UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In re DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND WEBCASTING DIGITAL PERFORMANCE OF SOUND RECORDINGS (Web IV)	Docket No. 14-CRB-0001-WR (2016-2020)

DETERMINATION

The Copyright Royalty Judges (Judges) hereby issue their written determination of royalty rates and terms to apply from January 1, 2016, through December 31, 2020, to digital performance of sound recordings over the Internet by nonexempt, noninteractive transmission services and to the making of ephemeral recordings to facilitate those performances.

The rate for commercial subscription services in 2016 is $0.0022 per performance. The rate for commercial nonsubscription services in 2016 is $0.0017 per performance. The rates for the period 2017 through 2020 for both subscription and nonsubscription services shall be adjusted to reflect the increases or decreases, if any, in the general price level, as measured by the Consumer Price Index applicable to that rate year, as set forth in the regulations adopted by this determination.

The rates for noncommercial webcasters are: $500 annually for each station or channel for all webcast transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, for each year in the rate term. In addition, if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 ATH on any individual channel or station, the noncommercial webcaster shall pay per-performance royalty fees for the transmissions it makes on that channel or station in excess of 159,140 ATH at the rate of $0.0017 per performance. The rates for transmissions over 159,140 ATH per month for the period 2017 through 2020 shall be adjusted to reflect the increases or decreases, if any, in the general price level, as measured by the Consumer Price Index applicable to that rate year, as set forth in the regulations adopted by this determination.

The Judges also determine herein details relating to the rates for each category of webcasting service, such as minimum fee and administrative terms, in the following analysis.

"Exhibit A"[1] to this determination contains the regulatory language codifying the terms of the Judges' determination.

I. Background

A. Purpose of the Proceeding

The licenses at issue in the captioned proceeding, *viz.*, licenses for commercial and noncommercial noninteractive webcasting, are compulsory. Title 17, United States Code (Copyright Act or Act), establishes exclusive rights reserved to copyright owners, including the right to "perform the copyrighted work publicly by means of a digital audio transmission." *See* 17 U.S.C. § 106(6). The digital performance right is limited, however, by section 114 of the Act, which grants a statutory license for nonexempt noninteractive Internet transmissions of protected works. 17 U.S.C. § 114(d). Eligible webcasters are entitled to perform sound recordings without an individual license from the copyright owner, provided they pay the statutory royalty rates for the performance of the sound recordings and for the ephemeral copy of the sound recording necessary to transmit it. 17 U.S.C §§ 114(f) and 112(e). Licensee webcasters pay the royalties to a Collective, which distributes the funds to copyright owners. The statutory rates and terms apply for a period of five years.

The Act requires that the Judges "shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). The marketplace the Judges look to is a hypothetical marketplace, free of the influence of compulsory, statutory licenses. *Web II*, 72 Fed Reg. 24084 24087 (May 1, 2007) The Judges "*shall* base their decision on economic, competitive[,] and programming information presented by the parties…." 17 U.S.C. §§ 114(f)(2)(B) and 112(e)(4) *Id.* (emphasis added). Within these categories, the Judges' determination shall account for (1) whether the Internet service substitutes for or promotes the copyright owner's other streams of revenue from the sound recording, and (2) the relative roles and contributions of the copyright owner and the service, including creative, technological, and financial contributions, and risk assumption. *Id.* The Judges *may* consider rates and terms of comparable services and comparable circumstances under voluntary, negotiated license agreements. *Id.* The rates and terms established by the Judges "*shall* distinguish" among the types of services and "*shall* include" a minimum fee for each type of service. *Id.* (emphasis added).

B. Procedural Posture

Following the timeline prescribed by the Act, the Judges published notice of commencement of this proceeding in the *Federal Register*.[2] 79 Fed. Reg. 412 (Jan. 3, 2014).

[1] The Judges proposed to the parties a reorganization of the regulations. Only one party's (Pandora's) proposed regulations followed the proposed new format. The other parties submitted proposed new subparts for each type of entity. One party (SoundExchange) specifically opposed the reorganization. The Judges find that reducing the amount of repetition in the regulations is not prejudicial to SoundExchange, and in the interests of plain language have used the new format.

Twenty-nine parties in interest filed petitions to participate in the proceeding.[3] Ten of those petitioners subsequently withdrew from the proceeding, the Judges rejected the petitions of three petitioners because the Judges determined they lacked the requisite substantial interest in the proceeding, and the Judges dismissed the Petition to Participate of another party due to a procedural default.[4]

1. Negotiated Settlements

a. Educational Webcasters

The Judges published notice of the CBI-SoundExchange settlement in November 2014.[5] The Judges received approximately 60 comments in response to the Notice. The Judges considered the comments, some of which supported and others of which opposed the proposed settlement, and concluded that the CBI-SoundExchange agreement provides a reasonable basis to adopt its proposed rates and terms. On September 28, 2015, the Judges published amended regulations substantially in conformity with the proposal.[6]

b. Public Broadcasters

The NPR-CPB settlement with SoundExchange proposed creation of a new Subpart D to part 380 of the Regulations entitled Certain Transmissions by Public Broadcasting Entities. IBS was the only commenting party. IBS made procedural and substantive objections to the settlement. Notwithstanding, the Judges concluded that, as the proposed settlement would bind only the "Covered Entities," *i.e.*, NPR, American Public Media, Public Radio International, and

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[2] Contemporaneously, the Judges commenced a proceeding to establish rates and terms for ephemeral recording and digital performance of sound recordings by "New Subscription Services" (NSS). *See* 79 Fed. Reg. 410 (Jan. 3, 2014). The NSS at issue in that companion proceeding were limited to NSS transmitting to residential subscribers through a cable television provider. *See* 37 C.F.R. § 383.2(h). That proceeding resolved by negotiated agreement and the Judges published rates and terms for new subscription licensees at 80 Fed. Reg. 36927 (Jun. 29, 2015). Settlement of the cable NSS did not have any effect on the Internet subscription services at issue in this proceeding.

[3] The 29 parties that filed Petitions to Participate were: 8tracks, Inc.; AccuRadio, LLC; Amazon.com, Inc.; Apple Inc.; Beats Music, LLC; Clear Channel (nka iHeartMedia, Inc.); CMN, Inc.; College Broadcasters, Inc. (CBI); CustomChannels.net, LLC; Digital Media Association (DiMA); Digitally Imported, Inc.; Educational Media Foundation; Feed Media, Inc.; Geo Music Group; Harvard Radio Broadcasting Inc. (WHRB); idobi Network; Intercollegiate Broadcasting System, Inc. (IBS); Music Reports Inc.; National Association of Broadcasters (NAB); National Music Publishers Association (NMPA); National Public Radio (NPR); National Religious Broadcasters Noncommercial Music License Committee (NRBNMLC); Pandora Media Inc.; Rhapsody International, Inc.; Sirius XM Radio Inc.; SomaFM.com LLC; SoundExchange, Inc. (SX or SoundExchange); Spotify USA Inc.; and Triton Digital, Inc.

[4] The ten parties that withdrew their Petitions to Participate were: 8tracks, Inc.; Amazon.com, Inc.; CMN, Inc.; CustomChannels.net, LLC; Digitally Imported, Inc.; Feed Media, Inc.; idobi Network; Rhapsody International, Inc.; SomaFM.com LLC; and Spotify USA Inc. The three parties whose Petitions to Participate were dismissed for lacking a substantial interest in the proceeding were: Music Reports Inc., NMPA, and Triton Digital. The Petition to Participate of AccuRadio was dismissed by the Judges due to a procedural default. Although they did not formally withdraw from the proceeding, Apple, Beats, and DiMA did not file Written Direct Statements and did not participate in the hearing. Educational Media Foundation joined with NAB and appeared by and through NAB and its counsel.

[5] 79 Fed. Reg. 65609 (Nov. 5, 2014).

[6] 80 Fed. Reg. 58201 (Sept. 28, 2015).

Public Radio Exchange, and up to 530 Originating Public Radio Stations as named by CPB, adoption of the settlement would not preclude the Judges' separate consideration of the concerns of IBS, which is not one of the "Covered Entities" subject to the new Subpart D. On October 2, 2015, the Judges published the settlement, substantially as proposed, as a final regulation.[7]

2. The Current Proceeding to Adjudicate Rates and Terms

The Act provides that the Judges shall make their determinations "on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress …" and their own prior determinations to the extent those determinations are "not inconsistent with a decision of the Register of Copyrights…." 17 U.S.C. § 803(a). Pursuant to 17 U.S.C. § 803(b), the Judges conduct a hearing to create that "written record," in order to issue their determination as required by 17 U.S.C. §§ 801(b)(1) and 803(1).

To that end, non-settling parties appeared before the Judges for a determination hearing. At the hearing, SoundExchange, Inc. (SoundExchange), a member organization comprised of copyright owners and performing artists, and the designated Collective in this proceeding, and Mr. George Johnson, dba GEO Music, represented the interests of licensors. Seven licensees participated in the hearing.[8]

The hearing commenced on April 27, 2015, and concluded on June 3, 2015. The parties submitted proposed findings and conclusions (and responses thereto) in writing, prior to their closing arguments on July 21, 2015. During the hearing, the Judges heard oral testimony from 47 witnesses, some of them for both direct case and rebuttal testimony. The witnesses included 16 qualified experts. The Judges admitted 660 exhibits into evidence, consisting of over 12,000 pages of documents, and also considered numerous illustrative and demonstrative materials that focused on aspects of the admitted evidence and the permitted oral testimony.

II. Context of the Current Proceeding

A. Prior Rate Determinations

Congress created the exclusive sound recordings digital performance copyright in 1995. *See* Digital Performance Right in Sound Recordings Act of 1995, P.L. No. 104-39, 109 Stat. 336 (Nov. 1, 1995). At the same time, Congress limited that performance right by granting noninteractive subscription services a statutory license to perform sound recordings by digital audio transmission. In 1998, Congress created the ephemeral recording license and further defined and limited the statutory license for digital performance of sound recordings. *See* Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (Oct. 28, 1998) (DMCA).

[7] 80 Fed. Reg. 59588 (Oct. 2, 2015). In publishing both negotiated settlements, the Judges postponed the designation of a Collective until issuance of the current determination.

[8] Harvard Radio Broadcasting, Inc. (WHRB), Intercollegiate Broadcasting System, Inc., iHeart Media, Inc., National Association of Broadcasters (also representing the interests of Educational Media Foundation), National Religious Broadcasters Noncommercial Music Licensing Committee, Pandora Media, Inc., and Sirius XM Radio, Inc.

1. Web I

The Copyright Office commenced the first webcasting rate determination in November 1998. The resulting rates, published in July 2002, covered a rate period from October 1998 through December 2002.[9] Interested parties negotiated rates and terms for 2003-2004, including for the first time radio broadcasters with Internet simulcast service.[10] The published webcasting rate determination confirmed that the willing buyer/willing seller standard in the Act is the determining standard. The Librarian of Congress (Librarian) determined that rate-setters must consider the promotion/substitution and relative contribution factors, although they must not consider those factors determinative, nor are they to use those additional factors to adjust a rate derived from the willing buyer/willing seller analysis. *See* 67 Fed. Reg. 45240, 45244 (July 8, 2002). This conclusion is part of the rate-setting precedent that instructs the Judges in the current proceeding.

2. Web II determination and appeals and Webcaster Settlement Acts

In November 2004, Congress passed the Copyright Royalty and Distribution Reform Act of 2004 (Reform Act), which became effective in May 2005. The Reform Act established the Copyright Royalty Judges as the institutional successor to the arbitration panel program managed by the Copyright Office. The new statute continued the extant 2004 rates through 2005 to enable the newly created Copyright Royalty Judges program to initiate rate proceedings. The new statute also expanded the rate period to five years.[11]

The Judges published the determination from their first webcasting rate proceeding, covering the period 2006 to 2010, on May 1, 2007 (*Web II*).[12] In *Web II*, the Judges differentiated the rate structure for commercial and noncommercial webcasters. They set commercial webcasters' rates using a per-performance structure and set noncommercial webcasters' rates as a flat fee up to a certain usage level, after which the commercial rates would apply. *See* 72 Fed. Reg. 24084, 24096, 24097-98. In accordance with the statute, the Judges established a minimum fee of $500 for each channel or station in either category. The Judges did not differentiate the minimum fee, as they based it upon the cost to SoundExchange, the designated Collective, to administer the license. For noncommercial webcasters, the minimum fee is the only royalty fee due, unless the webcaster exceeds established usage limits.

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[9] *See* 67 Fed. Reg. 45240 (Jul. 8, 2002); *see also* 67 Fed. Reg.78510 (allowing non-precedential, negotiated modification of 1998-2002 rates and terms for "small webcasters" under the Small Webcaster Settlement Act of 2002).

[10] *See* 68 Fed. Reg. 35008 (Jun. 11, 2003)(noncommercial webcasters' rates, effective 1998-2004); 37 Fed. Reg. 5693 (Feb. 6, 2004) (subscription and nonsubscription services' and simulcasters' rates, effective 2003-04, and new subscription services' rates, effective 1998-2004).

[11] Public Law 108-419, 118 Stat. 2341. In 2004, the Copyright Office initiated a proceeding to adjust rates and terms for the Section 114 and 112 licenses for 2005-2006 under the CARP system. Congress terminated this proceeding, however, and directed that the rates and terms in effect on December 31, 2004, remain in effect at least for 2005. *See* 70 Fed. Reg. 7970 at n.2 (Feb. 16, 2005) and 70 Fed. Reg. 6736 (Feb. 8, 2005).

[12] 72 Fed. Reg. 24084.

Intercollegiate Broadcasting System, Inc. (IBS) appealed the amount of the minimum fee as it applied to noncommercial webcasters. The U.S. Circuit Court for the D.C. Circuit remanded the issue for further fact-finding.[13] The Judges received further evidence and ruled on remand to keep the minimum fee at $500 for all licensees. *See* 75 Fed. Reg. 56873, 56874 (Sept. 17, 2010). IBS again appealed to the D.C. Circuit, challenging the application of the minimum fee to noncommercial educational webcasters. The court stayed the second *Web II* appeal pending its resolution of a constitutional question raised by IBS in relation to the Judges' *Web III* determination. Ultimately, the court again remanded *Web II* to the Judges.[14] The Judges conducted a *de novo* review of the record and published their determination on the second remand in 2014. *See* 79 Fed. Reg. 64669 (Oct. 31, 2014). IBS moved to drop its third appeal of *Web II* and the court dismissed it on September 11, 2015.[15]

After the Library published the *Web II* determination, Congress passed the Webcaster Settlement Act of 2008 (2008 WSA) and the Webcaster Settlement Act of 2009 (2009 WSA). These acts enabled webcasters to renegotiate rates and terms for a portion of the *Web II* rate period and set rates for the succeeding rate period (2011-2015). Entities accounting for 95% of the webcasting royalties paid to SoundExchange negotiated settlements under the 2008 WSA and the 2009 WSA.[16]

3. Web III determination and appeals

On January 5, 2009, the Judges commenced a proceeding to establish rates and terms for webcasting for the period January 1, 2011, through December 31, 2015 (*Web III*).[17] Many interested webcasters had recently reached agreements with SoundExchange pursuant to the WSAs and did not participate in the *Web III* proceeding. Only three licensees did participate: College Broadcasters, Inc. (CBI), Live365, Inc. (Live365), and IBS.[18]

CBI's participation was limited to its defense of a proposed settlement it negotiated with SoundExchange. Under the CBI/SoundExchange agreement, the Judges were asked to adopt regulations that established a subcategory of noncommercial webcasters, *viz.*, noncommercial educational webcasters (NEWs). The Judges did so and established the minimum fee for the educational category at the same level as every other category of webcasting service, *i.e.*, $500 per year for each station or channel, applicable to the flat fee for usage. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings,* 76 Fed. Reg.13026 (March 9, 2011)

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[13] *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Board*, 574 F.3d 748, 771 (D.C. Cir. 2009).

[14] *Intercollegiate Broadcasting Sys., Inc., v. Copyright Royalty Board*, No. 10-1314 (D.C. Cir. Sept. 30, 2013) (order granting joint motion for vacatur and remand).

[15] *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Board*, No. 14-1262 (D.C. Cir. Sept. 11, 2015) (order granting joint motion to dismiss appeal).

[16] 79 Fed. Reg. 23102 at n. 5 (Apr. 25, 2014).

[17] 74 Fed. Reg. 318 (Jan. 5, 2009).

[18] As part of the *Web III* determination, the Judges confirmed their adoption of agreed rates and terms for commercial broadcasters (simulcasters) proposed in a settlement agreement between SoundExchange and NAB. 76 Fed. Reg. at 13027.

(*Web III*). Recognizing the operational constraints on educational webcasters, the Judges also adopted less burdensome usage reporting standards for the category. Educational webcasters not exceeding 159,140 Aggregate Tuning Hours (ATH) of webcasting per month could opt for sample reporting in *lieu* of census reporting of each sound recording performance. Educational webcasters not exceeding 55,000 ATH could forego reporting usage at all by paying a $100 proxy fee to defray the cost to SoundExchange of developing proxy usage data.

For the commercial webcaster rates, SoundExchange and Live365 each proposed a per-performance rate structure. Live365 attempted to reach a per-performance rate by way of a revenue analysis, factoring in the webcasting services' costs and a presumed 20% profit, and applying the remainder of revenue to royalties. SoundExchange approached the calculation by analyzing comparable market "benchmark" agreements, with adjustments as necessary to account for differences in the services. SoundExchange relied on interactive services rate agreements.

The *Web III* Judges rejected the Live365 attempt to base rates on a service's ability to pay. Instead, the Judges derived the commercial webcasting rate in *Web III* from a review of market benchmarks presented by SoundExchange. SoundExchange provided only *interactive* services' licenses as benchmarks. The Judges adjusted those benchmarks to account for significant functional differences between interactive services and noninteractive services subject to the statutory rates and terms.

IBS appealed the *Web III* determination.[19] The D.C. Circuit agreed with the IBS argument that the Librarian's appointment of the Judges under the Reform Act violated the Appointments Clause of the Constitution. The D.C. Circuit severed that portion of the Reform Act that limited the Librarian's ability to remove Judges, remanding the substantive merits of the determination for decision by a validly appointed panel of Judges. The Librarian appointed the current Judges and they issued a determination on remand in April 2014.[20] In their *Web III Remand*, the Judges relied upon the rates set forth in the WSA agreements between SoundExchange and the NAB and between SoundExchange and Sirius XM, and, to a lesser extent, SoundExchange's benchmark analysis of various interactive agreements. *Id.*

IBS appealed the Judges' remand determination on May 2, 2014. The D.C. Circuit affirmed the determination on August 11, 2015.[21]

B. Web IV

When the Judges commenced the present proceeding (Web IV) in January 2014, they invited all potentially affected entities to consider in the presentation of their respective cases: (1) the pros and cons of revenue-based rates, (2) the existence or propriety of price differentiation in

[19] *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd*., 684 F.3d 1332 (2012). SoundExchange and CBI intervened.

[20] *See Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 79 Fed. Reg. 23102 (Apr. 25, 2014) (*Web III Remand*).

[21] *See Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd*., Case No. 14-1098 (Aug. 11, 2015).

a market in which the product (digital sound recordings) can be reproduced at a near-zero marginal cost, and (3) economic variations among buyers and sellers in the relevant market.[22] The parties addressed many of these issues in their filings (including their rate proposals) and in testimony provided during the proceeding.

III. Judges' Resolution of General Issues

A. Rate differentiation

1. Majors vs. Indies

In the evidence presented during the hearing, the Services established a potentially meaningful dichotomy between rates they pay to Major Labels and those they pay to independent record companies (Indies). Put simply, in the marketplace, Services have agreed to pay higher royalty rates to Majors than to Indies.[23]

The Act provides that the Judges must differentiate rates based upon differences in the webcasting services, but is less clear on whether the Judges may also establish differential rates based on differences among copyright owners as revealed by the evidence. To gain clarity on the latter issue, the Judges referred to the Register of Copyrights the novel question whether the Copyright Act permits the Judges to differentiate based on types of licensors. After careful review, the Register concluded that the Judges' question "d[id] not meet the statutory criteria for referral," and declined to answer it. *Memorandum Opinion on Novel Question of Law*, at 7 (Nov. 24, 2015) (Register's Opinion).

Citing the fact that no party in the proceeding had proposed a rate structure that differentiated among licensors, the Register found that "such a structure was not understood to be a subject of litigation." *Id*. at 8-9. Consequently, the Register found that the issue was not "presented" in the proceeding as required by the "novel question" provision in 17 U.S.C. § 802(f)(1)(B). *Id*. at 7. The Register's Opinion appears to be premised, in part, on an interpretation of the D.C. Circuit's decisions in *Settling Devotional Claimants v. Copyright Royalty Bd*., 797 F.3d 1106 (D.C. Cir. 2015), and *Intercollegiate Broad. Sys. v. Copyright Royalty Bd*., 574 F.3d 748 (D.C. Cir. 2009). *See Register's Opinion*, at 9. The Register appears to interpret those cases as barring the Judges from relying on theories "first presented in the Judges' determination and not advanced by any participant." *Id*.

Section 802(f)(1)(B) provides that the Register's timely decision of a novel question is binding on the Judges. Because the Register has *declined* to decide the question that the Judges referred to her in the current proceeding, however, there is *no decision* that binds the Judges on this issue. Moreover, to the extent that the Register's Opinion rests on an interpretation of the D.C. Circuit's application of traditional standards of administrative law to particular facts, that

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[22] *See* 79 Fed. Reg. 412 (Jan. 3, 2014).

[23] This point is exemplified by the different effective rates in the Pandora/Merlin Agreement and the iHeart/Warner Agreement, discussed *infra*.

interpretation does not constitute a resolution of a "novel question concerning an interpretation of … provisions of" title 17 that would bind the Judges.

Nevertheless, the Judges acknowledge that interpretation of the evidence out of context and without adequate input of the parties would be capricious. Moreover, reopening the proceeding at this juncture, long after the closing of the record pursuant to 37 C.F.R. § 351.12, for further evidence and argument on this issue would be improper. The Judges, therefore, do not resolve the legal issue they referred to the Register and do not set rates in this proceeding that distinguish among classes of copyright owners.

2. Commercial Webcasters vs. Noncommercial Webcasters

In accordance with the statutory direction to "distinguish among the different types of eligible nonsubscription transmission services," 17 U.S.C. § 114(f)(2)(A), the Judges (and the Librarian of Congress before them) have recognized noncommercial webcasters as a separate rate category from commercial webcasters in prior proceedings.[24] The Judges deemed different (and lower) rates for noncommercial webcasters to be appropriate because "certain 'noncommercial' webcasters may constitute a distinct segment of the noninteractive webcasting market that in a willing buyer/willing seller hypothetical marketplace would produce different, lower rates than we have determined … for Commercial Webcasters." *Web II Original Determination*, 72 Fed. Reg. at 24097.

The record in the instant proceeding demonstrates some of the reasons why, in a hypothetical marketplace, a noncommercial webcaster's willingness to pay for sound recordings would be lower than a commercial webcaster's willingness to pay. For example, a noncommercial religious broadcaster that streams a simulcast of its broadcasts is prohibited under FCC regulations from selling advertising.[25] NRBNMLC Ex. 7000 ¶ 18 (Emert WDT). Increased Internet performances are thus unlikely to lead to increased revenue, even as they result in an increased royalty burden. *See* 5/21/15/15 Tr. at 5270 (Henes).[26]

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[24] *See Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, 67 Fed Reg. 45240, 45258-59 (July 8, 2002) (*Web I*); *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 Fed. Reg. 24084, 24097 (May 1, 2007) (*Web II Original Determination*); *Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings,* 79 Fed. Reg. 23102, 23122 (April 25, 2014) (*Web III Remand*).

[25] The NRBNMLC also highlights a number of differences between broadcasters and other "pure play" webcasters. *See*, *e.g.*, NRBNMLC PFF, at ¶ 33. No party has proposed noncommercial *broadcasters* as a rate category separate from other noncommercial *webcasters*, and the record does not provide the Judges a sufficient basis to establish separate rates for those separate categories. Consequently, the differences that the NRBNMLC highlights are irrelevant.

[26] As discussed above, SoundExchange and two groups of noncommercial webcasters – CBI and NPR/CPB – submitted settlement agreements covering certain noncommercial webcasters that establish separate, lower effective royalty rates for some noncommercial webcasters. The Judges adopted these agreements. 80 Fed. Reg. 58201 (Sept. 28, 2015); 80 Fed. Reg. 59588 (Oct. 2, 2015). These agreements demonstrate that willing sellers are prepared to accept royalty rates for at least some noncommercial webcasters that are different and lower than commercial webcasting rates.

Indeed, the NRBNMLC and SoundExchange both proposed that the Judges adopt a different rate structure for noncommercial webcasters than for commercial webcasters, which suggests to the Judges that there is continued support in the marketplace for a different rate structure for commercial and noncommercial webcasters.

Therefore, for all of the foregoing reasons, and in accordance with the Judges' reasoning from *Web II* and *Web III,* the Judges adopt a separate rate structure for noncommercial webcasters than the one applicable to commercial webcasters.

3. Simulcasters vs. Other Commercial Webcasters

The NAB participated in this proceeding on behalf of its member terrestrial radio stations that simulcast over-the-air broadcasts on the Internet. iHeartMedia (iHeart) also owns and operates terrestrial broadcasting stations that simulcast, in whole or in large part, their over-the-air programming. In this proceeding, the Judges focus solely on the Internet transmissions of these broadcasters.

The NAB argues that simulcasting is different from other forms of commercial webcasting. Given these purported differences, the NAB advocates for a separate (lower) rate for simulcasters than for other commercial webcasters. The NAB avers that simulcasting constitutes a distinct submarket in which buyers and sellers would be willing to agree to lower royalty rates than their counterparts in the commercial webcasting market. *See* NAB Proposed Rates and Terms, at 2 (definition of eligible transmission) (Oct. 7, 2014). No other party's rate proposal treats simulcasting differently from other commercial webcasting.

