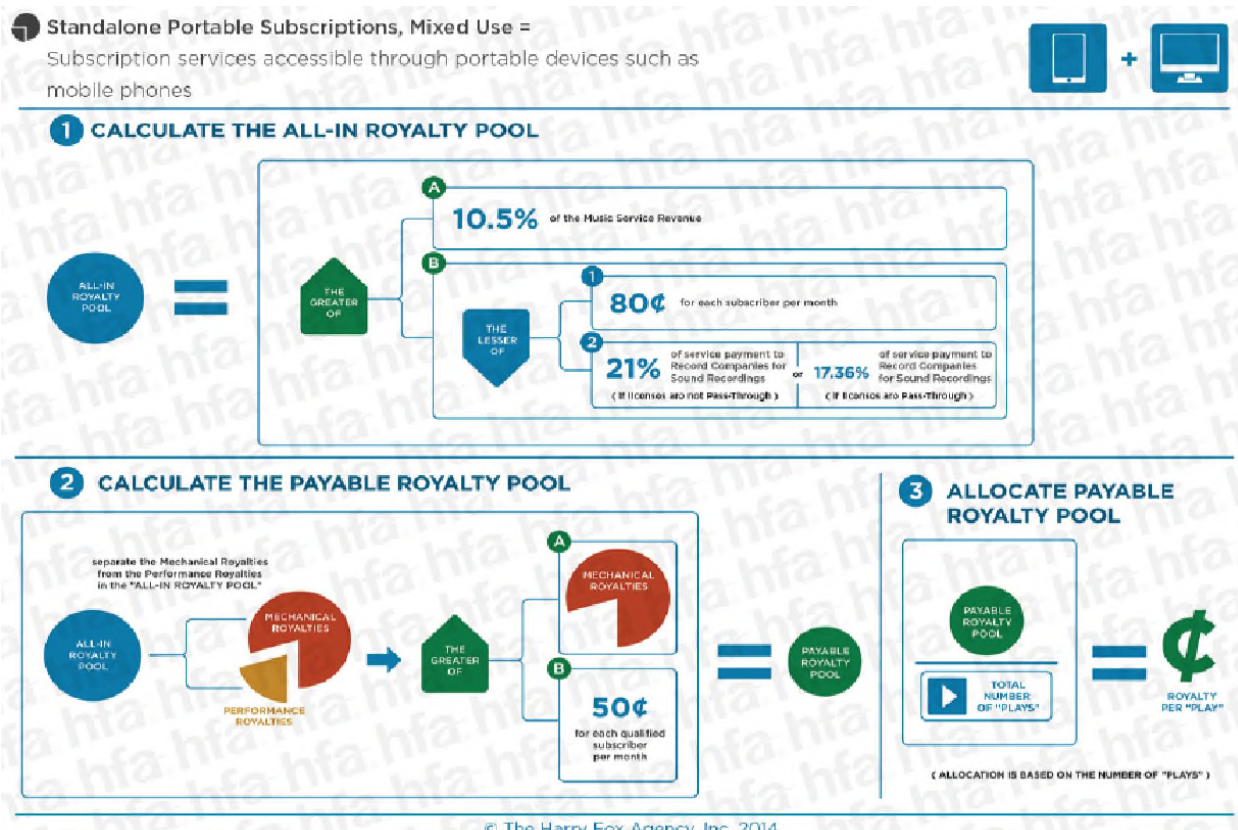
[REDACTED] This is also equal to total composition royalties for this service because there is no second step per-user floor applicable to ad-supported services.

14. Spotify’s average PRO royalty rate for its ad-supported service was [REDACTED] of revenue, and because there is no second step per-user floor, Spotify’s average mechanical royalty rate was simply the all-in royalty rate minus the PRO royalty rate, or [REDACTED]

15. [REDACTED]
[REDACTED]
[REDACTED]

Mechanicals for the Paid Service Averaged [REDACTED] with [REDACTED]

16. The formulas for mechanical royalties for Spotify’s paid service is illustrated below (see 35 C.F.R. 385.12–13):



17. In 2015, Spotify's average all-in royalty rate for its paid service was [REDACTED] of revenue.

[REDACTED]

[REDACTED] (I will refer to this as the "first step per-user floor" to distinguish it from the other.) Spotify's average PRO royalty rate for its paid subscription service was [REDACTED] of revenue.

18. Unlike the rates for free-to-users ad-supported services (such as Spotify's ad-supported service), mechanical royalties for so-called "Standalone Portable Subscription, Mixed Use" services (such as Spotify's paid service) are subject to an additional floor as discussed above, the second step per-user floor. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

19. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

20. [REDACTED]

[REDACTED]

Blended Average Mechanicals (Ad-Supported and Paid) Averaged [REDACTED] and Are Driven By Paid

21. [REDACTED]
[REDACTED]
[REDACTED]

22. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]⁴

23. The following tables summarize the above information:

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

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

24. In 2015 Spotify paid around [REDACTED] per paid member per year in total composition royalties, and around [REDACTED] per person when ad-supported users are averaged in. [REDACTED]

[REDACTED]

⁴ Figures include Spotify's Basic Desktop service, [REDACTED]
[REDACTED]

The Impact of Removing the Per-user Floor on Spotify's Financials

25. [REDACTED]

26. [REDACTED]

27. The following tables summarize the above information:

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

The Per-user Floor Unfairly Sets a Higher Effective Mechanical Rate [REDACTED]

28. The second step per-user floor of the mechanical calculation (and to a lesser extent, the first step per-user floor) introduces pricing risk [REDACTED]

[REDACTED] This is because as long as the floor is triggered, it causes the mechanical royalty rate [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

29. This problem is not merely theoretical. [REDACTED]

[REDACTED] For example, in 2016 Spotify launched [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

30. Ignoring royalty costs, [REDACTED] has generated revenue for Spotify and rightsholders from customers [REDACTED]

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

32. More flexible royalty rates would enable Spotify [REDACTED]

[REDACTED] So long as people [REDACTED]
[REDACTED]
[REDACTED] getting them
to pay grows the pie for everybody. Therefore, these flexible royalty rates would benefit
not only Spotify but also rightsholders and are in everyone's interest.

The Importance of Royalty Rates to Spotify's Business

33. [REDACTED]
[REDACTED]
[REDACTED] and royalty rates have a large impact on our ability to operate profitably. Our ability to maintain and attract investment into Spotify, in order to grow and innovate, [REDACTED]
[REDACTED]

34. The ability for Spotify to innovate and grow our business will be dependent [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] We invest heavily in research and development as well as sales and marketing. These activities improve our product and expand the music universe for both our current and future users. As we grow our business, as well as the overall market, our efforts create value for both rightsholders and users. With lower royalty rates, we can develop a better product, and if we can develop a better product, more people will be willing to pay, the market will expand, and the total value to the entire ecosystem will grow.

35. Therefore, lower royalty rates are critical to Spotify's future and promote revenue not just for the company but also for copyright owners. Lower royalty rates would allow Spotify

to spend more on revenue growth drivers, which would result in more absolute revenue for everyone as well as a [REDACTED] for the company.

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DECLARATION OF PAUL VOGEL

I, Paul Vogel, declare under penalty of perjury that the statements contained in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information, and belief. Executed this 31st day of October 2016 in New York, New York.



Paul Vogel