As the proponent of a rate structure that treats simulcasters as a separate class of webcasters, the NAB bears the burden of demonstrating not only that simulcasting differs from other forms of commercial webcasting, but also that it differs in ways that would cause willing buyers and willing sellers to agree to a lower royalty rate in the hypothetical market. As discussed below, based on the record in the current proceeding, the Judges do not believe that the NAB satisfied that burden. Therefore, the Judges do not adopt a different rate structure for simulcasters than that which applies to other commercial webcasters.

a. History

No prior rate determination has treated simulcasters differently from other webcasters. In *Web I,* the Librarian, at the recommendation of the Register, rejected a CARP report that set a separate rate for retransmission of radio broadcasts by a third-party distributor, and adopted a single rate for commercial webcasters. 67 Fed. Reg. at 45252.[27]

In *Web II,* the Judges rejected broadcasters' arguments that rates for simulcasting should be different from (and lower than) royalty rates for other commercial webcasters.

[27] The Librarian also rejected arguments that broadcasters who stream their own radio broadcasts should be treated differently from third parties who stream the same broadcasts. *Id*. at 45254.

> The record before us fails to persuade us that these simulcasters operate in a submarket separate from and noncompetitive with other commercial webcasters. Indeed, there is substantial evidence to the contrary in the record indicating that commercial webcasters … and simulcasters … regard each other as competitors in the marketplace.

Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24084, 24095 (May 1, 2007), *aff'd in relevant part sub nom. Intercollegiate Broad. Sys. v. Copyright Royalty Bd*., 571 F.3d 69 (D.C. Cir. 2009) (*Web II*).

The NAB reached a WSA settlement with SoundExchange prior to the conclusion of *Web III* covering the remainder of the *Web II* rate period and all of the *Web III* rate period.[28] At the request of the NAB and SoundExchange, the Judges adopted the settlement as statutory rates and terms binding on all simulcasting broadcasters. *See* 75 Fed. Reg. 16377 (April 1, 2010). Consequently, simulcasters did not participate in the Web III proceeding, in which the Judges determined rates for "all other commercial webcasters." Although the Judges did not determine separate rates for simulcasters in *Web III*, because the Judges adopted the NAB settlement, simulcasting broadcasters currently pay different rates than webcasters that operate under the rates determined by the Judges.[29]

b. Comparable Agreements

In the current proceeding, the NAB presented no benchmarks in support of its rate proposal, opting instead for an alternative economic analysis.[30] The NAB does not, therefore, direct the Judges to any marketplace benchmarks to demonstrate different prevailing royalty rates for simulcasters than for other webcasters.

The only agreements in the record that relate specifically to simulcasting are the NAB WSA settlement agreement and the 26 direct licenses between iHeartMedia and independent record labels (the iHeart/Indie Agreements). The NAB settlement (which the NAB repudiates as a benchmark) does not support the NAB proposal. The average of the settlement rates over the *Web III* rate period is precisely the same as the average of the rates that the Judges determined for all other commercial webcasters in *Web III*.[31] The 2015 rate of $0.0025 per performance is *five times* the rate that the NAB proposes for the 2016-2020 rate period ($0.0005).

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[28] The NAB Settlement rates rose from $0.0017 per performance in 2011 to $0.0025 in 2015.

37 C.F.R. § 380.12(a).

[29] Under the NAB settlement, participating simulcasters initially paid lower per-performance royalty rates than those set by the Judges in *Web III*. In later years, however, the rates increased to levels that exceed those set by the Judges in *Web III*. As a consequence, simulcasters currently pay a *higher* royalty rate than all other commercial webcasters. Since no party has asserted that simulcasters should pay a higher rate than other commercial webcasters, the Judges do not reach that issue at this time.

[30] *See* discussion *infra*, section IV.G.2.

[31] In both cases the average per-performance royalty rate over the 2011-2015 period is $0.00214.

The Judges cannot compare the iHeart/Indie rates directly to the NAB settlement rate because they do not employ a per-performance royalty rate. Instead those agreements set royalties at the record company's pro-rata share of [redacted]% of [redacted]. *See, e.g.*, Ex. 3351, at 7-8 (Clear Channel-RPM Entertainment License Agreement). Without additional data (*e.g.*, iHeart's net simulcasting revenues and the number of simulcast performances of recorded music), the Judges are unable to convert the [redacted] rate into a per-performance rate. Moreover, there is insufficient evidence and economic analysis in the record for the Judges to determine whether the headline rate for simulcasting in the iHeart-Indie agreements fully accounts for the economic value of the licenses to the parties.[32] The Judges are unable to determine on this record whether or not the iHeart-Indie agreements support the NAB proposal. Therefore, the Judges find that the iHeart-Indie agreements do not provide adequate evidentiary support for the NAB's proposed differential rate for simulcasters.

c. NAB's Qualitative Arguments for a Separate Rate for Simulcasters

In lieu of quantitative benchmarks, the NAB offers several qualitative arguments why willing buyers and sellers would agree to lower simulcasting rates. Each argument proceeds from two basic premises: (1) the programming content on a simulcast stream is the same as programming content on terrestrial radio; and (2) terrestrial radio is fundamentally different from music services.[33]

i. FCC License and Public Interest Requirement

Radio broadcasters, which are licensed and regulated by the FCC, are legally required to act in the public interest. *See* NAB Ex. 4001 ¶ 14 (Newberry WDT). By extension, this requirement distinguishes simulcasters from other commercial webcasters.

The NAB's witnesses testified persuasively that the public interest requirement is a key consideration for radio broadcasters as they conduct their business. *See*, *e.g.*, 5/20/15/15 Tr. at 5075 (Newberry); Dimick WDT at ¶ 33. What is far less clear is the connection between this requirement and the NAB's proposal that simulcasters should pay lower royalty rates than other commercial webcasters. The NAB did not present any persuasive evidence that the public interest requirement would in any way affect the royalty rates that willing buyers and sellers would agree to in the hypothetical market. To the extent the NAB's argument is that, as a matter of public policy, radio broadcasters' public interest requirement justifies lower royalty rates for simulcasting, that argument is without any basis in section 114.

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[32] For example, the agreements include payments that are characterized as royalties for performances of recorded music by means of [redacted]. *See*, *e.g.*, IHM Ex. 3351, at 7. Since U.S. copyright law confers no exclusive right of public performance by means of terrestrial radio transmissions for sound recording copyright owners, the Judges would need further evidence to determine whether, as an economic matter, these payments should be treated, at least in part, as compensation for other uses (such as [redacted]) covered by the agreements that *do* require a license under copyright law.

[33] *See*, *e.g.*, NAB Ex. 4002 ¶¶ 4, 11, 30-40 (Dimick WDT); NAB Ex. 4009 ¶ 5 (Dimick WRT); 5/26/15/15 Tr. 5798-99 (Dimick); 5/20/15/15 Tr. at 5076-78, 5104 (Newberry); NAB Ex. 4003 ¶¶ 2, 13-26, 29 (Knight WDT); NAB Ex. 4005 ¶ 14, 24-34 (Downs WDT); 5/21/15/15 Tr. at 5217-19 (Downs); NAB Ex. 4006 ¶¶ 3, 9-19 (Koehn WDT).

ii. Local Focus and Community Involvement

NAB witnesses testified that radio broadcasters' focus on their local market both in their terrestrial broadcasts and in their simulcast streams. They attribute this local focus to their legal obligations under FCC regulations, 5/20/15/15 Tr. at 5075 (Newberry), to the needs of their advertisers to reach customers proximate to their places of business, *id*. at 5077-78, and to their desire to connect with their listeners and, presumably, build listener loyalty. *Id*. One aspect of that local focus is involvement in, and reporting of, activities in the community. *See, e.g.*, Knight WDT at ¶ 18; Dimick WDT at ¶ 33.The Judges find neither record evidence nor an articulated rationale to support a lower royalty rate for simulcasters based on the purported local focus of radio broadcasters. The Judges decline to infer such a rationale.

iii. On-air Personalities and other Non-music Content

The NAB stresses the role of on-air personalities, news, weather, and other non-music content in cultivating the loyalty of radio listeners and distinguishing a radio station from its competitors. Once again, the NAB ably demonstrated a distinction between simulcasting and other webcasting, but failed to articulate why that distinction supports differential royalty rates for simulcasters.

The NAB cites a survey conducted by Professor Hanssens that concluded that 12.2% of the value that simulcast listeners derive from listening to music-formatted stations is attributable to "hosts, DJs, and other on-air personalities." NAB Ex. 4012 ¶ 62, App. 8 (Hanssens WRT); NAB Ex. 4015 ¶ 67, Table 5 (Katz AWRT). The NAB presents no evidence, however, that the on-air time consumed by on-air personalities exceeds, on a percentage basis, the value that listeners attribute to them. By including non-music content in their transmissions, simulcasters reduce the number of performances of recorded music, thus reducing their royalty obligation under a per-performance rate structure. The NAB failed to present any evidence that the value of non-music content is not fully accounted for in this reduction of royalties.[34] Absent such evidence, the Judges find that the relative amount of non-music content transmitted by simulcasters versus the amount transmitted by other commercial webcasters does not support a reduced royalty rate for simulcasters.

iv. Degree of Interactivity

The NAB argues that simulcasters should pay a lower royalty rate in recognition of the fact that simulcast transmissions are the least interactive form of webcasting. The NAB contends that three SoundExchange fact witnesses—Dennis Kooker, Raymond Hair, and Aaron Harrison—conceded as much in their testimony and pretrial depositions. NAB PFF at ¶¶ 114-118.

[34] Were the Judges to adopt a percentage-of-revenue rate structure, an appropriate adjustment would be necessary to reflect the lower percentage of recorded music as compared with an Internet music service. As the Judges do not adopt a percentage-of-revenue rate structure in this proceeding, however, no adjustment is needed.

(A) Kooker Testimony

Dennis Kooker, President, Global Digital Business at Sony Music Entertainment, testified that

> statutory licensees pay for their content at compulsory rates, and as a consequence exert downward pressure on privately negotiated rates. One of the original justifications for allowing statutory services to pay these lower rates was that the offering under the statutory license would provide a user experience similar to terrestrial radio. Statutory services could offer channels of particular musical genres, but the programming would be selected by the service. If listeners wanted to select their programming, they would have to pay for it through directly licensed services.

SX Ex. 12 at 15 (Kooker WDT). The NAB contends that "Mr. Kooker recognized a dichotomy between service-selected programming, which is eligible for the lower statutory rate, and listener-selected programming, which requires payment of a higher, directly licensed rate." NAB PFF at ¶ 115.

Even accepting Mr. Kooker's testimony at face value,[35] it is not a concession that simulcasters should be charged lower rates than other webcasters. It is clear in context that the "dichotomy" that Mr. Kooker identifies is that established in section 114 between interactive services, which are directly licensed, and noninteractive services, which are subject to the statutory license that is the subject of this proceeding.[36] Mr. Kooker does not state that, among statutory services, some should pay lower rates than others based on how interactive they are. Mr. Kooker's testimony does not support a conclusion that he believes simulcasters should pay lower rates than other webcasters, much less support the conclusion that willing sellers would accept a lower rate in the hypothetical marketplace.

(B) Hair Testimony

In his hearing testimony, Raymond Hair, International President of the American Federation of Musicians, confirmed that he had previously expressed[37] the opinion that services with greater "functionality" should pay higher rates than services with less functionality. 4/29/15 Tr. at 806 (Hair).[38] Mr. Hair's opinion is not authoritative in this context, however, because he represents neither the buyer nor the seller in the hypothetical transaction that he describes.

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[35] Mr. Kooker does not cite any evidence of legislative history to support his conclusion that the similarity of noninteractive webcasting to terrestrial radio was a "justification" for allowing statutory services to pay lower rates. That statement is merely an expression of Mr. Kooker's lay opinion.

[36] Mr. Kooker then argues that that distinction is "rapidly disappearing" in the marketplace. Kooker WDT at 15.

[37] The earlier statement was in comments Mr. Hair submitted on behalf of the AFM to the Copyright Office in connection with a study on music licensing issues. The comments are not a part of the record of this proceeding.

[38] Mr. Hair's view of what constitutes "functionality" is not entirely clear, however, though it appears to include the ability to "hear what I want to hear and hear it when I want to hear it." *Id*. at 809.

(C) Harrison Testimony

The strongest evidence the NAB offers on this point is Aaron Harrison's testimony. Mr. Harrison, Senior Vice President, Business and Legal Affairs of UMG Recordings, agreed with the statement "the higher the level of interactivity, the higher the rate" because "higher levels of interactivity are more substitutional than less on-demand." 4/30/15/15 Tr. at 1101 (Harrison). Mr. Harrison also agreed that "simulcast is the least substitutional." *Id*.

As a record company executive, Mr. Harrison's testimony provides some evidence that record companies would be willing to accept lower royalties from services that are less interactive, because those services are less likely to displace sales of sound recordings. The probative value of his evidence in determining whether a differential rate is justified for simulcasters is limited, however. First, Mr. Harrison was responding to a question posed in the abstract, rather than identifying specific transactions that he had witnessed or in which he had participated. Second, Mr. Harrison stated that he was aware of no empirical data on the subject, and was merely testifying as to his "perception from being in the industry." *Id*. at 1102. In sum, testimony regarding the perceptions of an industry participant carries considerably less weight than actual examples of marketplace behavior. Nevertheless, Mr. Harrison's testimony carries *some* weight that hypothetical sellers view the amount of interactivity that a service offers as a relevant factor in assessing the royalty rate that service should be required to pay. As such, the Judges consider it together with the other evidence relevant to the NAB's arguments.

Nevertheless, Mr. Harrison's testimony provides little support for the NAB's assertion that simulcasters generally should be entitled to pay lower royalty rates than other commercial webcasters. While the NAB posits that simulcasting is less interactive than custom webcasting, it has not established (or attempted to establish) that simulcasting as a rule is materially less interactive than any other form of non-custom, noninteractive webcasting, all of which would be subject to the general commercial webcasting rates. The statutory license is available to services that offer a continuum of features, including various levels of interactivity, which are offered in a manner consistent with the license. On the record before them, the Judges find little support for attempting to parse the levels of interactivity that the various statutory services offer to try to cobble together a customized rate structure among categories of commercial webcasters based solely on statutorily permissible levels of interactivity.

v. Promotional Effect

The record of this proceeding is replete with statements concerning the promotional value of terrestrial radio play for introducing new artists and new songs to the public and stimulating sales of sound recordings. *See, e.g*., Knight WDT ¶¶ 30-31; Dimick WDT ¶ 43; IHM Ex. 3226 ¶ 7 (Poleman WDT); 4/28/15/15 Tr. at 386-87, 461-62 (Kooker). There appears to be consensus, or near-consensus, on this point.

The consensus breaks down, however, when it comes to the promotional effect of webcasting, including simulcasting. The NAB offers a somewhat tautological argument: simulcasting is, by definition, simultaneous retransmission of the content of a terrestrial radio broadcast over the Internet; it is, therefore, the same as radio; therefore, it must have the same promotional impact as terrestrial radio. NAB PFF at ¶¶ 107-113; *see* NAB Ex. 4000 at ¶ 83 (Katz WDT); Katz AWRT at ¶ 98; *see also* iHeartMedia PFF at ¶¶ 123-124. SoundExchange disputes this conclusion. *See* SoundExchange PFF at ¶¶ 897-938.

As SoundExchange points out, there are a number of differences between terrestrial radio and simulcasting. For example, terrestrial radio broadcasts are (as the NAB stresses) locally-focused; simulcasts, by contrast, can be accessed throughout the country or even overseas. *See* 5/14/15/15 Tr. at 3909-10 (Peterson); 5/29/15/15 Tr. at 6556 (Kooker); Dimick WDT at ¶ 12. The choices available to radio listeners are more limited than those available to simulcast listeners. *See* 5/7/15 Tr. at 2522-23 (Wilcox); 5/29/15/15 Tr. at 6556 (Kooker). Through aggregation sites, such as iHeartRadio and TuneIn, simulcasting offers listeners greater functionality (*e.g*., the ability to search, pause, rewind and record) than radio does. *See* 6/1/15 Tr. at 7075-77 (Burress); SX Ex. 27 at 5 (Kooker WRT); 5/26/15/15 Tr. at 5840-51 (Dimick).

These differences may affect listening habits in a way that diminishes the promotional effect of simulcasting. This is supported by uncontroverted evidence that radio advertisers are generally unwilling to pay to promote their products and services on simulcast streams, *see* Downs WDT at ¶ 22; 5/21/15/15 Tr. at 5242-43 (Downs), and record companies do not view simulcasting as having the same promotional impact as terrestrial radio.[39] *See* 6/1/15 Tr. at 7045, 7048, 7050 (Burress); Ex.3242, at 20, 33 (Walk Deposition, at 75, 129). *See also* Blackburn WRT at ¶ 42 ("neither interactive nor noninteractive services have a statistically significant promotional impact on users' propensity to purchase digital tracks") (Ex. 24).

In short, there is no empirical evidence in the record that simulcasting is promotional to the same degree as terrestrial radio, and the narrative that the NAB puts forward to support the proposition that it is, is flawed at best. The Judges need not, however, decide that particular question in order to determine whether simulcasters should receive a discounted rate. Whether or not simulcasting is as promotional as terrestrial radio simply is not the relevant question. The relevant questions are (1) whether simulcasting is *more* promotional *than other forms of commercial webcasting* and, if so, (2) whether such heightened promotional impact justifies a discounted rate for simulcasters. Assuming for the sake of argument that a promotional impact *could* justify a discounted royalty rate for simulcasters, the NAB would be required to demonstrate that such promotional effect is greater for simulcasting than for other forms of commercial webcasting to an extent that would justify a lower rate for simulcasters. The NAB has not done so.

The licensee services introduced two studies in this proceeding to demonstrate empirically that statutory webcasting is promotional. Pandora presented a study by Dr. Stephen McBride that examined the effect on sales of particular albums (in the case of new music) or songs (in the case of catalog material) in particular geographic regions if Pandora did not play that music in that region. *See generally* McBride WDT (PAN Ex. 5020). iHeartMedia presented a study by Dr. Todd Kendall that examined the relationship between music purchases made on

[39] The NAB and iHeart repeatedly point to evidence that record company promotional personnel thank music services for playing their artists' music to support the conclusion that such "spins" are promotional. *See*, *e.g*., Emert WDT ¶ 25; 5/13/15 Tr. at 3573 (Morris); 5/21/15 Tr. at 5165 (Poleman); Exs. 3241, 3569, 3570, 3576, 3575, 3576, 3643. The Judges do not find this argument persuasive. It is at least equally plausible that record company executives were merely displaying "common courtesy." 6/1/15 Tr. at 7046-47 (Burress).

certain machines (PCs) and the amount of time that music was streamed on those same machines. *See generally* Kendall WRT (IHM Ex. 3148).

Dr. McBride's study concluded that Pandora has a positive effect on music sales. *See* McBride WDT at ¶ 49. As it was focused solely on the effect that Pandora, a custom radio service, has on music sales, the McBride study reveals nothing about the relative promotional value of performances by simulcasters as compared with other commercial webcasters.

Dr. Kendall's study compares the promotional effect of interactive and noninteractive streaming services, finding that noninteractive services have a greater promotional effect. *See* Kendall WRT at ¶¶ 25-29. Again, however, this study fails to compare simulcasters with other commercial webcasters. The noninteractive services that were included in Dr. Kendall's study included both simulcast and non-simulcast webcasters. *See* IHM Ex. 3151 (Exhibit A to Kendall WRT).

The Judges are well aware of SoundExchange's criticisms of these two studies. However, for purposes of assessing the strength of the NAB's argument for a separate rate for simulcasters, it suffices to note that these studies do not even purport to answer the central question whether simulcasting has a greater promotional effect than other forms of commercial webcasting. In conclusion, the record does not support a separate rate for simulcasters on the basis of any purported promotional effect simulcasting may have.

vi. Additional Considerations Supporting the Same Rate for Simulcasters and other Commercial Webcasters

(A) Competition with other commercial webcasters

Simulcasters and other commercial webcasters compete for listeners. The record shows that Pandora, the largest commercial webcasting service, regards iHeartRadio, one of the largest services that aggregates simulcast streams (as well as providing a custom streaming service), as a competitor, and vice versa. *See*, *e.g.*, SX Ex. 269, at 18 (including iHeart among Pandora competitors); *see generally* Ex. 166 (including Pandora among iHeart competitors). Pandora broadly includes other interactive and noninteractive streaming services, as well as terrestrial radio, as its competitors. *See* Ex. 159, at 18-19. Internal iHeartMedia emails demonstrate [redacted]. *See*, *e.g.*, Exs. 373, 1028, 1189.The mutual competition between simulcasters and other commercial webcasters is a strong indication that simulcasters and other commercial webcasters operate in the same, not separate submarkets. *See Web II*, 17 Fed. Reg. at 24095.

(B) Proposed Definitions of simulcast

The NAB proposes to define "broadcast retransmissions" (the term used to denote simulcasts in the Judges' regulations) as follows:

> Broadcast Retransmissions means transmissions made by or on behalf of a Broadcaster over the Internet, wireless data networks, or other similar transmission facilities that are primarily retransmissions of terrestrial over-the-air broadcast programming transmitted by the Broadcaster through its AM or FM radio station, including transmissions containing (1) substitute advertisements; (2) other programming substituted for programming for which requisite licenses or

> clearances to transmit over the Internet, wireless data networks, or such other transmission facilities have not been obtained, (3) substituted programming that does not contain Performances licensed under 17 U.S.C. 112(e) and 114, and; (4) occasional substitution of other programming that does not change the character of the content of the transmission.

NAB Proposed Rates and Terms, at 2.

iHeartMedia proposes to amend the current definition of "broadcast retransmission" in 37 C.F.R. § 380.11 by adding:

> [A] Broadcast Retransmission does not cease to be a Broadcast Retransmission because the Broadcaster has replaced programming in its retransmission of the radio broadcast, so long as a majority of the programming in any given hour of the radio broadcast has not been replaced.

iHeartMedia Proposed Rates and Terms, at 3.

Both proposed definitions would permit the substitution of substantial portions of the content of a broadcast before retransmitting it over the Internet. [redacted], in fact, has already developed and deployed [redacted] to accomplish this substitution more easily. *See* 5/13/15/15 Tr. at 3662 (Littlejohn); *see generally* IHM Ex. 3210 (Littlejohn WDT).Even if the Judges were persuaded that simulcast streams bear unique characteristics that distinguish them from other webcast streams, the ability and demonstrated willingness of broadcasters to alter those streams casts doubt on any proposal to grant simulcasting lower rates than other commercial webcasters.

d. Conclusion Regarding Separate Rate for Simulcasters

Based on the record in the current proceeding, the Judges do not find that a separate rate category for simulcasters is warranted. The NAB's arguments in favor of a separate rate category for simulcasters lack support in the record, or are otherwise unpersuasive. The bulk of relevant evidence in the record persuades the Judges that simulcasters and other commercial webcasters compete in the same submarket and therefore should be subject to the same rate. Granting simulcasters differential royalty treatment would distort competition in this submarket, promoting one business model at the expense of others.

B. Greater-of Rate Structure

In their notice commencing this proceeding, the Judges inquired about price differentiation in the market and the desirability of using a percentage-of-revenue rate structure *in lieu* of, or in addition to, the per-performance rate structure in use for the licenses at issue in this proceeding. Perhaps in response to this solicitation of comment, SoundExchange and Pandora each proposed different greater-of rate structures employing a per-play rate and a percentage-of-revenue rate. Nevertheless, all of the Services apart from Pandora oppose adoption of this two-prong approach. As discussed below, after careful consideration of all rate structure proposals presented in the proceeding, the Judges find that a greater of rate structure is not warranted in the current rate period.

1. SoundExchange's Support for a Greater-of Rate Structure

In support of its proposed greater-of rate structure, SoundExchange makes the following arguments.

- According to Dr. Daniel Rubinfeld and Dr. Thomas Lys (two SoundExchange economic expert witness), willing buyers and willing sellers have demonstrated a "revealed preference" for a greater-of rate structure, as evidenced by the adoption of such rates in the market.[40] For example, many agreements that allow for more "lean-forward" functionality contain a two-pronged per-play and revenue percentage structure like the one SoundExchange proposes.[41]
- A greater-of structure provides positive economic efficiencies that benefit licensees as well as licensors. 5/5/15 Tr. 1756-58 (Rubinfeld).
- In particular, the greater-of structure provides reasonable compensation to the record companies because: (1) the per-play prong provides a guaranteed revenue stream, especially against the vicissitudes of consumer demand; and (2) the percentage-of-revenue prong allows record companies to share in any substantial returns generated by a Service. Rubinfeld CWDT at ¶¶ 96; 100.
- The greater-of structure benefits the Services because the presence of the percentage-of-revenue prong, on the upside, allows for a lower per-play rate than would exist if a single-prong, per-play rate were established, and a lower per- play rate would encourage entry into the market by new services. Rubinfeld CWDT at ¶ 95.
- The greater-of structure would enable a beneficial form of price discrimination. All else being equal, services facing relatively low price elasticities (facing more inelastic demand) would be more likely to charge higher prices, earn greater revenues and thus trigger the percentage-of-revenue prong. Conversely, services facing relatively high price elasticities (facing more elastic demand) would be more likely to charge lower prices, generate lower revenues and therefore pay royalties on the per-play basis. Rubinfeld CWDT at ¶ 112.[42]

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[40] SX Ex.17 at ¶ 94 (Rubinfeld CWDT); SX Ex. 14 at ¶¶ 25-32 (Lys WDT) (94% of 62 label-service pairings adopt a greater-of structure). The majority (50% to 60%) of the purely interactive agreements that contain a greater-of structure utilize the same two prongs that SoundExchange proposes–a per-play rate and a percentage-of-revenue rate. Rubinfeld CWDT at ¶ 206; SX Ex. 63 (App. 1a).

[41] See SX Ex. 2070 (the [redacted] Agreement § 1(b), at1); SX Ex. 2071 (the [redacted] Agreement § 1(d), at 2; SX Ex. 33 (the [redacted] Agreement § 3(b)(2), at 15-16); IHM Ex. 3343 at 9; IHM Ex. 3365 at 11; IHM Ex. 3356 at 9-10; Rubinfeld CWRT at ¶ 87 ([redacted]'s agreements with [redacted]); SX Ex. 80; ([redacted] Agreement); SX Ex. 87 ([redacted] Agreement); SX Ex. 100 ([redacted] Agreement); IHM Ex. 3476 ([redacted] Term Sheet); SX Ex. 100 ([redacted] Agreement); SX Ex. 80 ([redacted] Agreement); PAN Ex. 5014 ([redacted] Agreement).

[42] SoundExchange proposed a "55% of revenue" rate as the second prong of its proposed greater-of rate structure based on Rubinfeld's survey of the revenue percentage shares contained in his interactive benchmark agreements, which identified a range between 50% and 60% of the services' revenues, with the majority falling between 55% and 60%. Rubinfeld CWDT at ¶ 206; SX Ex. 63, App. 1a (Rubinfeld CWDT App. 1a). The following noninteractive services and/or nonsubscription services also have percentage-of-revenue prongs that approximate the 55% rate SoundExchange has proposed:

2. The Services' Opposition to a Greater-of Rate Structure

The Services that oppose the greater-of structure in principle argue[43] that such a structure allocates all of the downside risk to the Services alone, while allocating to the record companies a share of potential upside benefits. *See, e.g.*, Katz AWRT at ¶ 140. Such misallocation of risk and reward, according to the opposing Services, not only unjustifiably allows the record companies to free-ride on a service's economic success, but also ignores the services' downside risk that they will fail to execute their respective business models and go out of business. *See, e.g.*, IHM Ex. 3216 ¶ 19-26 (Pakman WDT); Katz AWRT at ¶ 149.[44]

A further economic deficiency in this two-prong approach, according to the opposing Services, is that it utilizes a percentage of *revenue* rather than a percentage of *profits*. An investment that raises revenues by less than the cost of the investment would reduce *profits*, yet, under a percentage-of-*revenue* prong, royalty payments would rise. In such a scenario, the "upside" from increases in revenues would not necessarily translate into an increase in profits. *See* Katz AWRT at ¶ 150.

According to the opposing Services, forty-two percent of the Majors' contracts examined by Dr. Rubinfeld *do not* contain a per-play prong, contradicting SoundExchange's claim that the market has demonstrated a consistent "revealed preference" for a greater-of approach. Katz AWRT at ¶ 143. According to these Services, all but one of the 62 "label-service pairings" identified by Dr. Lys related to interactive services, thereby further contradicting SoundExchange's claim of a revealed marketplace preference for a greater of rate structure. 5/4/15 Tr. 1474-75 (Lys).

- [redacted]'s agreements with Universal, Warner, and Sony for [redacted] Service, which purportedly does not have on-demand functionality, has a greater-of structure with percentage-of-revenue shares of between [redacted]%-[redacted]% paid by the labels.
- [redacted]'s agreements with Universal, Sony, and Warner for [redacted] streaming service, which allegedly does not have on-demand functionality, has a greater-of structure with a pro-rata share of [redacted]% of [redacted] premium net revenue.

[redacted]'s free radio service has a percentage-of-revenue prong in its agreement with [redacted] for a pro-rata payment of [redacted]% of revenue. *See* SX Ex. 80, SNDEX_0024312_[redacted]_20130101 at SNDEX0024322 ([redacted] Agreement). SoundExchange acknowledges that several other agreements contain a percentage-of-revenue prong of [redacted]%. More particularly, the [redacted] agreements with [redacted] and [redacted] have a greater-of compensation formula that includes a pro-rata [redacted]% share of ad revenues for the [redacted] service. SX Ex. 2070 at section 1(b), p. 1 ([redacted] Agreement); SX Ex. 2071 at section 1(d), p. 2 ([redacted] Agreement). Also, the [redacted] Agreement contains a greater-of structure that includes a *pro rata* share of [redacted]% of gross, non-simulcast webcasting revenues. SX Ex.33 § 3(b)(2), at 15-16.

[43] The NAB, iHeart, and Sirius XM raise additional objections to the use of a percentage-of-revenue prong as applied to *simulcasters*. Because the Judges decline to adopt a separate rate that applies only to simulcasters they need not address these additional objections.

[44] These Services assert that there is no economic justification for "rewarding" record companies for "incremental value that is created by the webcaster above and beyond that created directly by the music itself," an additional value that may arise from lower price elasticities not attributable to the sound recordings. *See, e.g.*, Katz AWRT at ¶ 148.

The opposing Services also note that the agreements entered into by [redacted] and [redacted] relied upon by Dr. Rubinfeld, were negotiated as parts of overall interactive agreements with their record company counterparties, and the specific services within those agreements upon which Dr. Rubinfeld relies have extra-statutory interactive functionality. *See* NAB PFF at ¶¶ 510, 528-530, 515-518, 525-527 (and citations to the record therein).[45]

The opposing Services point out that the parties to the other agreements relied upon by Dr. Rubinfeld did not demonstrate an expectation that the revenue prong of the greater-of formula would ever be triggered (given the relative levels of the per-play and revenue percentage prongs). *See, e.g.*, PAN Ex. 5110 5/6/15Tr. 6956-57 (Lexton). Rather, according to the opposing Services, the percentage-of-revenue prongs were added by the record companies merely to create favorable precedent for future proceedings. *See generally* Katz AWRT at ¶ 193-196; PAN Ex. 5365 at 5-6 (Shapiro SWRT); 5/15/15 Tr. 4025 (Lichtman); 6/2/15 Tr. 7362-63 (Cutler). Consistent with this point, the opposing Services note that:

- there is no evidence that [redacted] has paid royalties under the percentage-of-revenue prongs of its agreements with [redacted] or the Indies. *See* NAB PFF 603 (and record citations therein); and
- [redacted] has not paid royalties under the percentage-of-revenue prong of its agreement with [redacted] 6/1 Tr. 6896-97 (Lexton).[46]

3. The Services' Opposition to the Percentage of Revenue that SoundExchange Proposed

Even assuming that a percentage-of-revenue prong should be included in a greater-of rate structure, the Services (*including* Pandora) oppose the 55% percent figure SoundExchange proposed. Their opposition is based on the following arguments:

First, as with his per-play proposal, Dr. Rubinfeld bases his percentage-of-revenue analysis entirely on the unsupported and economically improper *assumption* that, in a competitive market, noninteractive services would pay the same percentage-of-revenue rates as do interactive services.[47]

Second, the Services assert that SoundExchange's reliance on evidence that the Majors were able to extract similar supra-competitive rates from a handful of services that are not fully

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[45] With particular regard to the [redacted] agreements, the opposing Services also note that they were global deals (rather than U.S.-only deals) and tied rates to the sale of [redacted], rendering those agreements inapplicable as benchmarks. Katz AWRT at ¶ 248.

[46] Moreover, in this vein, the opposing Services point out that [redacted] did not even estimate the potential value of the percentage-of-revenue prong in its agreement with [redacted] *Id.* at 6895.

[47] Pandora's RPFF at ¶ 226 (*quoting* Rubinfeld CWDT at ¶ 169 ("I have *assumed* that the ratio of the average retail subscription price to the per-subscriber royalty paid by the licensee to the record label is approximately the same in both interactive and noninteractive markets.")) (emphasis added). Pandora's RPFF at ¶ 226 (*quoting* Rubinfeld CWDT at ¶ 169 ("I have *assumed* that the ratio of the average retail subscription price to the per-subscriber royalty paid by the licensee to the record label is approximately the same in both interactive and noninteractive markets.")) (emphasis added).

on-demand fails to support an importation of the 55% revenue rate into a fully and effectively competitive noninteractive market. Pandora's RPFF ¶ 227 (responding to SX PFF at ¶¶ 425-430).

Third, the Services argue that Dr. Rubinfeld inexplicably ignored an agreement between Slacker and Warner for Slacker's *DMCA-compliant noninteractive radio service* that requires Slacker to pay the greater of [redacted]% of revenue (or the stated per-play rates). The terms of this agreement are in stark contrast to Slacker's agreement with Warner for Slacker's *on-demand service*, under which Slacker pays the greater of [redacted]% of revenue (or the stated per-play rates). PAN Ex. 5222 (Nov. 2013 agreement) at 16-17; *see also* 5/7/15 Tr. 2495:5-2498:8 (Wilcox). Similarly, the Services note that Dr. Rubinfeld ignored a Slacker agreement with Universal, under which Slacker paid (until June 2014), the greater of [redacted]% of revenue (or the stated per-play rates) *for the on demand service*, but only the greater of [redacted]% of revenue (or the stated per-play rates) *for Slacker's radio service.* PAN Ex. 5034 at 0022479-80; 4/30/15 Tr. 1133:6-1135:18 (Harrison).[48]

The Services further note that the [redacted] revenue-sharing provision relied on by SoundExchange is not for "[redacted]'s free radio service," but rather applies only to two premium subscription services and specifically excludes [redacted]'s free offerings.[49] Both subscription services offer on-demand functionality, among other interactive features.[50] [51]

Fourth, the Services point out that Dr. Rubinfeld ignored the percent-of-revenue levels in the Pandora/Merlin Agreement and the 27 agreements between [redacted] and independent labels as they related to custom (pureplay) webcasting. Among those agreements, all but one contained an alternative greater-of prong with a [redacted]% of revenue rate, far less than Dr. Rubinfeld's proposed 55% rate. *See, e.g.*, PAN Ex. 5014; IHM Ex. 3343.[52] This discussion is

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[48] Additionally, the Services point out that beginning in June 2014, Slacker and [redacted] agreed to a reduction in the on-demand percentage to [redacted]% in exchange for an increase in the basic radio percentage to [redacted]%, but the radio service percentage-prong royalty rate therefore was still significantly *only 64% of the rate for the on demand service*. PAN Ex. 5035 at 116684-87; 4/30/15 Tr. 1137:19-1140:10 (A. Harrison).

[49] *See* [redacted] Agreement, SNDEX_0024312_[redacted]_20130101 (SX Ex. 80) at 11 of 82 (revenue-share provisions); *id.* at 3 of 82 (defining "Portable Service"); [redacted] Agreement, SNDEX0023904_[redacted]_20100528 (SX. Ex. 80) at 15 of 155 (defining "Tethered Service" and "Subscription Service").

[50] *See* [redacted] Agreement, SNDEX0023904_[redacted]_20100528 (SX. Ex. 80) at 15 of 155 (describing functionality of "Subscription Service").

[51] Additionally, the Services aver that [redacted] service relied on by SoundExchange is not DMCA compliant, and therefore is not a noninteractive service, as SoundExchange claims. *See* IHM PFF ¶¶ 352-355 (and citations to the record therein). Furthermore, the [redacted]% of revenue share agreed to by [redacted] for the [redacted] service is below SoundExchange's proposed interactive-based 55% benchmark rate. According to the Services, the provisions of the [redacted] agreements cited in this paragraph do not reflect a comparable "greater of compensation formula," as SoundExchange claims, but rather reflect a formula whereby a per-play rate is *added to a different percent-of-revenue figure*. *See* [redacted] Agreement § (1)(b), at 1-2 (SX Ex. 2070) ("[redacted]% of Net Advertising Revenue Per Play"); [redacted] Agreement §1(d), p.2 (SX Ex. 2071) ("[redacted]% of Net Advertising Revenues per Play").

[52] Pandora notes one outlier, the agreement between [redacted] and iHeartMedia, that contains a [redacted]% of revenue prong for iHeartMedia's custom offering. The Services argue that this [redacted]% rate should be given little weight, in that it

largely academic, however, because, as discussed below, the Judges have determined not to adopt a greater of rate structure and instead will continue the current per-play structure for commercial webcasters.

4. The Judges Reject Adoption of a Great-of Rate Structure

The Judges reject the proposals by SoundExchange and by Pandora that the statutory rate should contain a greater-of structure. Rather, the Judges find that the statutory rate should continue to be set on a per-play basis for commercial webcasters. The Judges reach this conclusion for several reasons, any one of which the Judges find to be sufficient to reject the greater-of approach with a percentage-of-revenue prong.

The Judges first note that none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered, which may suggest that the parties to those agreements viewed the per-play rate as the rate term that would most likely apply for the length of the agreement. *See, e.g.*, 6/2/15 Tr. 7362-63 (Cutler) (distinguishing "hard" negotiations over the iHeart/Warner per-play rate from the percentage-of-revenue prong to which Warner "agreed because we were never really going to hit that feature anyway.").

Additionally, the agreements, or portions of agreements, relied upon by SoundExchange in support of a greater of rate structure, are not contained within the benchmarks relied on by SoundExchange. SoundExchange, through Dr. Rubinfeld, looked at agreements *other than* his benchmark agreements to find rate structures with a percentage-of-revenue prong. In other words, the agreements that SoundExchange contends are most reflective of the marketplace value of the copyright owners' rights under the statutory licenses do not contain a greater of rate structure.

Further, for its part Pandora pointed to the 25% revenue rate from the Pandora/Merlin Agreement to support a greater of rate structure. Unlike the steered rate provision in the Pandora/Merlin Agreement, however, the 25% of revenue prong was nothing other than a figurative "cut and paste" of the Pureplay percentage rate. As such, it reveals nothing about whether the parties in the marketplace would agree to include such a prong in an agreement.[53] Indeed, Dr. Shapiro proffered virtually no justification for the inclusion of the percentage-of-revenue prong in Pandora's proposal.

Relatedly, SoundExchange's rationale in support of a greater of structure that record companies should share in the upside if the Services monetize their models at a faster rate is wholly unconvincing. Absent proof that the per-play prong had been set too low, there is no justification for assuming that the record companies should share in that monetization through a

"was only agreed to because it was almost certainly not going to become binding during the term of the agreement." 6/2/15 Tr. 7362:21-7363:5 (Cutler).

[53] When Pandora and Merlin agreed to a lower per-play rate through steering, they created a rate that was *not* the higher Pureplay rate. By contrast, the 25% of revenue prong that they incorporated into the agreement, which equaled the Pureplay rate, reveals nothing about any specific negotiations between Pandora and Merlin over that term. For example, if Pandora and Merlin had agreed to a 20% or a 30% revenue prong, that fact would perhaps have been informative of a marketplace term.

percentage-of-revenue prong in the rate structure.[54] Dr. Rubinfeld indicated that his "ratio equivalency" per-play methodology resulted in a per-play royalty payment that approximated 55% of service revenue. Successful monetization by the Services might drive the percent-of-revenue equivalence below 55%, but there is no economic basis to support maintaining that level with a separate percent-of-revenue prong.[55]

Only SoundExchange and Pandora proposed a two-prong approach, and, as discussed above, the Judges find their reasons in support of such a structure unpersuasive. Moreover, other parties raised numerous, valid objections to the use of a greater-of structure with a percent-of-revenue prong. *See, e.g.,* NAB Ex. 4011 (Weil WRT) (a percent-of-revenue rate would create uncertainty and controversy regarding the definition and allocation of revenue).

Finally, by maintaining the statutory rate as a per-play rate, the Judges are acting in a manner consistent with prior decisions, consistent with 17 U.S.C. § 803(a)(1). Although new and persuasive evidence could cause the Judges in future proceedings to consider a greater-of rate structure and a percent-of-revenue rate, no such evidence has been provided to the Judges in this proceeding.[56]

For these reasons, the Judges reject the two-pronged rate proposals proposed by SoundExchange and Pandora, and shall continue the current practice of setting the statutory webcasting rates on a per-play basis.

C. Promotion and Substitution

The Act provides, among other things, that the Judges base their hypothetical marketplace rates on "economic, competitive[,] and programming information" that the parties present, *including promotion and substitution as factors that would influence rates in the marketplace.* 17 U.S.C. § 114(f)(2)(B).[57]

As set forth in this determination, *infra*, the Judges have relied upon certain marketplace agreement as benchmarks for the setting of the statutory rates. In prior determinations, the

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[54] A potential rationale for the percentage-of-revenue prong is that it could offset a per-play rate that is "too low." The Judges have taken great care to discount any proposed rate that they believe would be too low to compensate adequately the licensors for the rights under the licenses. As discussed below, the per-play rates that the Judges adopt for commercial webcasters are consistent with rates negotiated in marketplace agreements.

[55] This criticism would not apply to the subscription rates for noninteractive services, based upon Dr. Rubinfeld's "ratio equivalency" model. However, the other criticisms set forth in the text are sufficient to reject the use of a greater-of rate structure with a percentage-of-revenue prong even for the subscription rate.

[56] Moreover, the Judges are concerned that, given the limitations of the evidence in this proceeding regarding agreements with greater of rate structures, any attempt to "mix and match" per-play rates with percentage-of-revenue rates could cause licensors and licensees alike to experience undesirable and potentially destabilizing swings in anticipated revenues and payments over the length of the license. Continuation of the current per-play rate structure helps to ameliorate this concern.

[57] In prior proceedings, the focus of the question of substitution has been physical record sales. In the current market, however, digital access through interactive services is a revenue stream that might be affected by consumers choosing the statutory noninteractive streaming services. To evaluate interactive licenses as benchmarks for noninteractive services, therefore, the Judges must look at how the latter might prove a substitute for the former.

Judges have concluded that contracting parties, as rational economic actors, factor in the promotion and substitution effects when negotiating direct licenses.[58] That is, parties negotiating direct licenses for the performance of sound recordings on services will be cognizant of the promotion and substitution effects, and those effects will influence the rate at which they agree to a license. Witnesses on both sides in this proceeding generally agree that promotion and substitution effects are factored into negotiated agreements. *See, e.g.*, Rubinfeld CWDT ¶ 31(d); Shapiro WDT at 39).[59]

The parties' mutual awareness reconfirms the Judges' earlier conclusion that the promotion and substitution effects on royalty rates are "baked in" to a negotiated license rate. To the extent the Judges adopt a rate based on benchmark evidence, it is not necessary to make additional adjustments to benchmarks to reflect the promotion and substitution factors. The Judges hold in this determination, as they have held consistently in the past, that the use of benchmarks "bakes-in" the contracting parties' expectations regarding the promotional and substitutional effects of the agreement. For the noninteractive benchmarks upon which the Judges rely, this long-standing position to deem substitution and promotion effects as incorporated into the agreements appears to be fully applicable.

SoundExchange disagrees, however, and points, for example, to testimony from Charlie Lexton of Merlin who stated that Merlin never considered the promotional or substitutional effects when agreeing to the terms of the Pandora/Merlin Agreement. 6/1/15 Tr. 6910 (Lexton). The Judges find that such testimony is not credible and not sufficient to support abandonment by the Judges of their long-standing treatment of promotional and substitutional issues. Indeed, the fact that Merlin arguably was so cavalier regarding the impact of the Pandora/Merlin Agreement on the positive promotional effects or the negative substitutional effects (to interactive streaming, download sales, and other revenue channels) implies that Merlin either understood the net value of these factors to be positive or, at worst, neutral. Apparently, SoundExchange infers: "This is not to say that [Merlin] did not value those terms – of course it did, but there was no precise calibration of the negotiated rate to Merlin's view of the promotional and substitutional impact of the deal." SX PFF ¶ 1101. It strains credulity to think that Merlin was oblivious to the potential promotional and substitutional effects of the Pandora/Merlin Agreement, yet still proceeded with the deal on unaltered terms.

Additionally, the Judges reject the argument, advanced by SoundExchange, that the Pandora/Merlin and iHeart/Warner Agreements are too new and untested to support the longstanding understanding that substitution and promotional effects are "baked in" to benchmark agreements. An important aspect of the benchmarking approach is that it credits

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[58] *See Web III Remand*, 79 Fed. Reg. 23102, 23119, n. 50 ("The adoption of an adjusted benchmark approach to determine the rates leads this panel to agree with *Web II* and *Web I* that such statutory considerations implicitly have been factored into the negotiated prices utilized in the benchmark agreements. *Web II*, 72 Fed. Reg. at 24095; *Web I*, 67 FR at 45244.").

[59] The more particular issue of whether noninteractive services substitute for interactive services is part and parcel of the issue of whether there has been important "convergence" between the two types of services, discussed at length in connection with the evidence regarding segmentation of listeners based on their willingness to pay.

sophisticated business entities that have carefully negotiated their agreements with an understanding of market forces. That is, there is a presumption that marketplace benchmarks demonstrate how parties to the underlying agreements commit real funds and resources, which serve as strong indicators of their understanding of the market. If promotional or substitutional effects had separate values that were not already reflected in those rate and play-quantity terms, rational commercial entities would identify those promotional and substitutional effects and account for them explicitly.

The "baked-in" aspect of promotional and substitutional effects does not address the issue of whether there is a difference between the promotional/substitutional effects of interactive services, on the one hand, and noninteractive services, on the other. To the extent the Judges rely on SoundExchange's interactive benchmark to set statutory rates in the noninteractive market, the Judges must identify and consider any difference in the promotional/substitutional effects between these markets in order to determine whether to adjust the interactive benchmark rate.

These potential promotional/substitutional effects hypothetically could occur in two different ways. First, the availability of noninteractive services could cause listeners to substitute noninteractive listening at the expense of interactive services. Second, noninteractive services could substitute for, or promote less, the sale of sound recordings through downloads or otherwise. To address these issues, the parties rely on expert witness testimony and on the observational and anecdotal testimony of industry witnesses. The Judges find the lay testimony to be unhelpful and essentially self-serving. Rather, the Judges find this issue to be technical in nature, and consider the expert testimony, discussed below, to be the type of evidence that has the potential to identify whether such differences exist. SoundExchange relied upon the survey work undertaken by Sarah Butler, a Vice President at NERA Economic Consulting. The Services' position was supported by the survey work of Larry Rosin, President of Edison Research.

Ms. Butler, a survey expert, designed and constructed a consumer survey to identify the types of music listening Pandora and iHeart substituted for, in the opinion of listeners. SX Ex. 5 at 3. Ms. Butler gathered information from on-line survey respondents on age, gender, and familiarity with different types of music listening formats. She then defined the relevant population as comprising those individuals who reported themselves as currently using iHeart or Pandora. For listeners who reported using both of these services, Ms. Butler testified that she assigned them to either the iHeart or the Pandora group. *Id.* ¶¶ 30-31.

Survey respondents were asked two substantive questions relating to each service. The first question asked:

> Imagine you could no longer listen to music on iHeart [or Pandora]. Which of the following statements represents what you would be most likely to do?
>
> - I would find a substitute for the music I listen to on iHeart [or Pandora]
> - I would stop listening to music
> - Don't know/unsure

Id. ¶ 38.

The second question asked respondents who answered the first question by stating they would find a substitute for the music they listened to on either Pandora or iHeart:

> Which of the following, if any, would be your most preferred substitute for iHeart [Pandora]?

Id. ¶ 40. Respondents were given a list of alternatives. *Id.*

Ms. Butler's survey found that for Pandora users, 43.3% would listen to one of the following services: Spotify (19.7%), iTunes Radio (9.7%), Amazon and Rhapsody (about 4% each), Google Play and Slacker (about 2% each), and Beats and Rdio (about 1% each). *Id.* ¶ 48, Figure 3. For iHeart users, Ms. Butler's survey showed that 30% would switch to Pandora, and 23.1% would instead listen to another service, including Spotify (10.7%), iTunes Radio (7.5%), or Amazon, Google Play, Slacker, or Rhapsody (about 1% each). *Id.* ¶ 50, Figure 5.

According to SoundExchange, these results show that interactive services are common, if not predominant, substitutes for noninteractive services, and that listeners would turn to such interactive services in a hypothetical world in which no statutory noninteractive services were available. SX PFF ¶¶ 1130-1131.

The Judges have evaluated Ms. Butler's survey, and the criticisms by the Services, and the Judges find that there are three significant problems with Ms. Butler's survey that preclude its usefulness in attempting to demonstrate that noninteractive statutory services substitute for interactive services. Any one of these problems, standing alone, is sufficient to preclude the Judges' reliance on Ms. Butler's survey.

First, Ms. Butler's survey fails even to attempt to measure listeners' willingness to pay (WTP) for different services. *See* 5/29/15 Tr. 6779, 6796-98 (Butler) (acknowledging that she did not measure WTP – including whether WTP for any listener was greater than zero). Her survey also did not test whether the responding listeners had any knowledge of the prices of the potential substitute services she provided to them when asking her second question. Given that the Judges are attempting to set rates in this proceeding, a survey that asks "listeners" to rank substitute services without providing price information fails to provide any meaningful information as to how those "listeners" will act as "consumers" of streaming services.

Second, Ms. Butler did not select her survey respondents in a random manner, and therefore had no ability to calculate margins of error or confidence intervals for her results. *See* 5/29/15 Tr. 6782 (Butler).

Third, Ms. Butler intentionally assigned virtually all respondents who reported listening to both Pandora *and* iHeart to the iHeart group only for further questioning. This caused her to omit about 40% of actual Pandora users from her results as they related to such Pandora users, including respondents who reported using Pandora daily. *Id.* at 6789, 6806-6808.

Accordingly, the Judges cannot and do not rely on Ms. Butler's survey results.

Mr. Rosin, on whose survey the Services rely, conducted his survey in a manner consistent with the standards and code of ethics of the American Association for Public Opinion Research, a major survey research standards organization. PAN Ex 5021 at 5, n.2. (Rosin WRT). Specifically, Mr. Rosin conducted a national telephone survey of Americans 13 years of age and older. Respondents were selected randomly, and 2,006 interviews were conducted via landlines and cell phones. The margin of error for his results was +/- 2%, with a confidence interval of 95%. Rosin WRT at 5, 7.

The responses to Mr. Rosin's survey revealed, *inter alia*, that

- only 1% to 1.6% of noninteractive users reported that their listening was replacing listening on interactive services;
- only 3.8% of survey respondents would subscribe to pay for an interactive service;
- only 2% of survey respondents were "very likely" to pay the market monthly subscription rate of $9.99 for an interactive service, and only 7% were "somewhat likely" to subscribe at this price point – 91% were "not at all likely" or "not very likely" to subscribe at that price.

Rosin WRT at 9, 12.

Based upon these findings, Mr. Rosin concluded that:

1. Most consumers are unwilling to pay monthly subscription fees for access to streaming services.
2. Noninteractive services like Pandora and iHeart are not close substitutes for interactive on-demand services such as Spotify.
3. Only a small market exists for paid (subscription) services.
4. Listeners to Pandora would not otherwise be listening to interactive services.

Rosin WRT at 4.

The Judges find Mr. Rosin's *random* survey to be generally credible, and certainly more informative than the *non-random* survey work done by Ms. Butler. Most importantly, Mr. Rosin treated "listeners" as "consumers" – inquiring as to their WTP rather than their preferences unconstrained by prices. SoundExchange argues that even this price-point inquiry indicates that some listeners, at some lower price points, might be somewhat likely to subscribe to an on-demand service. *See* Rosin WRT at 10 (only 79% of respondents "not at all likely" or "not very likely" to spend $4.99 per month for a streaming subscription, and that percentage drops to 69% if the price is lowered to $2.99 per month). However, there is no dispute that a minority of overall streaming listeners are subscribers (as noted *infra* in the discussion of "Convergence"), so it is not particularly revealing that these levels of survey respondents would consider subscribing instead to an on-demand interactive service at various lower price points.[60]

The Judges reject the additional criticism by SoundExchange that Mr. Rosin should not have presented specific price points to respondents, but rather should have asked if they were willing to pay a "small fee" for interactive subscriptions. Such a vague phrase would be less informative, and more subjective, than particular price points. The Judges also reject the

[60] Also, to the extent subscribership might increase if the subscription price were lowered, then the commensurate royalty derived by SoundExchange's interactive "ratio equivalency" benchmark analysis (discussed *infra*) would likewise be reduced. Thus, these criticisms of Mr. Rosin's survey results undermine any broad use of SoundExchange's own interactive benchmark.

criticism that Mr. Rosin should not have indicated that an alternative to noninteractive services was to listen to "free" FM radio and that another alternative was to "pay" for a subscription to an interactive service, because interactive services do offer "freemium" subscriptions, which begin as free subscriptions subject to a conversion option. The Judges find that Mr. Rosin's language meaningfully reinforces the different pricing and pricing strategies that exist in the market, because FM radio *is* free to the listener and on-demand services are designed to obtain paying subscribers, whether at the outset of the subscription period or by using ad-supported services as a "freemium" tool to convert listeners into subscribers. (Indeed, SoundExchange's economic expert, Dr. Rubinfeld, testified that he did not even use interactive ad-supported rates as a benchmark because they were designed as tools to convert listeners into subscribers.)

The Judges take note of SoundExchange's criticism of Mr. Rosin's decision not to rotate one of his multiple choice answers to the question of what a listener would do if no free streaming services existed. *See* Rosin WRT at App. B. The choice "would you just listen to less music" was always asked last, whereas the other three choices (listen to free FM radio, listen to your CDs and downloads or watch music videos, YouTube, or Vevo) were rotated. SoundExchange notes the presence of a potential "recency effect" if one choice is always presented last, possibly inducing respondents to favor that choice. Mr. Rosin acknowledged the general existence of such an effect, 5/14/15 Tr. 3755 (Rosin), but he indicated that "pinning" certain options in a multiple choice question was necessary to enhance the respondents' ability to comprehend the question. 5/14/15 Tr. 3743-44 (Rosin). The Judges do not find that there was record evidence sufficient to find that it was unreasonable for Mr. Rosin, in applying his expertise, to weigh these technical survey issues and construct his choices in this manner, nor do the Judges find that there was sufficient record evidence to indicate that Mr. Rosin's fundamental conclusions would have been materially different if he had rotated that final choice on that single question.

Finally, the Judges do not agree with SoundExchange's criticism that Mr. Rosin's survey is deficient because he failed to describe in sufficient detail the features offered by a hypothetical on-demand interactive subscription service in one of his questions.[61] However, in that question, he specifically mentioned Spotify, Rhapsody, and Rdio, *see* Rosin WRT App. B at 9, and he identified additional features of an on-demand service (Spotify) in a prior question. *See id*., Question 7E. There is not sufficient record evidence to suggest that the structuring of these questions in this manner weakens the probative value of Mr. Rosin's survey and conclusions.

Turning to the question of whether there is a difference between the substitution or promotion effects of interactive versus noninteractive services with regard to *music sales*, the parties presented different empirical analyses.

iHeart relied upon the expert testimony of Dr. Todd Kendall, who attempted to analyze the effect of listening to online streaming on music purchases, by reviewing data from 10,000

[61] Mr. Rosin basically described them in Question 9A as services that allow listeners to stream music as they choose, for access but not ownership.

personal computers over a six month period. IHM Ex. 3148 ¶ 8 (Kendall WRT). Dr. Kendall used three categories of monthly data for each sample computer: (1) the amount of time spent listening to music; (2) the number of digital music purchases made on Amazon and iTunes; and (3) the amount of time spent visiting music sites, such as RollingStone.com. *Id.* ¶¶ 10, 12; *see* IHM Exs. 3151-3153.

He then compared the relative promotional effect of fourteen on-demand services, including Spotify, with the relative promotional effect of nine Internet radio services, including Pandora and iHeart. Kendall WRT ¶¶ 9, 15-17. Dr. Kendall found that a 10% increase in listening to Internet radio was associated with a statistically significant 0.070% increase in music purchasing. *See id.* ¶ 22; IHM Exs. 3154, 3156-3158. Based on this finding, Dr. Kendall opined that noninteractive services are *15 times* more promotional than interactive services. Kendall WRT ¶ 5.

There are several important flaws in Dr. Kendall's work, however, that render it insufficient for the Judges to conclude that Dr. Rubinfeld's interactive benchmark should be reduced to reflect a supposed lower promotional effect. Most importantly, Dr. Kendall's conclusion is premised on his finding that on the computers he analyzed individuals spent *18 times* more time listening to interactive services than to noninteractive services. 5/12/15 Tr. 3274 (Kendall). When listeners spend more time on a service, that drives down the calculation of the number of purchases per hour of listening, which is the promotional effect being sought by the analysis.

SoundExchange demonstrated in its cross-examination of Dr. Kendall that this extreme multiple resulted from the different methods of recording listening time for interactive and noninteractive services. More particularly, Spotify, a leading interactive service, is more widely used on desktop applications, and Pandora is more widely accessed through web browsers. SX Ex. 1568; 5/12/15 Tr. 3305 (Kendall). Web site listening measurements were cut off if the listener had not interacted with the Pandora web site. Kendall WRT ¶ 5, n.14. By contrast, listening measurements based on the use of desktop applications simply measured the time the application was open on a user's desktop, and otherwise not in hibernation mode, screen saver mode, or some other similar mode. *Id*. Further, the default setting for the Spotify application is for it to launch when the computer is turned on – even if no one is listening. 5/12/15 Tr. 3306-07 (Kendall).

Simply put, these differences in measuring listening time alone skew Dr. Kendall's analysis and results. Accordingly, the Judges cannot conclude from his testimony and analysis that noninteractive services are more promotional of music sales than interactive services.

With regard to the relative promotional or substitutional effects of interactive versus noninteractive streaming services on music sales, SoundExchange relies on the testimony of Dr. David Blackburn. Unlike Dr. Kendall, he did not attempt to relate the amount of time spent listening to these services to increases in purchasing music. Rather, Dr. Blackburn attempted to determine whether there was any meaningful promotional or substitution effect on music sales as between those who use the two different types of services.

In this instance, the particulars of the study are less important than the conclusion. Dr. Blackburn opined that, based on his analysis, "neither interactive nor non-interactive services have a statistically significant promotional impact on users' propensity to purchase digital tracks." SX Ex. 24 ¶ 42 (Blackburn WRT). Because Dr. Blackburn is a SoundExchange witness, and because the point of the present discussion is to determine whether an interactive benchmark rate must be lowered or raised to reflect such differences, his conclusion fails to support any change in SoundExchange's interactive benchmark for promotional or substitutional effects.

Finally, the Judges take note of Pandora's "Music Sales Experiments" conducted by its Senior Scientist, Economics, Dr. Stephan McBride. The purpose of that experiment was "to test whether performance of sound recordings on Pandora have a positive or negative impact on sales of those sound recordings." PAN Ex. 5020 ¶ 23 (McBride WDT). However, whether or not Pandora has a net promotional or substitutional effect does not address the issue of whether that net effect is different from the net promotional/substitutional effect of interactive services.

Rather, when relying on benchmarks, the Judges deem the benchmark agreements of rational actors to include an implicit understanding of the promotional and substitutional effects of their transaction. Therefore, Dr. McBride's conclusions, as well as Dr. Blackburn's criticisms of those "Music Sales Experiments," do not affect the Judges' rate determination.

D. Impact of Parties' Financial Circumstances

The Services aver that the rates set in this proceeding must be sufficiently *low* to permit their business models to be profitable. *See, e.g.*, NAB PFF at ¶¶ 119-149; IHM at ¶¶ 245-57 (and citations to the record therein). Reciprocally, SoundExchange argues that the rates must be sufficiently *high* to allow the record companies to cover their costs and to obtain the necessary return on investment (ROI), plus a profit. *See, e.g.*, SX PFF at ¶¶ 165-208 (discussing costs and investments and noting (at ¶ 165) that "[t]he rates that record companies receive from streaming services ha[ve] been – and over the next five years will continue to be – critical to [the record companies'] ability to make such recurring investments."); 4/30/15 Tr. 972-73 (A. Harrison) ("[T]he profit maximization goal is definitely… a top goal of the company … and also provides the incentive to create music.").

The Judges find that they do not need to directly relate the rates set in this proceeding to the parties' proposed business models. Rather, the Judges' adoption of the benchmark method of determining rates obviates the need to: (1) analyze whether the record companies' costs require a particular rate to allow them to obtain an appropriate ROI; and (2) protect particular noninteractive services whose business models might require a low enough rate to sustain their survival and/or growth. Benchmarks based on marketplace agreements, by their very nature, reflect the parties' need for rates that allow them to project a sufficient ROI and enable them to implement their respective business models.

As with the promotional and substitutional impact of the rates, the Judges conclude that the benchmarking process "bakes-in" (internalizes) these necessary elements, given the assumed rational, maximizing nature of sophisticated business entities. Moreover, even if the Judges were to attempt to ascertain whether a particular ROI could be met by a given rate, or whether a particular business model could be sustained, the present record would preclude such an analysis. The Judges would require much more detailed financial and economic data regarding the parties' costs and revenues before attempting to make such determinations.

Further, as the Judges have previously held, the statute neither requires nor permits the Judges to protect any given business model proposed or adopted by a market participant. 72 Fed.

Reg. at 24089. The Judges further noted in the *Web III Remand* that any attempt by the Judges to set rates with these ROI and business model issues in mind would essentially convert this section 114(f)(2)(B) proceeding into a classic public utility style rate-of-return hearing. 79 Fed. Reg. 23107. None of the parties argues that the statutory standard permits such a process, and neither the D.C. Circuit, nor the Judges (or any of their predecessors) have so held.

E. The Effect of the alleged "Shadow" of the statutory rate

The parties assert that the benchmarks that are adverse to their positions are compromised by the fact that they were set in the "shadow" of the statutory rate. *See, e.g.*, Rubinfeld CWDT ¶¶ 80-85 (statutory rate as a shadow pushing rates *down*); Talley WRT at 46;; Shapiro WDT at 36 (statutory rate as a shadow pulling rates *up*); 5/15/15 Tr. 3993-94 (Lichtman); Fischel (same).There are essentially two types of statutory shadows noted by the parties.

The first purported shadow is cast by the *existing* statutory rate, whether set in a CRB proceeding or through the parties' WSA settlements. As an initial matter, the Judges find that any such "shadows" that could have been cast by existing statutory rates did not meaningfully affect the effective steered rates in the Pandora/Merlin Agreement or the IHeart/Warner Agreement. As discussed herein, those rates are below the otherwise applicable statutory rates, and it would be irrational for a licensor to accept a rate below the statutory rate when it could have rejected the direct deal and enjoyed the higher statutory rate. Also, the supposed shadow of the existing rate is less relevant to the subscription-based benchmark proffered by SoundExchange, because it is based on benchmarks that are at a further remove from the statutory license. Rubinfeld CWDT ¶ 18.

Dr. Shapiro argues that the statutory shadow not only exceeds the marketplace rate, but also acts like a "focal point," or "magnet," pulling a freely negotiated rate higher than it would be in the absence of the statutory shadow. Shapiro WDT at 36-37. However, neither Dr. Shapiro nor any other expert provides a sufficiently detailed explanation as to how the statutory rate would pull up a below-statute consensual rate that is otherwise mutually beneficial. Rather, the experts who advance this variant of the shadow argument simply note the existence of a "focal point," "magnet" or "anchor" theory in the economic literature and then posit that such an effect is present in the noninteractive market—without making a sufficient connection between theory and evidence. Indeed, Dr. Shapiro candidly acknowledged that the focal point/magnet/anchor hypothesis is not an "ironclad" economic law. *Id.* at 37, n. 65. In sum, the Judges do not credit this conjecture as sufficient to affect their determination of the rate in this proceeding.

On behalf of SoundExchange, Dr. Talley asserts that the existing statutory rate casts a shadow so dark as to obscure entirely evidence of consensual transactions that would have been consummated in the noninteractive space, but for the statutory rate. More particularly, Dr. Talley notes that any pairing of willing licensors and licensees ("dyads" in Dr. Talley's parlance) in which the licensee's WTP was greater than the statutory rate, and greater than or equal to a licensor's "willingness to accept" (WTA) (also above the statutory rate), would not consummate an agreement at a consensual rate, because the buyer would always default to the lower statutory rate. SX Ex. 19 at 58 (Talley WRT) (Concluding "in an economic environment most relevant to this setting, a statutory licensing option can crowd out negotiated transactions for relatively high-valuing buyer-seller dyads while not affecting other, low-valuing dyads. … [T]his crowding out phenomenon can generate downward statistical bias, leaving behind only a subset of negotiated deals involving buyers and sellers whose valuations … reflect[] prices which serve as poor benchmarks for estimating the price [to which] willing buyers and sellers would agree.)[62]

The Services counter that, although the logic of Dr. Talley's point may be correct, Dr. Talley's analysis is purely theoretical and he did not examine the evidence to determine whether his analysis was supported by the facts. In particular, the Services criticize Dr. Talley's "shadow" argument because he assumes that the "missing dyads" would reflect a significantly different WTP and WTA than those of the parties who entered into agreements (*e.g.*, the Pandora/Merlin dyad and the iHeart/Warner dyad). *See*, *e.g.*, Pandora RPFF 96-103 (and citations to the record therein). Dr. Talley counters, quite correctly, that the very point of his analysis is that no negotiations or agreements for above-statutory rates would exist because the parties would not waste their time engaging in bargaining that was made moot by the statutory rate. *Id.* at 6032-34.

Dr. Talley suggests though that Dr. Rubinfeld's interactive benchmark may approximate the "unseen" noninteractive transactions because it is affected less by the shadow of the statutory rate. *Id.* at 6036. However, that argument fails to note the fundamental distinction in Dr. Rubinfeld's benchmark—that it pertains to an upstream market for interactive licensees in which upstream demand is derived from downstream consumers who have a positive WTP for streaming services. The "missing dyads," so to speak, would be those in the upstream noninteractive market in which the "missing" agreements would reflect only the downstream demand of listeners to free-to-the-listener ad-supported platforms, not those dyads identified by Dr. Rubinfeld in the *subscription* market.[63]

Relatedly, the Services also criticize Dr. Talley's argument because it fails to note the potential steering, "competitive dynamics" or other interactions that would cause dyads to cluster closely. 5/19/15 Tr. 4660-61 (Shapiro).

On balance, the Judges find Dr. Talley's criticism, albeit rational and hypothetically correct, too untethered from the facts to be predictive or useful in adjusting for the supposed shadow of the existing statutory rate. The Services' criticisms are likewise speculative, but that simply underscores the factual indeterminacy of Dr. Talley's argument. Further, Dr. Talley's point appears to be a back-door way to question both the applicability of the benchmarks in the noninteractive market, as well as the benchmarking process itself. However, the Judges have found that the Pandora/Merlin Agreement and the iHeart/Warner Agreement to be sufficiently representative benchmarks (and have found that Dr. Rubinfeld's benchmark analysis is likewise representative) *in particular segments of the statutory market*. This *segmented* analysis

[62] For example, assume the statutory rate was \$.0010. If a licensor had a WTA of \$0.0015 and a licensee had a WTP of \$0.0020, then in the absence of a statutory rate, these parties would strike a deal between \$0.0015 and \$0.0020. However, with the statutory rate at \$0.0010, the licensee would not negotiate, but would default to the lower statutory rate. Dr. Talley describes such a foreclosed agreement as having been obscured by the shadow of the statutory rate.

[63] This important distinction between listeners based on their differentiated WTP is discussed in greater detail *infra* in connection with Dr. Rubinfeld's proposed benchmark.

strengthens the representativeness of the benchmarks and weakens the speculative argument that "missing dyads" might tell a different story.

The second shadow identified by the parties is cast by the statutory rate yet to be established in this proceeding. The record is replete with evidence that the parties entered into various transactions with the knowledge, if not the intent, that such agreements could be used as evidentiary benchmarks in this proceeding. *See* SX PFF ¶¶ 567-570 (and citations to the record therein regarding the Pandora/Merlin Agreement); IHM PFF ¶¶ 359-362 (and citations to the record therein regarding Apple's agreements with the Majors); NAB PFF ¶¶ 456-458. Of course, a proposed benchmark is not disqualified because a contracting party wanted it to be a benchmark. Such a desire would apply to otherwise proper benchmarks as it would to dubious benchmarks. The Judges analyze the proposed benchmarks based on the overall factual merits attendant to their formation and applicability, not based upon the parties' hopes or manipulations. If a benchmark is deficient in some manner, the adversarial process of this proceeding allows the parties to expose those deficiencies.

The Judges agree with a particular criticism made by iHeart of the shadow argument asserted by SoundExchange: in the absence of the statutory shadow, the antitrust policy toward the noninteractive streaming market could well be different. *Cf.* 141 Cong. Rec. S. 11,962-63 (daily ed. Aug. 8, 1995) (Letter from Assistant Attorney General Andrew Fois to Hon. Patrick Leahy, July 21, 1995, noting that any noncompetitive rates created by the existence of only a single collective could be corrected by the "rate panel."). Although that comment was made in connection with the potential anticompetitive consequence of a single collective, it suggests to the Judges that the so-called "shadow" of the statutory rate offsets any potential device that would cause rates to deviate from an "effectively competitive" level.[64]

Thus, to the extent the "shadow of antitrust law" has receded, it was counterbalanced by the "shadow of the statutory rate." Accordingly, the presence of the so-called statutory shadow appears to reflect a trade-off and a second-best solution, rather than a distortion of an effectively competitive marketplace.

Additionally, the Judges' consideration of the Pandora/Merlin Agreement and the iHeart/Warner Agreement as appropriate benchmarks for the ad-supported (free-to-the-listener) market obviates the supposed "shadow" problem. In both benchmarks, the rate is *below* the otherwise applicable statutory rates. The statutory rates did not cast a shadow that negatively affected the licensors in those agreements because (as noted *infra*) they voluntarily agreed to rates below the applicable statutory rates (in exchange for the steering of more plays), rather than defaulting to the higher statutory rate.

Further, in the *subscription* market the Judges have adopted the SoundExchange benchmark approach, which analogizes between the interactive and noninteractive markets. As Dr. Rubinfeld testified, the interactive contracts on which he relied for his subscription-based

[64] The issue of "effective competition" is discussed at length, *infra*.

benchmark "minimize[] the effect of the statutory shadow" because the interactive services cannot default to the statutory rate. Rubinfeld CWDT ¶ 18.

Finally, the Judges emphasize that they find the "shadow" criticism to be both nihilistic and self-contradictory. If the "shadow" infects all benchmarks so as to disqualify that method of rate-setting, then the parties would need to adjust or abandon their benchmarking strategies and develop new bases for analysis. That could mean the wholesale abandonment of benchmarking, to be replaced by a valuation approach yet to be applied and accepted in these proceedings.[65]

F. The Legal Issue of Whether Effective Competition is a Required Element of the Statutory Rate

The statutory language that includes the "willing buyer/willing seller language also commands that "[i]n determining such rates … the … Judges "*shall* base their decision on economic, *competitive* and programming information presented by the parties …" 17 U.S.C. § 114(f)(2)(B) (emphasis added). *Accord*, 17 U.S.C. § 112(e)(4) (regarding ephemeral licenses). Several previous decisions by the D.C. Circuit, the Librarian, the Judges and the CARP (in *Web I*) have discussed the concept of "effective competition" and its relationship to section 114(f)(2)(B).

SoundExchange and the Services disagree as to whether section 114(f)(2)(B) and prior decisions require the Judges to set a rate that reflects an "*effectively competitive*" market populated by willing buyers and willing sellers. SoundExchange argues that no authority allows for such a requirement, while the Services assert that the statute and prior decisions require the Judges to set rates that would be established an "effectively competitive" market.[66]

The Services construe section 114(f)(2)(B) as explicitly requiring the Judges to utilize competitive information introduced in evidence to set a marketplace rate that reflects "effective competition," and to adjust an otherwise appropriate benchmark in order to reflect "effective competition." In support of this position, the Services make several principle arguments.

The Services assert that prior decisional law constitutes precedent that requires the Judges to set rates that are "effectively competitive." They point to the most recent determination by the Judges – the *Web III Remand* – in which the Judges approvingly cited and relied upon the

[65] As explained elsewhere in this determination, the Judges have rejected the non-benchmarking approaches to rate setting proposed by some parties in this proceeding. They were not rejected because they were not benchmarks, but because each was unpersuasive in its own right.

[66] As discussed in more detail in this determination, SoundExchange asserts that its interactive benchmark need not be reflective of an "effectively competitive" market because such a requirement is not contained within section 114(f)(2)(B). SoundExchange also argues that, assuming an "effectively competitive" market standard is part of the statutory scheme, its interactive benchmark is a product of effective competition. The Services argue that their respective proposed benchmarks reflect rates that have been set in an "effectively competitive" market, unlike SoundExchange's proposed interactive benchmark that is the product of a market lacking the necessary competitive features. iHeart and Pandora each maintains that, even assuming that the statute does not contain an "effectively competitive" market standard, their respective benchmarks are nonetheless appropriate, because they represent the rates to which willing sellers and willing buyers would agree in the market, notwithstanding whether those rates reflect "effective competition."

language in prior decisions by the Librarian in *Web I* and the Judges in *Web II* regarding the need to set rates under section 114(f)(2)(B) that reflect those that would be set in an "effectively competitive market." *Web III Remand* at 23114 n.37. The NAB further notes that in *Web II*, the Judges held that "neither sellers nor buyers can be said to be 'willing' partners to an agreement if they are coerced to agree to a price through the exercise of overwhelming market power." *Web II* at 24091. SiriusXM emphasizes other particular language from *Web II*, which states: "An effectively competitive market is one in which super-competitive prices or below-market prices cannot be extracted by sellers or buyers…." 72 FR at 24091.

The NAB emphasizes that in the present proceeding the Judges must follow these decisions because 17 U.S.C. § 803(a)(1) expressly requires the Judges to act in accordance with the Librarian of Congress's interpretation. NAB PFFCL ¶ 689. The Services also rely on a decision by the D.C. Circuit as persuasive, if not binding precedent, because it states that section 114(f)(2)(B) "does not require that the market assumed by the Judges achieve *metaphysical* perfection in competitiveness. " *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Board*, 574 F.3d 748, 757 (D.C. Cir. 2009) (emphasis added). Apparently, the Services construe the use of the adjective "metaphysical" to require, or at least suggest, that the rates reflect some lesser yet nonetheless effective quantum of competition.

The Services further argue that the legislative history of Section 114 reflects a Congressional intention for rates to be set at a level that avoids "higher-than-competitive prices." *See* 141 Cong. Rec. S11945-04, S11962 (1995). In similar fashion, according to the Services, the legislative history makes it plain that the willing buyer/willing seller standard in section 114 was intended to direct the CARP (now the Judges) "to determine reasonable rates and terms."). H.R. Rep. No. 105-796, at 86 (Conf. Rep.); *see* H.R. Rep. No. 104-274, at 22 (1995) (the legislative history of the DPRSRA expressly provides that in the rate proceeding "[i]f supracompetitive rates are attempted to be imposed on operators, the copyright arbitration royalty panel can be called on to set an acceptable rate."). In this regard, the Services note that the Department of Justice's objection to an earlier draft of the statute, relating to whether the record companies could negotiate exclusively through a common agent, was resolved because the ratemaking body (now the Judges) could intercede and establish reasonable rates. 141 Cong. Rec. S. 11,962-63 (daily ed. Aug. 8, 1995) (Letter from Assistant Attorney General Andrew Fois to Hon. Patrick Leahy, July 21, 1995, noting that any noncompetitive rates created by the existence of only a single collective could be corrected by the "rate panel.").

The Services also note that, in comparable circumstances, courts construe "reasonable rates" to be those "rates that would be set in a competitive market." *ASCAP v. Showtime/The Movie Channel, Inc.*, 912 F.2d 563, 576 (2d Cir. 1990); *see also* NAB PFFCL ¶¶ 706-709 (and cases cited therein); *In re Pandora Media, Inc*., 6 F. Supp. 3d 317, 353-54 (S.D.N.Y. 2014), *aff'd sub nom. Pandora Media, Inc. v. ASCAP*, 785 F.3d 73 (2d Cir. 2015).

Finally, the NAB asserts that the statutory histories of the DPRA and the DMCA reflect a Congressional intent to create a three-tier performance right/rate structure, whereby: (1) terrestrial radio continues to enjoy free access to sound recordings; (2) interactive services must pay market-negotiated royalties in order to play sound recordings on demand; and (3) noninteractive services, falling between these two extremes, cannot play sound recordings for free, shall not to be subjected to the purely market rates paid by on-demand interactive services and, instead, shall pay intermediate rates set by the Judges (formerly the CARP arbitrators subject to Librarian review). *See* NAB ¶¶ 678 *et seq.*; 682 *et seq.* (and authorities cited therein).

On the other hand, SoundExchange construes section 114(f)(2)(B) as precluding the Judges from adjusting an otherwise appropriate benchmark in order to reflect "effective competition." In support of this position, SoundExchange makes several principal arguments.

First, SoundExchange emphasizes that the words "effective competition" or the like are not included within the statute. Thus, SoundExchange maintains that the plain language of the statute clearly does not include such a standard. SX PCOL ¶ 21.

Second, SoundExchange relies upon a statement by the CARP in *Web I* that "the willing buyer/willing seller standard is the only standard to be applied." *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2 at 21 (Feb. 20, 2002), *appv'd and modif'd by Librarian*, 67 Fed. Reg. 45240 (July 8, 2002) (*Web I*). SoundExchange construes this language as confirming the exclusion of the "effectively competitive" condition from the "willing buyer/willing seller" marketplace standard.

Third, SoundExchange argues that the "willing buyer/willing seller" standard is essentially a restatement of the traditional "fair market value" test. *See id.* at 45244 (the *Librarian's Web I* decision notes that the statutory standard requires rates that reflect "strictly fair market value"). The Supreme Court has defined "fair market value" as SoundExchange notes, as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." *United States v. Cartwright*, 411 U.S. 546, 551 (1931).

Fourth, SoundExchange argues that statutory enactments of the fair market value test and its willing buyer/willing seller component constitute adoptions of a recognized common law definition of the test. Therefore, the common law meaning should prevail because it is a "settled principle of statutory construction that, *absent contrary indications*, Congress intends to adopt a common law definition of statutory terms. *United States v. Shabani*, 513 U.S. 10, 13 (1994); *see also United States v. Wells*, 519 U.S. 482, 491 (1997) (same).

Fifth, SoundExchange points out that, when Congress intends a legal standard to be based on "effective competition," it makes the point expressly, and explicitly defines "effective competition." *Cf.* 47 U.S.C. § 543(1)(1) (defining "effective competition" in the Cable Television Consumer Protection and Competition Act of 1992).

Sixth, SoundExchange characterizes the references to effective competition in *Intercollegiate Broad. Sys.* and *Web I* as mere *dicta* that may be ignored by the Judges.

Seventh, SoundExchange asserts that any attempt to apply an "effective competition" requirement would render the statutory test indeterminate, unworkable, and vague. SoundExchange notes that the Services' economic experts acknowledged the absence of a "bright line" separating a market that is "effectively competitive" from one that is not. Moreover, SoundExchange asserts that there is no evidence or testimony setting forth what the level of rates would need to be in SoundExchange's proffered interactive benchmark market, in order for it to equate with "effectively competitive" rates.

Having considered the issue and the parties' positions, the Judges conclude that they are required by law to set a rate that reflects a market that is effectively competitive. The Judges reach this conclusion through a consideration of the plain meaning of the statute, the clear statutory purpose, applicable prior decisions, and the relevant legislative history.

The Judges' starting point is the language of the statute itself. The statute *requires* that the Judges "*shall* base their decision on [*inter alia*] competitive … information presented by the parties …." 17 U.S.C. § 114(f)(2)(B) (emphasis added); a*ccord*, 17 U.S.C. § 112(e)(4) (identical language for the setting of rates for the ephemeral license). The D.C. Circuit has expressly noted that, by this specific language, "Congress *required* the Judges to follow certain statutory guidelines" one of which is that "the Judges *must* 'base [their] decision on … *competitive* … information presented by the parties.'" *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Board,* 574 F.3d 748, 753 (D.C. Cir. 2009).

SoundExchange invites the Judges to ignore this statutory directive and judicial command. The Judges cannot. The parties presented the Judges with voluminous evidence and testimony comprising the required "competitive information" relating to Dr. Rubinfeld's proposed interactive benchmark market, the Services' proposed noninteractive benchmarks, the noninteractive market at issue in this proceeding, and the alleged differences and similarities among them.[67] The Judges are commanded by the statutory language quoted above to "base their decision" on precisely this sort of information, and, as *Intercollegiate Broadcast System* makes plain, it would be legal error for the Judges to ignore this statutory directive.

The Judges further conclude that, even if the directive that they "shall" consider competitive information could be somehow construed as ambiguous, their consideration of "competitive information" is certainly a permissible, reasonable, and rational application of section 114, for a number of reasons.

First, the D.C. Circuit, the Librarian, the Judges, and the CARP have all acknowledged that the Judges can and should determine whether the proffered rates reflect a sufficiently competitive market, *i.e.*, an "effectively competitive" market. The Judges made this point clearly in their decision in the *Web III Remand*, which included a summary of the past decisional language regarding the section 114 standard:

The DC Circuit has held that this statutory section does not oblige the Judges to set rates by assuming a market that achieves "metaphysical perfection and competitiveness." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Board*, 574 F.3d 748, 757 (D.C. Cir. 2009). Rather, as the Librarian of Congress held in *Web I*, the "willing seller/willing buyer" standard calls for rates that would have been set in a "*competitive* marketplace." 67 FR at 45244-45 (emphasis added); *see also Web II*, 67 FR at 24091-93 (explaining that *Web I* required an "*effectively* competitive market" rather than a "*perfectly* competitive market." (emphasis added)). Between the extremes of a market with "metaphysically perfect competition" and a monopoly

[67] The "competitive information" provided by the parties was extensive. SoundExchange and the Services provided factual and expert testimony regarding: (1) the "upstream" market (in which streaming services acquire licenses from the record companies); (2) the "downstream" market (in which streaming services may (or may not) compete with each other for listeners); (3) the horizontal "upstream" market (where the record companies compete (or fail to compete) with each other; and (4) the interactions of these several markets.

(or collusive oligopoly) market devoid of competition there exists "[in] the real world … a mind-boggling array of different markets," Krugman & Wells, *supra*, at 356, all of which possess varying characteristics of a "competitive marketplace." *Web III Remand*, 79 *Fed. Reg.* at 23114, n.37.

It is noteworthy that SoundExchange has not characterized the *Web III Remand* decision as *dicta*. Thus, even if the prior language on which the *Web III Remand* Judges had relied was *dicta*, there is no argument that the holding in the *Web III Remand* was *dicta*. It is also noteworthy that SoundExchange did not assert that the holding in *Web II*, that an excess of market power can preclude a finding that a buyer or seller was a "willing" participant, was *dicta*.[68]

In *Web III*, a licensee, Live365, asked the Judges to reject certain of SoundExchange's proposed benchmarks that were based on the Webcaster Settlement Act (WSA) agreement between SoundExchange and the NAB, and the WSA agreement between SoundExchange and Sirius XM. (The parties to those agreements agreed to allow those WSA agreements to be introduced as evidence in *Web III*.) Live365 argued that "the rates … reflect the monopoly power of a single seller in those two contracts." 79 Fed. Reg. at 23113. The Judges rejected that argument – and did so by taking a "decisional path" of reasoning based on: (1) a conclusion that an effective level of competition was required for the Judges to adopt those benchmarks; and (2) the facts of the case that demonstrated the sufficiently competitive nature of those benchmarks.[69] That legal conclusion and that factual finding led the Judges to an application of law to fact whereby they concluded that the proposed benchmarks were reflective of an effectively competitive market and therefore satisfied the section 114(f)(2)(B) standard. Specifically, the Judges held in the *Web III Remand*:

> An oligopolistic marketplace rate that did approximate the monopoly rate could be inconsistent with the rate standard set forth in 17 U.S.C. § 114(f)(2)(B), as that standard has been set forth by the D.C. Circuit and the Librarian of Congress. …

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68 Not only did SoundExchange fail to assert that the *Web III Remand* decision regarding "effective competition" was *dicta*, that decision could not possibly be construed as *dicta*. The distinction between a holding and *dictum* has been thoroughly analyzed and succinctly stated:

> A holding consists of those propositions along the chosen decisional path or paths of reasoning that (1) are actually decided, (2) are based upon the facts of the case, and (3) lead to the judgment. If not a holding, a proposition stated in a case counts as *dicta*.

M. Abramowicz and M. Stearns, *Defining Dicta*, 57 Stan. L. Rev. 953, 961 (2005). Courts have long held that, in contrast with a "holding," *dicta* as "language unnecessary to a decision, ruling on an issue not raised, or [an]opinion of a judge which does not embody the resolution or determination of the court, … made without argument or full consideration of the point." *Lawson v. U.S.*, 176 F.2d 49, 51 (D.C. Cir. 1949). As detailed in the text, a consideration of the pertinent ruling in the *Web III Remand* and of the ultimate decision in the *Web III Remand* itself, demonstrates that the statements regarding the necessary competitive state of the market were clearly holdings rather than *dicta*.

69 Both Sirius XM and the NAB assert in the present proceeding that those two WSA settlement agreements were not reflective of effective competition, based on evidence they have presented in *this* proceeding but was not presented in *Web III*. That issue is addressed *infra*, but, for present purposes, the pertinent point is that the Judges found on the *Web III record* that these WSA settlement agreements reflected an effectively competitive market.

> [I]n this proceeding the *evidence* demonstrates that sufficient competitive factors exist to permit the [benchmarks] to serve as useful benchmarks, and does not demonstrate that the rates in the [benchmarks] approximated monopoly rates.
>
> * * *
>
> The parties presented no evidence from which the Judges could conclude …that SoundExchange necessarily wielded a level of pricing power sufficient to affect the use of the WSA Agreements as benchmarks.

79 Fed. Reg. at 23114 (emphasis added). Thus, in the *Web III Remand*, the Judges unequivocally applied the prior pronouncements of the D.C. Circuit, the Librarian and the Judges to render an unambiguous holding: (1) adopting a competitiveness standard; (2) applying the facts to the competitiveness standard; and (3) using that application of facts to law to reach their judgment. Alternately stated (and applying the D.C. Circuit's *Lawson* definition of *dicta* quoted *supra*), this decision regarding "effective competition" in the *Web III Remand* was *necessary* to determine an issue raised in the proceeding (the effectively competitive status of the WSA settlement agreements), after argument and full consideration.

Moreover, even past *dicta* "deserves serious consideration" in subsequent decisions when "sufficiently persuasive." *U.S. v. Libby*, 475 F. Supp. 2d 73, 81 (D.D.C. 2007). Thus, "persuasive dictum in an important early case [can] establish[] [a] principle" to be followed by other courts. *Committee of U.S. Citizens Living in Nicaragua v. Reagan*, 859 F.2d 929, 938-39 (D.C. Cir. 1988). Accordingly, although SoundExchange assets that the statements relating to an effectively competitive market in the D.C. Circuit's *Intercollegiate Broadcast System* decision and the Librarian's *Web I* decision were *dicta*, the Judges in *Web II*, the *Web III* Remand and the present proceeding were all clearly able to convert such asserted *dicta* into binding holdings.

Thus, the Judges conclude that they are bound to follow the prior directives that instruct them to make certain that the statutory rates they set are those that would be set in a hypothetical "effectively competitive" market. In light of this conclusion, based on the foregoing reasons, the remainder of the arguments are insufficient to alter the Judges' decision in this regard. However, in the interest of completeness, the Judges address other arguments, including those raised by the parties, that further support their conclusion.

The Judges agree that the legislative history supports the conclusion that section 114 directs the Judges to set rates that reflect the workings of a hypothetical effectively competitive market. The legislative history equates rates set under the willing buyer/willing seller standard with "reasonable rates." As the Services note, the phrase "reasonable rates" has been construed by the rate court, in an analogous context, as "rates that would be set in a competitive market."

The Judges are informed by the analogous use of the willing buyer/willing seller standard in eminent domain law. *See, e.g., Kirby Forest Ind., Inc. v. U.S.*, 467 U.S. 1, 10 (1984) (applying willing buyer/willing seller test in eminent domain valuation dispute). In such cases, the courts must consider whether to award a forced seller the "holdout" value of the seller's parcel, an additional value that exists solely because the seller's property is a necessary *complement* to the other properties that are needed by the governmental unit. As discussed in detail *infra*, it is precisely this *complementary oligopoly* value that the Judges are declining to include in the statutory rate based upon their analyses of the parties' benchmarks proffered in this proceeding. *Cf.* Thomas Miceli and C.F. Sirmans, *The Holdout Problem, Urban Sprawl and Eminent*

Domain, 16 J. Housing Econ. 309, 314 (2006) ("*complementarities* among properties in the assembly case that are not present in the individual transaction" are the consequence of "market failure," economic "rent seeking" and generate inefficient "transaction costs.") (emphasis added).

The Judges are also persuaded that the structure of the Act with regard to the sound recording performance right—as it relates to terrestrial radio, noninteractive services and interactive services—confirms the necessity of adopting an "effectively competitive" standard in the rate-setting process. Copyright owners were provided a limited performance right with regard to the use of their sound recordings by noninteractive services – something less than the purely private market-based rate for interactive use, but clearly more than the "zero rate" required from terrestrial radio. The Judges conclude that a rate that simply reflected or overemphasized either of the polar extremes would be inconsistent with the three-tier structure of the statute.[70] As the Services note, if the Judges were simply to apply the competitive dynamics of the interactive market, they would be disregarding the particular statutory history that led to the three-tier rate structure. *See generally*, William W. Fisher III, *Promises to Keep* at 104-05 (2004) (different statutory treatment of terrestrial radio, interactive services, and noninteractive services based upon fundamental ability and limits regarding the performance, promotion of, and substitution for sound recordings).

SoundExchange's arguments to the contrary are unavailing. First, the fact that the statute requires the Judges to consider "competitive information" adequately rebuts SoundExchange's contention that the statutory language does not address the issue of competitiveness. That provision, combined with the legislative history and the prior judicial and administrative pronouncements make it clear that the statutory language requires the Judges to establish rates that are effectively competitive.

Second, the Judges do not find that the traditional fair market value test permits the Judges to ignore the competitive status of the hypothetical market in which the statutory rate is established. As SoundExchange concedes in the very case law that it quotes, the common law meaning of a phrase should only prevail when construing a statute "absent contrary indications." Here, the requirement that the Judges consider "competitive information," the prior judicial and administrative holdings and pronouncements, and the legislative history all combine to clearly provide more than "indications" that the Judges must set reasonable rates that reflect "effective competition."

Third, the mere fact that, in another setting (regarding the cable television industry) Congress chose to define "effective competition" hardly suggests that such an "effective competition" standard does not exist in the present case. Indeed, the absence of a definition, combined with the requirement that the Judges weigh "competitive information," is more

[70] As discussed *infra*, the Judges also reject rates proposed by several of the Services that attempt to use the "zero rate" paid by terrestrial radio as a guide in this proceeding. The rejection of such proposals can be seen as a bookend to the Judges' requirement that the statutory rate reflect effective competition, rather than the complementary oligopoly power present in the interactive market.

consistent with the idea that Congress intended to delegate discretion to the Judges to determine whether the rates they set reflected an appropriate level of competitiveness.

Finally, the Judges reject SoundExchange's assertion that there is no pre-existing "bright line" test sufficient to distinguish a rate which is "effectively competitive" from one that is not. The very essence of a competitive standard is that it suggests a continuum and differences in degree rather than in kind. Once again, the statutory charge that the Judges weigh "competitive information" indicates that the Judges are empowered to make judgments and decide whether the rates proposed adequately provide for an effective level of competition. Moreover, in the present case, the Judges were presented with highly specific facts regarding how to use the impact of steering on rate setting in order to measure and account for the "complementary oligopoly" power of the Majors that serves to prevent effective competition.

IV. Commercial Webcasting Rates

A. Analyses and Findings

The rates proposed by the Services and SoundExchange are marked by a wide disparity. Although it is unsurprising that adverse parties would have strikingly different positions, what is surprising is that, despite these differences, the parties' positions are supported to a great extent (but not in all cases) by persuasive and logical economic analyses. Initially, this created a conundrum for the Judges, because none of these persuasive and logical economic analyses could easily be rejected.

On closer inspection, however, what became clear to the Judges was that the reason why many of these disparate economic analyses and models could all appear to be correct was that they each reflected *only a portion of the marketplace*. That is, to draw on a classic analogy, the experts testified to different aspects of the market in much the same manner as the several proverbial blind men[71] who, after touching but one part of an elephant, were asked to describe the animal, and gave starkly different descriptions based upon whether they had touched only the trunk, the torso or the tail. Perhaps an even more apt analogy has been made with regard to the testimony of experts as similar to the men in another fable:

> In a certain kingdom was a cave containing a treasure, guarded by a beast of fierce repute. The king wished to know the nature of the beast, and dispatched three of his subjects to invade the pitch darkness of the cave and report. The first returned and declared that he had felt the head of the beast, and it was toothed and maned like a lion. The second reported that he had felt the sides of the beast, and that it was winged and feathered like an eagle. The third reported that the legs of the beast were long and hoofed like a horse. A fearsome portrait of the beast was drawn up, and all were thereafter afraid to approach the cave. Of course, in reality, the cave contained a lion, an eagle, and a horse.

[71] The analogy is not meant to suggest that the testifying experts were metaphorically blind. Indeed, they were all learned and persuasive with regard to the aspects of the market upon which they opined.

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> Another, less allegorical, way of saying this is that many of the problems that the law has had in handling expertise in the courtroom have sprung from a failure to examine the concept of expertise in appropriate taxonomic detail.

Michael Risinger, *Preliminary Thoughts on a Functional Taxonomy of Expertise for the* Post-Kumho *World*, 31 Seton Hall L. Rev. 508, 508-09 (2000).

This phenomenon among experts has particular applicability to economists. As one proiminent economist has recently written:

> Rather than a single, specific model, economics encompasses a collection of models …. The diversity of models in economics is the necessary counterpart to the flexibility of the social world. Different social settings require different models. Economists are unlikely ever to uncover universal, general-purpose models. But … economists have a tendency to misuse their models. They are prone to mistake a model for *the* model, relevant and applicable under all conditions. Economists must overcome this temptation.

Dani Rodrik, *Economics Rules* 5-6 (2015) (emphasis in original).Each party and its experts nonetheless invite the Judges to rely on but a single economic model – their model – as representative of the entire noninteractive market. As this determination makes clear, the Judges decline that invitation. Rather, the Judges have found that no single economic model – no one mythic beast – reigns over the noninteractive market *writ large*. Rather, the evidence and testimony reveal a marketplace for sound recordings that is segmented, if not fragmented. Indeed, the Judges note the following economic dichotomies demonstrated by the evidence:

- Market Segmentation by WTP

Services that attract listeners who have no willingness to pay (WTP) for access to a noninteractive service, and therefore who listen mainly to ad-supported services, versus services that attract relatively more listeners who have a WTP greater than zero, and therefore can attract more subscription-based listeners.

- Market Segmentation by On-Demand Functionality

Services that meet the statutory definition of an "interactive service" and thus provide an on-demand function, *i.e.,* that allow listeners to select the sound recording they wish to hear whenever they choose, versus noninteractive services, that – despite whatever other functionality they may include – do not and cannot provide an on-demand feature.

- Market Segmentation by Major or Indie

The Majors, who have the ability to negotiate relatively higher rates, versus the Indies, who have relatively less market power when negotiating rates.

- Complementary Oligopoly Power versus Oligopoly Market Structure

"Complementary oligopoly" power exercised by the Majors designed to thwart price competition and thus inconsistent with an "effectively competitive market," versus the Majors' non-complementary oligopolistic structure not proven to be the consequence of anticompetitive acts or the cause of anticompetitive results.

- Custom Pureplay Webcasting versus Simulcasting

Custom (pureplay) noninteractive services that play only sound recordings, versus simulcasters, who play principally (but not exclusively) the sound recordings and other materials transmitted simultaneously on a terrestrial broadcast.

The presence of such dichotomies is not particularly unusual. For example, in *Web II*, the Judges noted that the marketplace consisted of a variety of commercial actors, who had a heterogeneous mix of features regarding costs, customers, business plans, and strategies. Such a variety exists today, and has been amplified by technological changes that have allowed for a greater diversity of music services. The directive in section 114, instructing the Judges to establish "rates and terms," that is, multiple rates and terms, anticipates the potential for more than one set of rates and terms that would have been negotiated in the marketplace between various willing buyers and willing sellers. Because the marketplace as presented by the record in this proceeding reveals important differences across these dichotomies, the Judges, as required by section 114, establish rates and terms in this proceeding that reflect those marketplace realities.

B. SoundExchange's Rate Proposal

1. Introduction

SoundExchange proposes a single rate for all commercial webcasters using a greater-of structure. All commercial webcasters would pay the greater of 55% of revenue attributable to webcasting and the following per-performance rate:

SoundExchange Proposed Per-Performance Rates	
Year	**Per-performance Rate**
2016	$0.0025
2017	$0.0026
2018	$0.0027
2019	$0.0028
2020	$0.0029

Id. at 2-3.

2. Dr. Rubinfeld's Proposed Interactive Streaming Services Benchmark

In support of its proposal, SoundExchange relies principally on an analysis undertaken by one of its economic witnesses, Dr. Daniel Rubinfeld, of rates set forth in direct licenses from record companies to certain interactive streaming services.[72]

[72] An "interactive service" is defined as one that "enables a member of the public to receive transmission of a program specially created for the recipient, or *on request, a transmission of a particular sound recording … which is selected by the recipient*." 17 U.S.C. § 114(j)(7) (emphasis added). A service that fails to meet the definition of an

a. Foundation for Rubinfeld's Proposed Per-Play Rates Benchmark

Dr. Rubinfeld derived SoundExchange's proposed per-play rates by analyzing more than 80 agreements between interactive streaming services and record companies. Dr. Rubinfeld identified 60 such agreements that contained data on per-play royalty rates. 5/28/15 Tr. 6297 (Rubinfeld). From those 60 agreements, he selected 26 that specified minimum per-play rates. Rubinfeld CWDT ¶ 205; SX Ex. 59 (Rubinfeld CWDT, Exhibit 16a) (listing 26 interactive streaming service agreements).

According to Dr. Rubinfeld, interactive streaming service benchmarks are more probative in this statutory rate proceeding than they were in prior statutory rate proceedings due to: (1) a "convergence" in features that interactive and noninteractive streaming services offer to the end-user ("downstream") market; and (2) greater head-to-head competition for listeners between interactive and noninteractive streaming services. Rubinfeld CWDT ¶ 21.

i. Convergence of Features

SoundExchange avers that the listening choices (*i.e.*, functionality) that interactive and noninteractive streaming services offer their customers are becoming much more similar than they were in previous years, *i.e.*, they are converging. *See, e.g.*, 5/6/15 Tr. 2013 (Rubinfeld) ("[C]onvergence [m]ean[s] that if I'm very active in telling Pandora [a noninteractive service] what I like and don't like, the nature of the station can evolve in ways that can become more similar to what I might do on Spotify [an interactive service] if I were curating my own station.").

According to SoundExchange, the increasingly similar functionality of interactive and noninteractive streaming services has "blurred" the previous distinctions between them. *See, e.g.*, SX Ex. 3, ¶ 13 (Blackburn WDT); SX Ex. 32, ¶ 25 (Wilcox WRT). This purported blurring has occurred, according to SoundExchange, because of technological evolution, marketplace developments, and changes in consumer preferences. *See, e.g.*, Kooker WDT at 16; SX Ex. 21 ¶ 36 (Wheeler WDT). SoundExchange asserts that, because of the market changes that it has highlighted, interactive and noninteractive webcasters alike recognize that any given music consumer "is both a lean forward and a lean back type of listener," whose particular preference "depends very much on the situation and the time of day" and the "mood that they're in." 5/29/15 Tr. at 6570 (Kooker); Kooker WRT.[73] SoundExchange further notes that even Pandora has recognized that for 75% of music consumers it is important that a music service afford them

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"interactive service" is, by default, a noninteractive service that may be entitled to a statutory license if it meets all other applicable criteria, *see* 17 U.S.C. § 114(d)(2)(C), including adherence to the "sound recording performance complement" as defined in 17 U.S.C. § 114(j)(13).

[73] "Lean-forward" and "lean-back" are not statutory phrases that define types of services, and the record does not reflect any precise meanings in the industry. Importantly, a "lean-forward service" is not necessarily the same as an "interactive service," and a "lean-back service" is not necessarily the same as a "noninteractive service." *Compare, e.g.*, 4/30/15 Tr. 1182-83 (A. Harrison) ("on-demand services have lean-back listening options" and "statutory [noninteractive] services have lean-forward capabilities.") *with* 5/13/15 Tr. 3396-97 (Herring) ("lean-back services are radio-like services, one where you hit play and the service kind of chooses for you …[w]hereas … lean-forward we consider on-demand services. So you go into the service and you choose exactly what you want to listen to.")

both "effortless listening" *and* "on demand music." SX Ex. 269 at 17 (Pandora Board of Directors: Strategy Day document, Oct. 30, 2014).

SoundExchange contends that to attract and retain listeners, interactive streaming services have moved beyond merely playing, on demand, the recordings selected by a listener, and have developed and promoted curated playlists, radio components and other lean-back methods of music delivery. Blackburn WDT ¶ 13; Wilcox WRT ¶ 25; Kooker WRT at 14; 5/13/15 Tr. 3448-50 (Herring). To support this point, SoundExchange introduced evidence and elicited testimony describing the various custom *radio* features of several predominantly interactive streaming services, *e.g.*, Rdio; Rhapsody; Slacker; Beats; Amazon; Google; and Apple. *See* SX PFF ¶ 266 (and record citations therein).

SoundExchange asserts that "lean back" features are a significant part of the consumer listening experience on some of these services. For example, SoundExchange points out that nearly [redacted]% of UMG's plays on Slacker are such programmed streams, rather than the traditional on-demand plays of an interactive service. SX Ex. 25 ¶ 11 (Harrison WRT). SoundExchange notes that on Spotify, approximately [redacted]% of total listening to Sony's repertoire occurs through playlists created by Spotify or other third parties (*i.e.*, not the listener). Kooker WRT ¶ 15.

SoundExchange further asserts that listener feature convergence is occurring from the other direction as well, with *statutory services* adding new "lean-forward" options. In May 2013, SoundExchange notes, Pandora, a noninteractive streaming service, initiated its "Pandora Premieres" feature, which "allows for on-demand selection of certain predetermined albums." Pan. Ex. 5002 ¶ 30 (Fleming-Wood WDT); Rubinfeld CWDT ¶¶ 53-54; 5/13/15 Tr. 3444 (Herring). Further, SoundExchange notes that a Pandora listener can "seed" multiple stations with various artists and sound recording tracks, and then influence the types of recordings on each station by using Pandora's "thumbs up/thumbs down" button. PAN Ex. 5000 ¶¶ 33-34 (Westergren WDT); Fleming-Wood WDT ¶¶ 8-9; Blackburn WDT ¶¶ 9, 12-13; Rubinfeld CWDT ¶ 53; Kooker WRT ¶¶ 10-11. SoundExchange continues that Pandora listeners can also skip songs, another form of customization. Rubinfeld CWDT ¶ 53.

SoundExchange also points out that Sirius XM's noninteractive steaming service ("My Sirius XM") allows listeners to move "sliders" to change the type of music played. For example, a listener can direct the service to play "more acoustic" or "more electric" within a particular genre. SX Ex. 232 at 15-21; 5/22/15 Tr. 5419-20 (Frear).

SoundExchange also notes that iHeart has developed a custom streaming service that, according to SoundExchange, makes it "very likely" that a listener who is seeking out a highly popular artist or song will "hear the exact song or songs he or she had in mind within minutes of starting the station." Kooker WRT at 7.[74]

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[74] To demonstrate this point, SoundExchange introduced evidence of several experiments that purported to show the high frequency with which an iHeart station played the most popular songs of a popular artist who was used to seed a custom station – in contrast to the uncertain song rotation on terrestrial radio. Kooker WRT at 7-8. In these experiments on iHeart's custom radio (*i.e.*, non-simulcast), a seeded popular artist, Meghan Trainor, and her current highest selling song, would play first 92% of the time. Ms. Trainor's first or second current highest selling song

SoundExchange also notes that the statutory services are developing new functionality that would allow even more listener control (while still satisfying the DMCA requirements).[75] These functions purportedly would allow listeners to:

- repeat songs, re-listen to songs they've "thumbed up," skip additional tracks, and create playlists of "thumbed up" songs, SX Ex. 1678 at 8;
- ban from stations certain artists, live tracks, instrumental recordings and tempos, SX Ex. 269 at 43; 5/13/15 Tr. 3498-3503 (Herring); and
- create stations that contain *only* those songs for which the listener has indicated a preference. SX Ex. 213.

SoundExchange notes that a prime catalyst for increased convergence between interactive and noninteractive streaming services is the trend away from desktop listening toward mobile listening. For example, SoundExchange points out that during the first quarter of 2015, 83% of the hours streamed by Pandora listeners occurred through mobile devices. 5/13/15 Tr. 3443 (Herring). SoundExchange asserts that the leading edge of this competition to "get into the car" by both noninteractive and interactive streaming services should hasten this trend. 5/8 Tr. 2731-32 (Shapiro). Moreover, because on-demand song selection is often incompatible with driving (absent hands-free voice controls or self-driving cars), SoundExchange opines that interactive streaming services have incentives to add "lean-back" functionality, such as Spotify's "Shuffle" service, to their mobile services. Blackburn WDT ¶ 39.

Based on the foregoing points, SoundExchange concludes that, notwithstanding the requirements noninteractive streaming services must meet to be eligible for the statutory license, statutory services are increasingly offering enhanced functionality that "come[] close to replicating" the on-demand listening experience of interactive streaming services. Rubinfeld CWDT ¶¶ 53-54; Blackburn WDT ¶ 9; Kooker WDT at 16. As summarized by one record company witness, statutory services now "employ sophisticated algorithms, user-interface controls, and other computer technology that allow users to communicate their preferences to the service, and the service to customize and curate programming tailored to the individual user." Kooker WDT at 16-17.

SoundExchange concludes that "[i]t is therefore no longer just directly licensed interactive services that allow users to *select* their programming. Users of statutory services can also lean forward and *influence* what they hear." SX PFF ¶ 278 (emphases added).[76]

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would play first 100% of the time. In 68% of the trials in the experiment, the seeded station played three or more of Ms. Trainor's songs among the first seven songs played. SX Ex. 27 at 7.

[75] None of the parties requested that the Judges interpret or seek an interpretation from the Register on whether any one listener feature or combination of features brought a particular noninteractive service outside the scope of the statutory license.

[76] The words "*select*" and "*influence*" as used by SoundExchange and quoted in the accompanying text, *supra*, are italicized to foreshadow the important distinction in meaning between those words, as discussed *infra*, section IV.B.3.b. Suffice it to note at present the different meanings of these two verbs – "to select" means "to choose in preference to another or others; pick out; to make a choice; pick," whereas "to influence" means "to … affect; sway." *See Dictionary.com.*

ii. Increased Competition for Listeners in the Downstream Market[77]

SoundExchange avers that interactive services and noninteractive streaming services compete with each other for listeners. SX Ex. 269; 5/13/15 Tr. 3462 (Herring). SoundExchange contends that Pandora, iHeart, and Sirius XM are all keenly aware of the developing competition from interactive services. SoundExchange points to numerous examples in the record of this purported competition for listeners between interactive and noninteractive streaming services.

With regard to Pandora, SoundExchange cites the following evidence:

- Pandora's own internal documents confirm that interactive services "compete head-to-head for listener hours with services that operate under the statutory license," Kooker WDT at 16;
- Pandora identifies Spotify as a "competitor" for the "consumers [it is] trying to attract to use Pandora," SX Ex. 266 at 12; 5/13/15 Tr. 3483-84 (Herring);
- Pandora identifies as "competitor services" Spotify's Free Mobile App (described by Pandora as "enabl[ing] [a] hybrid 'lean-in'/'lean-back' experience") and Beats Music (a "[p]ure on-demand service with a novel personalization feature"), SX Ex. 266 at 15-21;
- Pandora's "Competitive Intelligence Report" details the product offerings of services like Beats, Google Play, Rdio, and Spotify, SX Ex16 52; SX Ex. 2244;
- In 2014, Pandora briefed its incoming CEO Brian McAndrews on the "[i]ncreased competition [that] exists from Apple, Google, and [other interactive] streaming services like Spotify." SX Ex. 2367; 5/27/15 Tr. 6163-65 (Fleming-Wood); and
- Pandora identified Spotify, Rdio, Deezer, Rhapsody, Slacker, Google, and Apple as "competitors" in Pandora's survey of competitors' product strategies and business models in a "Strategic Planning Overview." SX Ex. 263 at 23.

Similarly, with regard to iHeart, SoundExchange notes the following evidence of competition between interactive streaming services and iHeart's custom noninteractive streaming service:

- iHeart consistently identifies interactive services like [redacted] [redacted] and [redacted] as competitors. SX Ex. 1262 at 4-11; SX Ex. 2157 at 5.
- iHeart has monitored [redacted] on its "competitor tracker" since [redacted] first launched [redacted] SX Ex. 211 at 6.
- iHeart has strategized as to how it could "match or beat [[redacted]'s] experience," and listed "major roadmap items to deal with [redacted]." Id. at 2, 6.

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[77] This proceeding involves two aspects of a vertical market: (1) the "*upstream* royalty market," in which record companies charge streaming services for the right to access the record companies' repertoires of sound recordings; and (2) the "*downstream* consumer market" in which streaming services offer music to listeners. Rubinfeld CWRT ¶ 132.

Finally, SoundExchange notes that Sirius XM also internally identifies interactive streaming services like [redacted] [redacted] [redacted], [redacted] and [redacted] as "competitors" for listeners of its noninteractive streaming service—My Sirius XM—and highlights [redacted] as "offer[ing] the strongest competition in terms of the quality of customization." SX Ex.1759 at 15; 5/22/15 Tr. 5461-63 (Frear). Additionally, Sirius XM conducted a service-wide survey of "competitive listening" in which it sought input from listeners not only on streaming services like [redacted] [redacted], [redacted] and [redacted] but also on interactive streaming services like [redacted] and [redacted]. SX Ex. 237 at 26.

Based on his proffered evidence of "convergence" and "downstream competition," Dr. Rubinfeld concluded that agreements between interactive streaming services and record companies were an appropriate foundation upon which to base a marketplace benchmark for determining rates in this proceeding. 5/15/15 Tr. 1785 (Rubinfeld).

b. Comparability of Dr. Rubinfeld's Proffered Interactive Streaming Services Benchmark to the Hypothetical Market

Dr. Rubinfeld asserts that his proposed interactive streaming services benchmark satisfies the following four part-test that he contends comprises the standard that the Judges applied in the *Web III Remand* to determine the usefulness of a proffered benchmark:

Willing buyer and seller test: Dr. Rubinfeld contends that the rates that the Judges are required to set must be those that would have been negotiated in a hypothetical marketplace between a willing buyer and a willing seller. Rubinfeld CWDT at ¶ 122(a). Dr. Rubinfeld opined that the interactive streaming services agreements upon which he based his proffered benchmark are indicative of the results of negotiations between willing buyers and willing sellers because they were entered into voluntarily between parties who did not have the option of electing the statutory license. *Id.* at ¶ 158(a).

Same parties test: Dr. Rubinfeld contends that the buyers and sellers in the hypothetical marketplace that the Judges are tasked with replicating (*i.e.*, statutory webcasting services and record companies, respectively) are "similar" to the buyers and sellers in his proffered benchmark. *Id.* at ¶¶ 122(b) and 158(b).

Absence of Statutory license test: Dr. Rubinfeld contends that the hypothetical marketplace is one in which there is no statutory license. *Id.* at ¶ 122(c). He opines that, among the spectrum of potential benchmarks that could have been offered, a benchmark based upon interactive streaming services agreements is least likely to be influenced by the statutory license because interactive services cannot default to the statutory license and therefore, according to Dr. Rubinfeld, his proffered benchmark is an appropriate replication of a market without a statutory license. *Id.* at ¶ 158(c).

Same rights test: Dr. Rubinfeld asserts that the products sold in the hypothetical marketplace consist of a blanket license for the record companies' complete repertoires of sound recordings, to be used in compliance with the DMCA requirements. *Id.* ¶ 122(d). Unlike the other three comparability tests discussed above, with regard to the "same rights test," Dr. Rubinfeld contends that certain adjustments must be made to enhance the comparability of the proffered benchmark to the hypothetical market. Dr. Rubinfeld asserts that these adjustments are necessary because the agreements upon which his proposed benchmark is based provide various functionality that is not permitted by the statutory license (*i.e.*, “on demand” choice of songs; unlimited skips; and “cached” downloads). *Id.* at ¶ 158(d).[78]

Therefore, according to Dr. Rubinfeld, “adjustments can and should be made to account for these differences when applying the set of interactive benchmarks.” *Id.*[79]

c. Per-Play “Ratio Equivalency” in Noninteractive and Interactive Markets

Dr. Rubinfeld “assumed that the ratio of the average retail subscription price to the per-subscriber royalty paid by the licensee to the record label is approximately the same in both interactive and noninteractive markets.” Rubinfeld CWDT at ¶ 169. This “ratio equivalency” is best presented by the following equation:

$$\frac{[A]}{[B]} = \frac{[C]}{[D]}$$

Where:

[A] = Avg. Retail ***Interactive*** Subscription Price

[B] = ***Interactive*** Subscriber Royalty Rate

[C] = Avg. Retail ***Noninteractive*** Subscription Price

[D] = ***Noninteractive*** Subscriber Royalty Rate

Dr. Rubinfeld testified that this “ratio equivalency” assumption is not only important, but indeed is foundational to his entire analysis. 5/6/15 Tr. 2026 (Rubinfeld).[80]

Dr. Rubinfeld calculated the interactive numerator and denominator [A] and [B], and the noninteractive numerator [C], from available data in the agreements he had analyzed. Dr. Rubinfeld did not have data to calculate the noninteractive denominator [D] – *i.e*., the per-play “Noninteractive Subscriber Royalty Rate.” Therefore, Dr. Rubinfeld attempted to estimate this number by: (1) applying the above equation; and (2) making what he describes as the necessary adjustments to the rate he derives to account for differences between the interactive and noninteractive markets and thus satisfy the “same rights” test.

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[78] Dr. Rubinfeld also noted that in the interactive streaming services agreements that formed the basis of his proffered benchmark, the licensed rights do not consist of a blanket license for the record companies’ complete repertoires of sound recordings. Instead, artist/labels may limit (or exclude) the right to license certain content from interactive streaming services. *Id.* Dr. Rubinfeld did not offer any proposed adjustments to account for this distinction.

[79] Dr. Rubinfeld made such adjustments, as discussed *infra*. Understanding those adjustments in the proper context requires a discussion of Dr. Rubinfeld’s basic model, which follows.

[80] This “ratio equivalency” assumption in Dr. Rubinfeld’s model is essentially the same as the assumption made by Dr. Pelcovits on behalf of SoundExchange in *Web II* and *Web III*. *See* Rubinfeld CWDT ¶ 207, n. 124(acknowledging that he followed “past practices”); 5/6/1/155 Tr. 2026-27 (confirming that his reference to “past practices” referred to Dr. Pelcovits’s approach). Dr. Rubinfeld indicates, however, that his application of the interactive benchmark analysis does not suffer from the defects in Dr. Pelcovits’ application of that model in a prior proceeding. *Id.* at 2027-28.

More particularly, to determine his Interactive Numerator [*A*] (the average monthly retail interactive subscription price), Dr. Rubinfeld calculated "the simple average of the [monthly] subscription prices for the interactive services, which turned out to be in this case $9.86." 5/5/15 Tr. 1797 (Rubinfeld).

To determine his Interactive Denominator [*B*] in his ratio (the interactive subscriber royalty rate), Dr. Rubinfeld first identified the average minimum per-play rate as defined in each of his selected interactive agreements. Rubinfeld CWDT ¶ 205. Next, Dr. Rubinfeld identified the various forms of non per-play consideration, if any, in these agreements, which included non-recoupable cash payments and advertising commitments with an explicit financial value. Rubinfeld CWDT ¶ 218. To convert these lump-sum payments and values into per-play values, Dr. Rubinfeld divided these payments by the number of actual plays (as set forth in the applicable service's performance statements). *Id.*[81] He then added this derived per-play value to the stated (*i.e.*, headline) per-play rate. Dr. Rubinfeld then took an average of these per-play rates, weighted by revenue, *id.* ¶ 203, to determine the interactive subscriber royalty rate for his interactive benchmark agreements.

Having obtained values for [*A*] and [*B*], Dr. Rubinfeld was able to calculate that the direct agreements with the interactive services provided record companies with a minimum revenue share that generally ranged between 50 percent and 60 percent of the services' revenues (based on the record company's share of total streams), with the majority falling between 55 percent and 60 percent. Rubinfeld CWDT ¶ 206 and, Appx. 1. Thus, given Dr. Rubinfeld's assumption that the ratios should be equal in both markets, the per-play royalty rate for noninteractive services [*D*] (*i.e.*, the statutory rate) would also have to provide record companies with the same minimum percentage of revenue out of [*C*] (the average monthly retail noninteractive subscription price).

However, Dr. Rubinfeld needed first to calculate [*C*] (the average monthly retail noninteractive subscription price). Dr. Rubinfeld calculated [*C*] – as he had calculated [*A*] – as a simple average of the monthly subscription prices for the services he had identified as "noninteractive." Because of varying rates within each service (depending on whether the average is computed using monthly or yearly fees), the average ranged between $4.84 and $5.25. 5/5/15 Tr. 1797 (Rubinfeld); Rubinfeld CWDT ¶ 207.

Having calculated values for [*A*], [*B*] and [*C*], Dr. Rubinfeld thus could, and did, use the ratio of the interactive to noninteractive subscription prices (the ratio of [*A*] to [*C*][82]) to solve for [*D*] (the statutory noninteractive per-play royalty rate). Dr. Rubinfeld determined that the ratio of the two monthly subscription prices ranged between 1.88 and 2.04.[83] Dr. Rubinfeld applied

[81] If the agreements provided the record companies with rights that were not quantifiable (*e.g.*, data provision or equity stakes), Dr. Rubinfeld did not account for the possible value of those rights in his benchmark calculation. *Id.*

[82] As a basic mathematical point, if $[A]/[B] = [C]/[D]$, then $[A]/[C] = [B]/[D]$. Thus, assuming Dr. Rubinfeld's approach was valid, he could mathematically determine [*D*] (the statutory noninteractive rate) by applying the ratio of [*A*] to [*C*], since he had calculated a value for [*B*] (the interactive royalty rate).

[83] 9.86/4.84=2.04 (rounded). 9.86/5.25=1.88 (rounded).

what he considered to be a reasonable and conservative figure within this range, 2.00, as a discount factor to make his proffered downward "interactivity adjustment" to the royalty rate for interactive services, which he then applied to determine his proposed royalty rate for noninteractive services.

i. SoundExchange's Alternative Calculation and Confirmation of its "Interactivity Adjustment"

Dr. Rubinfeld attempted to confirm the reasonableness of his 2.0 interactivity adjustment by considering a different method of calculating the adjustment, undertaken by another SoundExchange expert economic witness, Dr. Daniel McFadden. Rubinfeld CWDT ¶¶ 171, 209. Dr. McFadden conducted a "conjoint survey"[84] to determine the value that future consumers of digital streaming services place on various features of those services. Dr. McFadden determined the value that future consumers place on various features that are available on streaming services, such as: (1) limited or unlimited skips; (2) offline listening; (3) on-demand (desktop and mobile); (4) addition of mobile service; (5) playlists (from algorithms and "tastemakers"); (6) presence or absence of advertising; and (7) catalog size between one million and twenty million. SX Ex. 15 ¶ 9 (McFadden WDT).

Relying upon the entire sample of respondents to Dr. McFadden's survey, Dr. Rubinfeld summed the *average* willingness to pay (WTP)[85] values for various attributes for hypothetical interactive and noninteractive services, in the following manner.

- On the interactive side, Dr. Rubinfeld included the following attributes: (1) unlimited skips; (2) offline listening; (3) on-demand availability (desktop and mobile); (4) mobile service; (5) playlists (from algorithms and "tastemakers"); (6) absence of advertising; and (7) catalog size between one million and twenty million)
- On the noninteractive side, Dr. Rubinfeld included these attributes but excluded the following features not offered by statutory services: (1) unlimited skips; (2) offline listening; and (3) on-demand availability (desktop and mobile); and catalogs greater than ten million (as arguably more reflective of noninteractive catalog sizes in the market). *Id*.

Rubinfeld CWDT ¶ 209, SX Ex. 56 (Rubinfeld CWDT Ex. 14).

According to Dr. Rubinfeld, the survey results from Dr. McFadden's conjoint survey indicated an interactivity ratio of 1.90, which Dr. Rubinfeld noted was less than the 2.0 interactivity ratio calculated by Dr. Rubinfeld through his own methodology, discussed *supra*.

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[84] A conjoint survey creates a slate of alternative products and asks the consumer to identify which product he or she most prefers. The sets of products are designed to realistically mimic the actual market process, in which a consumer is presented with and chooses among various competing bundles of alternatives. By presenting each consumer with several sets of choices, the researcher can determine the relative importance and dollar value that consumers place on each of the attributes. McFadden WDT ¶ 13.

[85] The word "average" is italicized in the text, *supra*, to presage an important element of Dr. McFadden's results, one that he identified and upon which one of the Services' economic experts, Dr. Steven Peterson, elaborated the relationship between the *average* WTP in Dr. McFadden's survey and the *bimodal nature* of Dr. McFadden's WTP results. That issue is discussed further in this determination.

(Because the interactivity ratio measures the relationship of interactive subscription prices to noninteractive subscription prices, the lower 1.90 ratio would indicate that noninteractive subscription prices are closer to interactive subscription prices, raising the benchmark interactive royalty rate as compared to Dr. Rubinfeld's 2.0 ratio.) Accordingly, Dr. Rubinfeld concluded that Dr. McFadden's alternative method of calculating the value of interactivity confirmed that Dr. Rubinfeld's own 2.0 interactivity adjustment was not only reasonable, but conservative. Rubinfeld CWDT ¶ 210.

ii. Additional Adjustments Made by Dr. Rubinfeld

The other differences between the interactive market and the noninteractive market that, according to Dr. Rubinfeld, required further adjustment before he could determine a per-play royalty rate based on his interactive benchmark analysis are described below.

(A) Adjustment for royalty-bearing plays (skips and pre-1972 recordings)

In his analysis, Dr. Rubinfeld accounted for the fact that, under the statute, a "skip," *i.e.*, a song that that a listener skips after several seconds, is considered a royalty-bearing play for a noninteractive service. By contrast, interactive services, pursuant to their direct license agreements with record companies, typically are permitted to exclude from the royalty obligation at least some skips. SX Ex.17 ¶ 212 (Rubinfeld CWDT). Offsetting to some extent this downward adjustment, according to Dr. Rubinfeld, was his understanding that statutory services (such as Pandora and Sirius XM) contend that they are not required to pay royalties for pre-1972 sound recordings under federal copyright law.[86] *Id.* ¶ 213 (Rubinfeld CWDT). However, Dr. Rubinfeld understood that directly-licensed interactive services, such as those in his proffered benchmarks, are usually bound by contract to pay royalties on pre-1972 sound recordings. *Id.*

In order to make an "apples-to-apples" comparison, Dr. Rubinfeld therefore corrected for these differences in royalty-bearing plays in his interactive benchmark market and the statutory noninteractive market. SX Ex. 29 ¶ 214 (Rubinfeld CWRT). Applying the foregoing factors, Dr. Rubinfeld calculated that the ratio of (i) royalty-bearing plays in his interactive benchmark market to (ii) royalty-bearing plays in the statutory noninteractive market was 1.0: 1.1. Accordingly, Dr. Rubinfeld divided his per-play rate (as calculated in the prior steps, *supra*) by a factor of 1.1.[87]

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[86] The Copyright Act only covers sound recordings fixed after February 15, 1972—the effective date of the Sound Recording Amendment, Pub. L. No. 92-140, 85 Stat. 391 (1971). Protection, if any, for sound recordings fixed prior to that date derives from state law.

[87] Dr. Rubinfeld calculated the 1.1 adjustment factor by: (i) estimating the number of royalty- bearing plays on a hypothetical service that does not pay for skips, utilizing information about the number of skips; the average skip length; song length; and ad minutes per hour, and then dividing that number by (ii) the estimated number of royalty-bearing plays as determined by analyzing Pandora's SEC filings. Rubinfeld CWDT ¶ 216; SX Ex. 57 (Rubinfeld CWDT Ex. 15a); SX Ex.58 (Rubinfeld CWDT Ex. 15b).

(B) Adjustment for Indies

Dr. Rubinfeld assumed that, on average, independent record companies, commonly known as Indies, (*i.e.*, those not owned by (or by a division of) Universal, Sony or Warner) would likely negotiate less beneficial arrangements with interactive services than would Majors. Rubinfeld CWDT ¶¶ 220, 223. Based on this assumption, he made a further assumption that the difference in the consideration received by the Majors and the Indies in the interactive market would be reflected completely in the assumed fact that Indies "would not receive any of the non per-play financial or other unquantified consideration major record companies receive …." *Id.* ¶ 223.[88] Dr. Rubinfeld then determined that the Indies accounted for an average of 24% of the streams on interactive services, and he weighted his benchmark by assuming that this 24% figure was also applicable to the noninteractive market. *Id.* ¶ 225.[89]

After applying the foregoing steps and adjustments, Dr. Rubinfeld calculated that, for the year 2014 (the year for which he had and applied data), the per-play royalty rate for noninteractive services implied by the interactive benchmark equaled $0.002376, or 0.2376 cents. SX Ex. 59 (Rubinfeld CWDT Ex. 16a).

(C) Adjustment for 2016-2020 Period

Finally, Dr. Rubinfeld determined that his proposed per-play rate should increase by a linear $0.00008 for each year in the statutory 2016-2020 period. In support of these annual increases, Dr. Rubinfeld relied upon: (1) the average $0.00008 annual increase in rates as set in *Web III*[90]*;* (2) his belief that there would be an ever-increasing convergence in the retail prices of statutory and nonstatutory services; (3) the presence of rate escalation provisions in the iHeart/Warner Agreement and the Pandora/Merlin Agreement; and (4) the presence of annual rate escalations in the *Web III* rates. Rubinfeld CWDT ¶¶ 137-141; PAN Ex. 5014 at 4, 5 (Pandora/Merlin Agreement). Thus, Dr. Rubinfeld increased his 2014 interactive benchmark of $0.002376 by $0.00008, for a 2015 benchmark of $0.002456. That 2015 figure was again

[88] Apparently, Dr. Rubinfeld did not separately examine the Indies/Services agreements in his collected interactive agreements to test his assumptions and apply the actual differences, if any, between the headline rates and other compensation received by the Indies, on the one hand, and by the Majors, on the other hand. *See* Rubinfeld CWDT ¶ 223 ("I also *assume* that these independent record companies receive the same per-play rates and proportionate revenue shares as the majors.") (emphasis added). Dr. Rubinfeld later modified his direct testimony to note what he described as confirmatory evidence – that in [redacted]'s [redacted] agreements with the Majors and the Indies, "the majors received [redacted] and the indies did not." SX Ex. 128 ¶ 29 (Rubinfeld CWDT App. 2.).

[89] Dr. Rubinfeld noted that Nielsen Soundscan information he possessed indicated that the independent record companies' 2013 market share was higher – it was approximately 35% -- but he chose to use the lower 24% interactive market figure. Rubinfeld CWDT ¶ 224 and, n. 131 (continuing to rely on the 24% figure for interactive plays of Indie sound recordings and noting (but not linking – logically or evidentially) the unsourced assertion that "a substantial portion of those sound recordings were distributed by major labels.").

[90] *See* 37 C.F.R. §380.3(a)(1) (setting forth *Web III* rates). Although the a*verage* rate increased annually by $0.00008, the rate remained constant for 2012 and 2013 (at $0.0021) and also remained constant for 2014 and 2015 (at $0.0023). Thus, in 50% of the year-over-year changes, the Judges declined to make any changes in the *Web III* rates.

increased by $0.00008 to reflect a rate for 2016 of $0.002536 (rounded by Dr. Rubinfeld to $0.0025).

iii. The Interactive Rate is an "Effectively Competitive" Benchmark Rate

SoundExchange maintains that Dr. Rubinfeld's interactive benchmark rate reflects effective competition because downstream competition mitigates any arguable market power record companies may have in the upstream licensing market. (However, it is worthy of note that SoundExchange did not attempt to demonstrate that the interactive market on which it relies for its benchmark is effectively competitive, until its rebuttal case, after the Services had made their direct arguments as to why the interactive market is not effectively competitive.) In support of its argument, SoundExchange relies on the testimony of another of its economic experts, Dr. Eric Talley.

According to Dr. Talley, rates in the interactive market are constrained by two factors. First, if there is an "elastic downstream demand curve" for an input (such as a sound recording), upstream prices for that input will be constrained. Second, if the "expenditure on that input versus other inputs" – "the cost intensity of that particular input" – is proportionately significant compared to other inputs in the downstream market, the constraint on pricing in the upstream market will be more pronounced. 5/27/15 Tr. 6054-55 (Talley).[91]

According to Dr. Talley, both of these factors are present here. First, high price elasticity exists downstream because of the threat from piracy and because of competition from other outlets, such as YouTube. Second, the variable costs associated with licenses are a very significant element of the downstream sellers' expenses. Thus, these elasticities would be passed upstream. *Id.* at 6054-58.

Dr. Talley then noted that his theoretical modeling demonstrated that such downstream competitive forces "will cause the WBWS price to be tightly clustered, reducing variations due to differences in bargaining power." SX Ex. 19, at 35, 44-45 (Talley WRT); *see also* SX Ex. 29 ¶ 132 (Rubinfeld CWRT).

Sound Exchange notes that Dr. Talley's assertions regarding the highly competitive state of the downstream market is essentially undisputed and borne out by the evidence. *See* SX PFF ¶¶ 449-458 (and record citations therein). Moreover, SoundExchange notes that Drs. Shapiro and Katz acknowledged that the presence of some "free alternatives" in the downstream market have reduced interactive rates in the upstream market. 5/20/15 Tr. 5049 (Shapiro); 5/11/15/15 Tr. 2973 (Katz).

SoundExchange also points to its negotiations with interactive services as evidence that the upstream interactive market is effectively competitive. Dr. Rubinfeld, described the

[91] Dr. Talley's testimony describes factors pertinent to the economic "Hicks-Marshall" principle, which provides that the upstream demand for a factor of production (such as sound recording licenses demanded by a webcaster) is "derived" in part from the downstream demand for the finished product (such as a subscription service that offers such sound recordings). Further, the elasticity of demand downstream will be reflected in the upstream demand for that factor of production.

negotiations as a “real give and take,” where the labels “have in mind a particular goal, but they have to give up something,” which is “consistent” with the “view that there’s some bargaining power on the part of the services.” 5/5/15 Tr. 1863 (Rubinfeld). He further testified that the possible bargaining range would at best only reveal “something about the other party’s willingness to pay or willingness to sell.” *Id*. at 1864-65. Dr. Rubinfeld and SoundExchange reached these conclusions based on their consideration of the back and forth and ultimate concessions record companies make in the final agreements reached (or abandoned) with Apple, Google, Beats, Spotify and Amazon. *See* SX PFF ¶ 471-80 (and citations to the record therein).

d. Direct Licenses for Noninteractive Services Corroborate Dr. Rubinfeld’s Interactive Benchmark

SoundExchange offered analyses of direct licenses between record companies and several noninteractive services to corroborate its interactive benchmark analysis. These include two licenses from major record companies to Apple, Inc. (Apple) for its iTunes Radio service, and several licenses for what SoundExchange describes as noninteractive offerings by services that also offer interactive streaming.

i. Apple Agreements

SoundExchange presented evidence of Apple’s license agreements with Warner and Sony, respectively, for Apple’s iTunes Radio service. iTunes Radio is a streaming service that offers users the opportunity to listen to playlists selected by industry “tastemakers,” as well as playlists that are generated by an algorithm based upon a song or artist “seeded” by the listener (similar to Pandora’s service). Dr. Rubinfeld described the iTunes Radio service as “DMCA compliant,” although he acknowledged that the rights granted to Apple are “not identical to the statutory license.” Rubinfeld CWRT, App. 2, ¶¶ 1-2.[92] Dr. Rubinfeld concluded that the effective per-play royalty rate under the Apple licenses with Warner and Sony range from $0.[redacted] to $0.[redacted], the low end of which exceeds the highest rate proposed by SoundExchange. *Id*. at ¶¶ 30, 42.

SoundExchange offered the Apple agreements as part of its rebuttal of a number of the licensee services’ criticisms of Dr. Rubinfeld’s interactive benchmark analysis. Dr. Rubinfeld contended that, because the (noninteractive) Apple agreements were not susceptible to those criticisms, those criticisms would be rebutted by evidence that the royalty rates derived from the Apple agreements were roughly equivalent to those derived from the interactive benchmark analysis. *Id*. at ¶ 3.

Specifically, Dr. Rubinfeld argued that the following critiques that the licensee services levied against his interactive benchmark analysis would not apply to Apple’s agreements with the majors for its noninteractive service.

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[92] All testimony on the subject of iTunes Radio was taken prior to the launch of Apple Music. Consequently, the discussion of iTunes Radio in this determination does not reflect any changes Apple may have made to the service as a result of that launch.

- The majors’ repertoires are “must haves” for interactive services, enabling the majors to charge supracompetitive prices. Id. at ¶ 4. The majors’ repertoires are not “must haves” for a noninteractive service, since a noninteractive service (and not its customers) determines which songs will be played.
- “[B]ecause noninteractive services purportedly have the ability to steer listeners to sound recordings offered by independent music labels and away from majors (or away from any particular major’s repertoire), record label catalogs are substitutes.” Id. at ¶ 5. iTunes Radio would have the same ability to steer listeners as any other noninteractive service. Id. at ¶ 7.
- “[B]ecause interactive services are primarily subscription services, they have substantially higher ARPUs than noninteractive services, which are primarily ad-supported,” and would therefore pay substantially higher royalties. Id. at 6. iTunes Radio, by contrast, is a nonsubscription service that, like other noninteractive services, is primarily ad-supported. Id. at ¶ 7.

Dr. Rubinfeld also offered two additional reasons why the Judges should consider the Apple agreements. First, he noted that Apple’s “unique position in the marketplace” confers substantial bargaining power in its negotiations with record companies, tending to negate any argument based on a disparity of bargaining power between licensor and licensee. *Id*. Second, Dr. Rubinfeld argued that the non-precedential language in the agreements demonstrates that the parties did not expect them to be used in this proceeding.[93] As a consequence, he suggested that the shadow of the statutory license may not affect the Apple agreements as strongly as other noninteractive benchmarks (*e.g*., the Pandora-Merlin and iHeart-Warner agreements). *Id*. at ¶ 8.

ii. Other Noninteractive Agreements

SoundExchange also offered Dr. Rubinfeld’s analysis of record company licenses to Beats Music’s “The Sentence,” Spotify’s “Shuffle” service, Rhapsody’s “Unradio,” and Nokia’s “MixRadio” to corroborate its interactive benchmark analysis. SoundExchange describes these services as noninteractive offerings, and concludes that the effective per-play rates in the agreements exceed the per-play rate derived from Dr. Rubinfeld’s benchmark analysis of interactive service agreements. *See* Rubinfeld CWRT ¶¶ 179-201.

[93] That proposition is questionable in light of other evidence of what euphemistically could be called “strategic behavior” by Apple and one of the major record companies. *See* IHM Ex. 3517 ([redacted] email from [redacted] to [redacted]) ([redacted]”) (emphasis added).

3. The Services' Opposition to the SoundExchange Rate Proposal and the Judges' Determination on the Issues

a. Dr. Rubinfeld's Interactive Benchmark must be Adjusted to Reflect Effective Competition

The Services' expert economic witnesses all agreed that SoundExchange's proposed interactive benchmark would fail to establish rates that are "effectively competitive." *See, e.g.*, Katz WDT ¶¶ 5, 17, 18-34; Shapiro WDT at 3, 10-16; Fischel & Lichtman AWDT ¶ 10; 5/11/15/15 Tr. 2799:9-16; 2800:3-18; 2801:9-17 (Katz); 5/8/15 Tr. 2604:10-22 (Shapiro); 5/15/15/15 Tr. 4094:7-19 (Lichtman); *see also, e.g.*, Shapiro WDT at10, n.11 ("My approach here is consistent with the one taken by the Judges in the *Web III Remand.*"). More particularly, the Services' economists equate the "effectively competitive" requirement as essentially equivalent to the economic concept of "workable competition." In its essence, "[a] workably competitive market is one not subject to the exercise of significant market power." Shapiro WDT at 10.[94]

The NAB's economic expert, Dr. Katz, essentially analogizes the D.C. Circuit's contrast between "metaphysical" and "effective" competition to the economists' contrast between "perfect" and 'workable" competition:

> The theoretical conditions of *perfect* competition often are not satisfied in actual markets …. It is thus necessary to consider markets that are competitive, but not perfectly so. Economists have long examined this concept, beginning with Professor J.M. Clark, who introduced the concept of "workable" competition. Economists also refer to such markets as reasonably or effectively competitive.

Katz WDT ¶29 (emphasis in original).

Dr. Shapiro describes a "workably" or "effectively" competitive market as follows:

> The hallmark of a workably competitive market is regular, significant competition among suppliers for the patronage of buyers. … A market can be workably competitive even when the products or services offered by different sellers are differentiated, so long as no single supplier has significant unilateral market power. Indeed, this is the norm for information products such as books, video programming, or software applications. Workable competition does not require marginal cost pricing or anything approaching the textbook model of perfect competition. A market can also be workably competitive even if it is quite concentrated, so long as the suppliers compete regularly and energetically to win business from each other. … In contrast, a market that is monopolized or controlled by a cartel is *not* workably competitive. If such markets were

[94] *See* J. M. Clark, *Toward a Concept of Workable Competition*, 30 Am. Econ. Rev. 241-56 (1940); Jesse Markham, *An Alternative Approach To The Concept Of Workable Competition*, 40 Am. Econ. Rev. 349, 349 (1950) (treating "effective competition" and "workable competition" as synonymous).

> considered workably competitive, the concept of workable competition would lose all meaning. Likewise, a moderately or highly concentrated market in which the leading suppliers tacitly collude is not workably competitive. For example, if the leading suppliers have settled into some form of coordinated interaction, *e.g.*, by refraining from competing actively to poach each other's customers, the market will fail to be workably competitive. More generally, if the leading suppliers are colluding – either expressly or tacitly – the market is not workably competitive.

Shapiro WDT at 10-11 (emphasis in original).

According to the Services' economists, the presence or absence of "workable" or "effective" competition in the present case must be determined by recognizing that the noninteractive services are "aggregators," that is, they aggregate sound recordings they have licensed from record companies in the upstream market and then provide access to such licensed sound recordings to listeners in the downstream market. In such a market, "workable competition" is present, according to the Services' economists, if "aggregators can offer attractive packages without the products of particular suppliers and to the extent to which these aggregators can steer their customers toward or away from particular suppliers." Shapiro WDT at 11. This ability to steer toward or away from certain suppliers is an example of price competition, according to Dr. Katz. *See* Katz WDT at ¶ 32 ("[C]ompetition arises *only* when buyers have the ability to substitute the offerings of one seller for those of another. It is this possibility of substitution that drives sellers to offer higher quality and lower prices in order to attract buyers to themselves rather than their rivals. Conversely, when buyers lack the ability to substitute among the offerings of different sellers, there is no competition among sellers to attract customers.") (emphasis in original).

The Services assert that the interactive service agreements that SoundExchange proffers as appropriate benchmarks are not the product of such an "effectively competitive" market. In support of this assertion, the Services advance several arguments.

First, the Services maintain that there is a fundamental difference between interactive and noninteractive services that precludes the former from serving as an "effectively competitive" benchmark for the latter. That fundamental distinction arises, they aver, from the fact that a *sine qua non* of on-demand services is that *each downstream listener* chooses the artists, albums, and tracks to which he or she listens, as well as the timing and frequency of each play. For this reason, on-demand interactive services must always be in a position to play any sound recording a listener might demand, and the on-demand services therefore lack the ability to steer performances away from higher-priced labels and toward lower-cost providers. *See* Shapiro WRT, at 23; *see also* Katz WDT ¶ 17 (describing buyer choice as the "essence of competition" and opining that "[t]he creation of a rate-determination process and its willing-buyer/willing-seller standard can best be reconciled with economic principles and common sense by interpreting willing buyers as those who have meaningful choices among competing sellers, rather than facing a single, all-or-nothing offer from a monopolist.").

Second, the Services note that a lack of effective competition in the upstream interactive market is confirmed by the testimony of numerous SoundExchange witnesses, who conceded that the licenses between record labels and on-demand services are the product of a market devoid of any price competition between record companies to obtain additional plays on on-demand services. *See* 4/28/15 Tr. 415-16 (Kooker) (Sony has "never cut [its] price responding to a competitor's proposal or for more plays."); 4/30/15 Tr. 1097-99 (A. Harrison) (Universal has never lowered a proposed rate as a consequence of finding out that another Major was offering a lower rate, and, more broadly, Universal does not take any actions to compete with Sony or Warner with respect to services); 5/7/15 Tr. 2485-86 (Wilcox) (Warner has never offered a lower rate to an interactive service for more plays).

Third, the Services' economists concluded that the reason for the absence of price competition in the upstream interactive market is that the repertoires of each Major are "complements" for each other. As Dr. Shapiro opined:

> In the parlance of economics, the "must have" suppliers are complements, not substitutes, because buyers need each of them and cannot substitute one for another …. This concept is well known in economics. When two essential inputs must be used together, they are often referred to as "Cournot Complements." The evidence … shows that the repertoires of the major record companies are Cournot Complements for interactive services.
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> * * *
>
> The evidence shows clearly that the major interactive services "must have" the music of each major record company to be commercially viable. The repertoires of the major record companies are not substitutes for each other in the eyes of either interactive services or the record companies themselves. This means that there is no true "buyer choice" in this market. Thus, the market for licensing recorded music to interactive services is not workably competitive ….

Shapiro WRT, at 15.

Fourth, the Services note that SoundExchange's economic expert, Dr. Rubinfeld, did not perform any separate analysis to determine whether the proffered interactive benchmark reflected the dynamics of a competitive market. Rather, he assumed, *i.e.*, he took "for granted," that his proffered interactive benchmark market was sufficiently competitive. 5/5/15 Tr. 1922 (Rubinfeld).

Fifth, the Services rely upon numerous statements in several documents from SoundExchange's own principal advocates in the present case that had been submitted to the Federal Trade Commission (FTC) on behalf of Universal seeking approval of Universal's then-proposed merger with EMI—subsequently approved by the FTC and later consummated.[95] These documents, according to the Services, reveal that Universal and its advocates asserted to the FTC that the proposed merger would not lessen competition *because the market for*

[95] Professor Rubinfeld acted as economic advisor to UMG and EMI in relation to that transaction, and Mr. Pomerantz, SoundExchange's lead counsel in this proceeding, acted as UMG's counsel. 5/5/15 Tr. 1942-43; 1950-51 (Rubinfeld); PAN Ex. 5345 at 1.

interactive services was already not competitive. Specifically, the Services point to statements to the FTC by or on behalf of Universal:

[redacted]

PAN Ex. 5349, at 1-2 (Universal).

[redacted]

PAN Ex. 5349, at 17 (Universal).

[redacted]

PAN Ex. 5025, at 2, 18 (Pomerantz).

[redacted]

NAB Ex. 4129, at 41-2 (Rubinfeld).

[redacted]

PAN Ex. 5025, at 18, 21 (Pomerantz); *see* NAB Ex. 4129 (Rubinfeld) [redacted]); 5/5/15 Tr. 1956-58, 1946-47 (Rubinfeld) (*quoting* PAN Ex. 5345 (June 22 letter to the FTC) ("[redacted]

[redacted]").

[redacted]

PAN Ex. 5349, at 17 (Universal) (emphasis added); *see* PAN Ex. 5025, at 16 [redacted].

Additionally, iHeart's economic experts, Drs. Fischel and Lichtman, relied upon a [redacted] document submitted to the FTC in connection with the Universal/EMI merger, contrasting the "must have" nature of the interactive service market with the more competitive noninteractive service market: [redacted]" IHM Ex. 3054 ¶41 n.70 (Fischel/Lichtman WRT) (*quoting* SNDEX 0266588-665) (emphasis added).

Sixth, according to the Services, the foregoing points demonstrate that Dr. Rubinfeld's proffered interactive benchmark market not only fails to be competitive, but also is *even worse than a market controlled by a single monopoly supplier*. Shapiro WRT, at 18; *see also* Katz WDT ¶¶ 41-43 (By logic first identified by Antoine Cournot in 1838, firms offering complementary products tend to set higher prices than would even a monopoly seller of the same products, illustrating that suppliers of complements do not compete with one another.); PAN Ex. 5349, at 19 (Universal White Paper to FTC explaining that "[redacted]").

Seventh, the Services note that the Majors structure their contracts with the interactive services to *avoid* any price competition with the other labels and to *prevent* the on-demand services from attempting to steer users away from their repertoires. *See* 4/28/15 Tr. 441-42 (Kooker); 4/30/15 Tr. 1142 (Aaron Harrison); 5/7/15 Tr. 2473 (Wilcox). Even more particularly, the Services note that the Majors' agreements with the leading interactive services contain provisions that effectively prevent the services from favoring the artists or repertoires of one label over another. These provisions apply variously to playlists, artist or album features, editorial content, home-page placements, advertisements, album recommendations, and/or other ways the interactive services may promote particular content to their users. *See* 4/28/15 Tr. 455-56 (Kooker); 4/30/15 Tr. 1144-45 (Harrison); 6/2/15 Tr. 7202-05 (Harrison); 5/7/15 Tr. 2487-88, 2490-93 (Wilcox).

The Services disagree with SoundExchange's assertion that downstream competition causes Dr. Rubinfeld's interactive benchmark to reflect "effective competition." In fact, Dr. Katz asserts that SoundExchange's conclusion is 180 degrees wrong:

> [W]hen you have a highly competitive downstream industry, there's going to be a smaller markup of [retail] price over cost because the competitive pressures are going to tend to drive [retail] price to cost. So what that means is … for any … license fees set by the record companies, we have a highly competitive downstream market. There's going to be a smaller markup. That then makes it profitable, more profitable to set a higher price upstream. So, actually, *the more intense the competition downstream, the greater the incentive to charge a high price upstream* because you don't have to worry about so-called double marginalization.[96]

5/11/15/15 Tr. 2819 (Katz) (emphasis added).

The Services take Dr. Talley and SoundExchange to task for failing to do any empirical work to confirm whether and to what extent piracy and other downstream alternative music delivery competitors may have affected upstream interactive rates. The NAB notes that Dr. Talley admitted that he had performed no empirical analysis to ascertain whether or to what degree "downstream competition is, in fact, impacting the upstream negotiations" in the interactive market. 5/27/15 Tr. 6092-93 (Talley); *see id.* at 6058 ("I haven't done an empirical analysis of that market …."). Dr. Tally further admitted that he had not studied either the downstream interactive service market or the upstream market in which the record companies license interactive services. *Id*. at 6080-83. Finally, although Dr. Talley made certain suppositions regarding the elasticity of demand flowing from the downstream market into the upstream market, the Services note that Dr. Talley admitted that he had not attempted to calculate any elasticity of demand whatsoever, because "within the ambit of how I was retained as an expert, I did not view that as part of my charge." 5/27/15 Tr. 6093 (Talley).

The Services also note that their own experts, contrary to SoundExchange's assertions, had not acknowledged that piracy and other forms of downstream competition had or would reduce upstream interactive rates to an "effectively competitive" level. Rather, as the NAB notes, for example, Dr. Katz testified that even if piracy imposes some constraint, "that doesn't render the market effectively competitive … it may be pressure on the monopoly price, but, nonetheless, it's a monopoly price." 5/11/15 Tr. 2823 (Katz). As Dr. Katz further explained, the merger submissions made by Universal argued that the merger would lead to lower prices because it would remove the Cournot complements pricing effect between UMG and EMI, and

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[96] "Double marginalization" occurs when the upstream supplier has upstream market power and its buyer, the downstream seller, has downstream market power. In that situation, "the price of the input is marked up twice: by the upstream firm and, in terms of the final product price, by the downstream firm." W. Kip Viscusi, *et al*. *Economics of Regulation and Antitrust* 239 (2005). In the absence of downstream market power on the part of the upstream buyers/downstream sellers, the upstream firms with market power can capture the full benefit of single marginalization, *i.e.*, of price above marginal cost.

that would not have been true if prices had already been squeezed by piracy to near the competitive level:

> [T]he parties were saying, if we're allowed to merge, we would find that it would increase our profits to lower our price. So clearly, piracy had not pushed them down to such a low price that going lower would reduce their profit. They actually say, going lower would raise our profits. And what that's telling you is, along with the fact that the other majors are must have [s] as well, is [that] they were actually concerned they were pricing above the monopoly level.

5/11/15 Tr. 2825 (Katz) (citing PAN Ex. 5025 at 22).

Additionally, the NAB, again through Dr. Katz, notes that identifying a hypothetical increase in the elasticity of demand in the upstream market arising from competition in the downstream market is not the same as identifying a competitive price in the upstream market. Thus, the Services assert that, although Dr. Katz testified that piracy and other forms of downstream competition could have "some sort of an effect, and I believe it's in a downward direction," 5/11/15 Tr. 2973 (Katz), he was not opining how far such competition might have pushed down the price. They point out that, when Dr. Katz noted the hypothetical possibility that downstream competition could push upstream prices down to competitive levels, he was not suggesting that such a hypothetical circumstance exists in the interactive market. Rather, he was simply saying something is "conceivable, if you're talking about hypotheticals" or "possible," which does not imply that it is likely, or in any way true in this case. *See* 5/11/15 Tr. 2976-78 (Katz).

The Judges find that the impact of piracy and other downstream competitors (such as YouTube) does not serve to promote "effective competition" in any of the relevant upstream markets, including the upstream market for sound recordings licensed for use by interactive subscription services. SoundExchange, through the testimony of Dr. Talley, did note persuasively that in theory these downstream competitors would depress the upstream price. SoundExchange also correctly noted that Drs. Katz and Shapiro concurred with that theoretical point. However, a close reading of the testimony of Drs. Talley, Katz, and Shapiro reveals *that none of them concluded that the impact of such downstream competition would necessarily depress any upstream price to a level that would offset the upward pricing effect of complementary oligopoly.* Rather, Dr. Talley and SoundExchange invoke the vague idea that any monopoly effects—after assuming the upstream impact of downstream competition—would be "benign" or "pedantic," and Drs. Katz and Shapiro acknowledged only the *hypothetical* possibility that downstream competition in some circumstance could eliminate the anticompetitive power of upstream monopolists or complementary oligopolists.

In the present case, though, the Judges are not left with mere hypotheticals regarding whether the anticompetitive elements of the interactive market are "benign" or "pedantic." Nor are the Judges hamstrung, as SoundExchange suggests, by the alleged absence of "bright line" demarcations as to when effective competition is present and when it is not. Rather, the Judges were presented with hard and persuasive evidence that competitive steering has reduced royalty rates in the noninteractive market and would do so in the hypothetical market as well. This evidence of steering (provided by Pandora and iHeart) demonstrates a measurable range of adjustment to the prices that would be set in a market for those streaming services if the services could inject price competition via steering. Thus, the rate set in Dr. Rubinfeld's upstream interactive benchmark market should be adjusted to reflect such price competition, so that it is usable as an "effectively competitive" rate in the segment of the market to which that benchmark applies: the noninteractive subscription market.[97]

The evidence of a range of potential steering adjustments also rebuts SoundExchange's argument that the concept of "effective" or "workable" competition is "fuzzy" and that no "bright line" can be drawn between effectively competitive and non-competitive rates. The Judges find that this "line" needs to be drawn on a case-by-case basis, from the evidence and testimony adduced at the hearing. Here, the range of steering adjustments from direct noninteractive licenses has been introduced in evidence, steering experiments have confirmed the reasonableness of such an endeavor and expert testimony has explained how steering is a mechanism by which to offset the complementary oligopoly power of the Majors (while not reducing their firm-specific and copyright-specific market power).

The Services dismiss the idea that the record companies' negotiations with interactive services are evidence of an effectively competitive market. The Judges agree with the Services criticism of this assertion. As Dr. Shapiro explained, the mere existence of such negotiations is uninformative as to whether the rates negotiated between the interactive services and the Majors are competitive. Pandora PFF ¶ 237 (and citations to the record therein). Moreover, the Services note that Dr. Rubinfeld conceded that the existence of such negotiations is not evidence of a competitive market, because even monopolists negotiate with their customers. *See* 5/28/15Tr. 6487-88 (Rubinfeld) ("Q. Do firms with monopoly power ever bargain with their customers? A. Yes. Q. Do firms with monopoly power ever make concessions or change their bargaining position in response to positions taken by buyers with which they are dealing? A. Yes."). Pandora further notes that, when questioned on this issue by the Judges, Dr. Rubinfeld conceded that "the fact that they're in negotiations, *per se*, doesn't mean the market is competitive.…" 5/5/15Tr. 1861-63 (Rubinfeld).

On this issue, the Judges also agree with Dr. Katz, who noted that negotiations over price can occur between a monopolist and its customers in order to facilitate price discrimination and *increase monopoly profits* rather than to concede to more competitive prices. Specifically, Dr. Katz testified:

> Bargaining with your customers and having some of the give and take can even be a form of price discrimination in a way to get additional monopoly profits, so the mere fact that your customer asks for something and you say, okay, I will give that to you, particularly if that is going to help you get more money, the fact that

[97] It appears that SoundExchange may be making an implicit argument that the rates in its interactive benchmark market have been so reduced by downstream competition that all supranormal profits have been eliminated. However, SoundExchange did not produce evidence sufficient to show record company profits overall to support such an argument. Also, as the Judges have previously noted, and note again in this determination, the rate-setting process under section 114(f)(2)(B) is not intended to preserve any parties' profits. Moreover, if the Judges were to go down that evidentiary road and base their rate decision on profits and reasonable rates of return, the process would in essence become a public-utility style proceeding and, as noted elsewhere in this determination, no party has suggested that section 114(f)(2)(B) proceedings could be conducted in such a manner.

you do that doesn't show you lack monopoly power. It shows you are economically rational.

5/26/15 Tr. 5715-16 (Katz).

The Judges reject SoundExchange's argument that evidence of its negotiations with interactive services demonstrates that the interactive market is effectively competitive. As the Judges pointed out in their *Commencement Notice* in this proceeding, price discrimination is a feature of markets such as sound recording markets, where the marginal physical cost of licensing a sound recording is essentially zero, and is also a relatively common feature in many markets. 79 Fed. Reg. 412, 413 (January 3, 2014).

Further, the Judges cannot ignore the testimony from several record company witnesses, discussed in this determination, in which they acknowledged that they never attempted to meet their competitors' pricing when negotiating with interactive services. Thus, the existence of the negotiations noted by SoundExchange cannot override this more specific testimony.

The Judges were presented with substantial, unrebutted evidence that the interactive services market is *not* effectively competitive. The Services conclude from this that the interactive services benchmarks are wholly uninformative with regard to the rates that would be negotiated in an *effectively competitive* noninteractive market. *See* Shapiro WRT, at 47 (explaining that Professor Rubinfeld is requesting that the Judges "replicate and extend the excessive royalty rates from interactive services market – where competition is manifestly not working – into the market for the licensing . . . to statutory webcasters …."). The Judges disagree.

The Services' own evidence demonstrates persuasively that competitive steering has reduced royalty rates in the noninteractive market and would do so in the hypothetical market as well. This evidence of steering (provided by Pandora and iHeart) demonstrates a measurable range of adjustment to the prices that would be set in a market for those streaming services if the services could inject price competition via steering. Thus, the rate set in Dr. Rubinfeld's upstream interactive benchmark market can and should be adjusted to reflect such price competition, in order to render it is usable as an "effectively competitive" rate in the segment of the market to which that benchmark applies – the noninteractive subscription market.[98]

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b. Dr. Rubinfeld's Interactive Benchmark is Applicable only to the Subscription Market

The Judges find that the interactive benchmark proposed by SoundExchange (adjusted as discussed in the previous section) is informative—but only to a particular segment of the noninteractive marketplace. The foundational aspect of Dr. Rubinfeld's interactive benchmark is his assumed equality between two ratios: (1) subscription revenues to royalties in the *interactive* market; and (2) subscription revenues to royalties in the *noninteractive* market. The Services claim, however, that Dr. Rubinfeld provided *no economic basis* for this "assumption." For example, the NAB asserts that Dr. Rubinfeld admitted that he was only "follow[ing] past practices" of Dr. Michael Pelcovits, an economic witness for SoundExchange in *Web II* and *Web III*. Rubinfeld CWDT ¶ 207 n. 124, 5/6/15 Tr. 2026-27 (Rubinfeld). This criticism was echoed by Pandora's economic expert, Dr. Shapiro, who testified "there is simply no plausible economic rationale that would support the use of Professor Rubinfeld's interactivity adjustment." PAN Ex. 5023 at 29-30 (Shapiro WRT).

However, Dr. Rubinfeld's oral testimony, and the testimony of the Services' economic experts, indicated that an economic principle indeed underlies his assumed equivalency in these ratios. More particularly, Dr. Rubinfeld acknowledged that his "ratio equivalency" was intended to create a rate whereby every marginal increase in subscription revenue would result in the same increase in royalty revenue, whether that marginal increase in subscription occurred in the interactive market or the noninteractive market. 5/5/15 Tr. 1767 (Rubinfeld). This result, Dr. Rubinfeld agreed, reflected an application of rational profit maximizing behavior by a willing seller, as explained in colloquy with the Judges:

> [THE JUDGES]
>
> [T]hat's an application … of a fundamental economic process of profit maximization …. [The record companies] would want to make sure that the marginal return that they could get in each sector would be equal, because if the marginal return was greater in the interactive space than the noninteractive … you would want to continue to pour resources, recordings in this case, into the [interactive] space until that marginal return was equivalent to the return in the noninteractive space. Would that be correct?
>
> [DR. RUBINFELD]
>
> It would. You said that just the way I would like to have said it when I was teaching that subject. Yes, I agree with that.

5/7/15 Tr. 2325 (Rubinfeld); *see* Rubinfeld CWRT ¶ 172 ("All else equal, the interactivity adjustment sets statutory rates that represent the same fraction of subscription prices as paid by the on-demand services ….").

Thus, Dr. Rubinfeld's "ratio equivalency," assumes a 1:1 "opportunity cost" for record companies, whereby, on the margin, a dollar of revenue spent on a subscription to a noninteractive service is a lost opportunity for royalties from a dollar to be spent on a subscription to an interactive service. Accordingly, and contrary to the Services' criticism, Dr. Rubinfeld's "ratio equivalency" *does* possess an underlying economic rationale.

However, the unwarranted assumptions lurking behind Dr. Rubinfeld's economic rationale were noted by the Services' economic expert witnesses. For example, Dr. Lichtman, an economic expert for iHeart, testified:

> [Dr. Rubinfeld] assum[es], I think, a perfect substitution … assumptions about substitution, competition how all of these markets interrelate …. [I]t's intuitive. I understand why he was drawn to it. It's so nice to say, yes, roughly these will all be the same, revenue to royalty, revenue to royalty.

5/16/15 Tr. 4043-44 (Lichtman).

Dr. Rubinfeld's "ratio equivalency" – as a means toward profit maximization – was more than a theoretical abstraction. The desire of the record companies to achieve such pricing parity across markets was confirmed by a senior Warner executive who testified on behalf of SoundExchange:

> Our goal, *aspirationally and in actual results*, has been a [redacted] percent rev[enue] share in this area generally.… So we've been kind of struggling, if you will, to pull these business models up to what we think is *the level of consideration that we find appropriate for essentially all of these music models, which is the* [redacted] *range*. So it was a combination of trying to be realistic and make major progress towards *our ultimate goal*.

6/3/15 Tr. 7406 (Wilcox) (emphasis added).

Mere assumptions as between interactive and noninteractive services regarding substitution, competition, market interrelationships and the like are inadequate, and thus limit the applicable scope of Dr. Rubinfeld's "ratio equivalency" approach. The unsupported and unrealistic assumptions in the "ratio equivalency" approach are considered below.

As Dr. Lichtman noted, the "ratio equivalency" in Dr. Rubinfeld's model makes assumptions regarding substitution, and how these markets interrelate. 5/6/15 Tr. 4043-44 (Lichtman). That is, the "ratio equivalency" approach assumes that the listeners who willingly pay for a subscription to a service have a WTP equal to the WTP of those who use ad-supported (free-to-the-listener) services. However, the record evidence is overwhelming that there is a sharp dichotomy between listeners who have a positive WTP and therefore may pay a subscription fee each month for a streaming service and those listeners who have a WTP of zero.

The most persuasive evidence on this point is found in the results of the conjoint survey conducted by a SoundExchange witness, Dr. McFadden. Dr. McFadden performed his conjoint survey to determine the WTP of consumers who were provided with a menu of bundled features that reflected bundles that existed in the marketplace. His findings revealed the dichotomy regarding the WTP of consumers of noninteractive services:

> I find that consumers of streaming services divide between those who are willing to pay for these services (and the extra features they offer) and those who are averse to paying for music streaming services ….

McFadden WDT ¶ 10 (SX Ex. 15) (emphasis added).

This dichotomy was examined in detail by another economist, Dr. Steven Peterson, who was a joint witness for the NAB and Pandora. Dr. Peterson noted a critical bimodality in Dr. McFadden's data (consistent with Dr. McFadden's finding) that reflected two classes of listeners; those who would pay a positive sum for various features available in a noninteractive service and those who refused to pay any money for any features. As Dr. Peterson explained, SoundExchange and Dr. Rubinfeld rely on the average WTP among the survey participants (to confirm Dr. Rubinfeld's interactivity adjustment), but that average obscured the clear bimodality of Dr. McFadden's results:

> Dr. McFadden presents only the estimated *average* willingness to pay for each feature addressed in his survey. However, it is possible to estimate each survey participant's willingness to pay for the features addressed in the survey. Based on the information for individual respondents, Dr. McFadden notes that *there is a group of users who are averse to paying for music streaming services*.… Thus, Dr. McFadden's results are consistent with the record labels' documents that indicate many consumers have a low willingness to pay for subscription streaming services.… Moreover, the distribution is bimodal, meaning it has two peaks.… [T]he average willingness to pay for a service with no ads masks the fact that there is a bimodal distribution … of preferences over the willingness to pay for a service with no advertisements and that the peaks occur so that consumers at the peaks have divergent preferences (*i.e.*, would respond in opposite ways) regarding a service with or without advertisements.

NAB Ex. 4013 at 32-34 (Peterson CWRT) (emphasis added; footnotes omitted).

This point is consistent with Dr. McFadden's own testimony, in which he stated: "*Most users* regard their use of [streaming] services as *free* in the sense that they require no out-of-pocket expenses to listen to music," McFadden WDT ¶ 56 (emphasis added). Dr. McFadden then testified that his own survey data confirmed "a group of consumers who place a high value on no out-of-pocket expenses … who are likely to remain [on] or adopt free plans." *Id.*

The Judges cannot disregard this bimodal chasm. Moreover, the record is replete with evidence corroborating this point. For example, testimony from industry witnesses underscored the unwillingness of a substantial percentage of listeners to pay any price to listen to noninteractive services. A Sony executive testifying on behalf of SoundExchange stated: "It's challenging to convince a consumer to open their [*sic*] wallet and pay for something that is similar to something that is available to them for free …." 4/28/15 Tr. 376-77 (Kooker). Even when the Majors provide incentives and disincentives to services in the form of royalty reductions and increases, they are unable to induce more than a minority of listeners to convert from a "free" service to a paid subscription service. One of the most successful interactive services, Spotify, has only been able to induce approximately [redacted]% of its listeners to pay for a subscription streaming service. *Id.* at 404-05; *see id.* at 430 (Mr. Kooker acknowledging no evidence of a meaningful group of users willing to pay to subscribe to Pandora beyond those who currently subscribe).

Another industry witness, Aaron Harrison of Universal, acknowledged that he had no data to support a conclusion that there is "some meaningful group of users who would be willing to pay to subscribe to Pandora beyond those who already have…." 4/30/15 Tr. 1115 (A. Harrison). This was consistent with a broader aspect of Mr. Harrison's testimony, in which he noted that "the music-buying public has never been a huge market…." *Id.* at 990.

Pandora's Chief Financial Officer similarly testified that "approximately an 80 percent slice of the market … is unwilling to spend significant money on music," as reflected in "numerous studies" [that] show that about half of Americans will never spend another dollar and another … 35 percent will spend … $15 per year." 5/13/15 Tr. 3553-54, 3356-57 (Herring). This portion of the dichotomized market comprises the core of Pandora's customers: "[T]hat's the group that we target, … people that aren't going to be able to be monetized through a $10 a month subscription or even a $5 a month subscription but want a free lean-back experience." *Id.* at 3554. Accordingly, Mr. Herring noted that 95% of Pandora's customers listen through the ad-supported free-to-the-listener, and only 5% are subscribers, which he understood to reflect "user preference" for "free sources," rather than a "bias" on the part of Pandora toward "growing market share." 5/13 Tr. 3435-36 (Herring).

Further supporting this dichotomy from the record company perspective, an internal Warner strategy document noted that "[a]d-supported services have proven to primarily be additive and to be targeting a different demographic than paid services." IHM Ex. 3118, at 11; *see* 5/7/15 Tr. 2405-06 (Wilcox) (noting that Pandora weaned listeners from terrestrial radio whose listening, therefore, had not previously been responsible for revenues that could be monetized into upstream royalties).

Expert testimony further confirmed this dichotomy. One of SoundExchange's own witnesses, Dr. David Blackburn, acknowledged that, at one end of the spectrum, consumers were willing to pay a lot of money, and at the other end of the spectrum are people who are unwilling to pay anything for music. 5/4/15 Tr. 1679 (Blackburn). An expert survey witness for Pandora, Larry Rosin, surveyed consumers and found that, annually, *for any sort of music, physical or digital*, 45% of respondents paid zero; 21% spent between $1 and $30, and 18% spent between $31 and $60. Further, when asked if they would pay for a Pandora subscription if the free-to-the-listener service was discontinued, 54% said it was "not at all likely" that they would pay for a subscription, and 25% said it was "not very likely" that they would pay for a subscription. Rosin WRT Figures 2 and 9 (PAN Ex. 5021); *see* 5/14/15 Tr. 3727 (Rosin). Mr. Rosin concluded from his survey that "the majority of people are essentially… seeking free services." *Id.* at 3742.

Despite the overwhelming evidence of this dichotomy in WTP, Dr. Rubinfeld's model is based solely on the subscription platform. Thus, it is not reasonable to conclude that the ratio of subscription rates to royalties in the interactive market is relevant to the opportunity cost to a record company of listeners who opt instead for ad-supported noninteractive listening. Rather, ad-supported (free-to-the-listener) internet webcasting appeals to a different segment of the market, compared to subscription internet webcasting, and therefore the two products differentiated by this attribute ("ads and free" vs. "no ads and subscription fee") cannot be compared to perform a 1:1 measure of opportunity costs as is the case in Dr. Rubinfeld's "ratio equivalency" model.

Even SoundExchange acknowledges that "directly licensed interactive services … allow users to *select* their programming … whereas … statutory services can [only] … *influence* what they hear. SX PFF ¶278 (emphases added). As a SoundExchange economic expert witness acknowledged, the consumer who values sound recordings highly is apt to have an interest in particular sound recordings, and will be more willing to pay for a subscription that allows him or her more "functionality," including the ability to select songs on demand for By contrast, the more casual listener, with a number of free alternatives such as terrestrial radio, lacks the same desire to select a particular song at a particular time. *See* 5/4/15 Tr. 1677, 1679 (Blackburn) (distinguishing "music aficionados" who "are willing to spend a lot of money on music" and "additional functionality" from "people who are unwilling to pay anything for music."

This undisputed distinction drives in part the bimodal nature of the distribution between listeners with a positive WTP for streaming and those with a zero WTP.

c. The Irrelevance of SoundExchange's "Convergence" Argument

The Services dispute the assertion that the increased overlap among the features of the statutory and non-statutory services constitutes a convergence that is meaningful in this rate setting proceeding. In support of this position, the Services make several specific arguments.

i. Fundamental Differences in the Services

The Services note a fundamental difference between interactive services and noninteractive services. They suggest a "bright line" difference between statutory services and non-statutory services that legally prevents convergence with regard to the most critical distinction, *i.e.*, the inability of listeners to statutory noninteractive services to choose the exact song or playlist of songs to which they will listen, as they would if accessing their own music collections. 5/13/15Tr. 3445-46 (Herring) (noting this "bright line" between statutory and non-statutory service); 5/7/15/15 Tr. 2304-05 (Rubinfeld) (none of Pandora's features "enhance the Pandora users' ability to select a particular song for listening at the time he or she wants to listen to it."); *see also* 5/15/15 Tr. 3397-98 (Lichtman) ("on-demand … [t]hat's the key thing that makes the services different, not the little features that have been added …."); Fischel/Lichtman WRT ¶ 11 ("Clearly, the most important difference between interactive and noninteractive services is … on-demand functionality ….").[99]

In addition to the above "bright line" difference, statutory licensees are subject to the various other limits imposed by the DMCA performance complement. 5/27/15/15 Tr. 6136-37 (Fleming-Wood) ("[P]andora adhere[s] to the performance complement for sound recordings…"); *see* 17 U.S.C. § 114(j)(13). Specifically, statutory services cannot offer to their listeners a pre-designated song; an entire album; more than four songs by the same artist or three songs from the same album in any given three-hour period; caching for off-line playback; a listener-created playlist played at the listener's discretion; the rewinding or fast-forwarding of songs; and a preview of upcoming songs. 5/6/15 Tr. 2016-18; 2049; 2088-89 (Rubinfeld).

[99] This criticism relates to the distinction between a listener's ability to "select" a song and a listener's more limited ability to "influence" the song that is played, as emphasized *supra*, note 76.

Additional differences highlighted by the participants in this proceeding include:

- Pandora's "thumbs up/thumbs down" feature, which does not provide a listener with the ability to select the actual artist or song that is played. 5/13/15 Tr. 3446-47 (Herring).
- The increased use of mobile devices, which does not address the lack of convergence between the essential functionalities of the two services. 5/7/15 Tr. 2304-05 (Rubinfeld); 4/28/15 Tr. 432-33 (Kooker).
- Spotify's mobile Shuffle service, which is not a noninteractive service but rather has numerous on-demand features. *See* IHM Ex. 3371 ¶ 14 (Fischel & Lichtman SWRT).

ii. Convergence Does Not Create Relevant Competition

The Services also take issue with the notion that functional convergence is probative of competition relevant to this proceeding. Specifically, the Services argue:

- The "convergence theory" focuses entirely on competition between services in the downstream consumer market, and therefore offers no insight into the lack of competition in the interactive upstream market that SoundExchange seeks to use as its benchmark market. Shapiro WRT at 46-47; 5/18/15 Tr. 4469-71; 4474-75 (Shapiro).
- The alleged convergence in the downstream market does not address the question of whether the upstream market is effectively competitive. Shapiro WRT at 46.
- Dr. Rubinfeld failed to consider: (1) substitution patterns among the various modes of music consumption; and (2) market shares in the downstream market. PAN Ex. 5022 at 10 (Shapiro WDT).
- Attempts by on-demand services to offer some radio-like functionality do not demonstrate competition between interactive and noninteractive services in the upstream market, but rather indicate only that on-demand services seek to "cross-over" and enter the "lean-back" market. 5/13/15 Tr. 3555-57 (Herring).
- The fact that some consumers want both lean-back and lean-forward functionality does not mean that each type of service is competing with the other. IHM RFOF 296 (and record citations therein).
- When Pandora imposed listening caps in 2013 and 2014, it lost listeners to other noninteractive services, not to interactive services, indicating that the competition did not crossover into the interactive market. Fischel/Lichtman WRT ¶¶ 17-18 and Exs. A & B.
- Statutory noninteractive services compete in the market for radio listening, which is distinct from the interactive market, and about 80% of music consumption in the United States occurs via "lean-back" radio-listening experience. Fleming-Wood WDT ¶ 14 n.2; 5/27/15 Tr. 6138 (Fleming-Wood); 5/13/15 Tr. 3397-99 (Herring); Pandora Ex. 5016 ¶ 9 and Figure 2 (Herring AWRT) (showing 76.2% of consumers listen to laid-back services); *see* Shapiro WRT at 9 & Figure 2; 5/18/15 Tr. 4478-79 (Shapiro) (terrestrial radio, noninteractive webcasting and satellite radio comprise 63% of time spent listening to music, and interactive services account for 7%).

iii. The Supposed "Interactive" Features Made Available by the Noninteractive Services Do Not Demonstrate Convergence

The Services claim that SoundExchange misrepresents the nature of their offerings in a manner that falsely implies a convergence of features available on noninteractive services with features available on an interactive service. The Services make the following points.

- The experiment that Mr. Kooker performed failed to demonstrate the purported convergence between interactive and noninteractive services. The services note that, on cross-examination, Mr. Kooker admitted to a number of acts that increased the chances of the desired artist playing during his experiment: (1) he created a new account for the experiment, meaning Pandora had no information on what tracks or types of music the creator liked other than the "seed" artist (unlike the typical Pandora listener who has created many stations, used the thumbs-up/thumbs-down button, skipped tracks, and provided Pandora a host of information on his/her tastes above and beyond the first "seed" artist); (2) he indicated that the new account user was a 25-year-old female, a demographic which Mr. Kooker admitted was specifically chosen because it was "the typical demographic, from Sony's experience, that would be looking for pop hit type of playlists" (and who would then be more likely to receive those playlists); and (3) he skipped songs until he had listened to five songs, even though he acknowledged that such activity could influence Pandora's playlist algorithms. *See* 5/29/15 Tr. 6589-92 (Kooker).
- iHeart's on-demand video service represents a very minor element of total listenership for iHeart's service. Fischel/Lichtman WRT ¶ 11 n. 14.
- "Pandora Premieres" is not a statutory feature and does not operate pursuant to the statutory license. 5/15/15 Tr. 3444 (Herring); *see* 5/6/15 Tr. 2006 (Rubinfeld).
- Even though noninteractive services compete with interactive services "for music listening generally," it is "marginal," *i.e.*, at that line between 80 percent [lean back] and 20 percent [lean in]," and the "core businesses are very different.… They're not substitutes for each other." 5/13/15 Tr. 3397-99 (Herring).

The Judges find that there is significant evidence of functional convergence (up to the limits prescribed by the DMCA) between interactive and noninteractive services. Further, the Judges find that downstream competition exists between such services, based on the evidence relied upon by SoundExchange.

However, such convergence and competition are swamped by the overwhelming evidence of the dichotomy regarding the WTP among listeners. Therefore, Dr. Rubinfeld's subscription-based benchmark approach does not demonstrate how convergence and competition affect the relative royalties in the ad-supported, free-to-the listener market. The Judges note, though, that such convergence in the subscription market is suggested by the fact that the subscription-based rate derived by Dr. Rubinfeld from 2014 data, $0.002376, is proximate to Dr. Shapiro's high-end proposed rate for the subscription market of 0.00215. When Dr. Rubinfeld's proposed rate is adjusted downward to reflect an effectively competitive market (as calculated in the Rate Conclusion section), the two rates are even more proximate. Those two benchmark subscription rates therefore indicate that competition and convergence indeed do cause interactive and noninteractive royalty rates to be similar in the subscription market.

Thus, the impact of functional convergence and downstream competition is relevant only in the subscription market. Therefore, once Dr. Rubinfeld's benchmark is limited to the subscription market, the Judges find that SoundExchange's emphasis on the functional convergence of, and downstream competition between, interactive and noninteractive services is pertinent.

Another important change in opportunity cost arises when the upstream purchaser (the noninteractive webcaster in the present context) has the ability to: (1) purchase a substitute input and "bypass" the input from the complementary oligopolists or monopolist; and/or (2) the ability to "use proportionately less" of the input of the complementary oligopolists or monopolist. In the present case, both Pandora and iHeart have demonstrated that, by steering,[100] a noninteractive service can: (1) partially "bypass" one or more Majors and substitute an increased proportion of songs from Indies or other Majors; and (2) thereby reduce their "proportion" of purchases from higher priced Majors up to a certain level.

Another important adjustment necessary to render Dr. Rubinfeld's "ratio equivalency" useful is to make certain that the outcome does not simply maintain or import supranormal prices that are the consequence ofthe absence of effective competition. The need to adjust for undue market power dates back to *Web I*, in which the CARP stated:

> Perhaps … a showing that the record companies themselves, or even the Majors, could exert oligopolistic power would tempt the panel to *import a device* … to alleviate the market power problem.

Web I CARP Decision, at 23 (emphasis added).

Additionally, Dr. Rubinfeld's model treats the complementary oligopoly pricing in the input supplier's market as its potential opportunity cost. Thus, his "ratio equivalency" will simply sustain whatever complementary oligopoly price distortions are present in the interactive marketplace. In the present case, the ability of noninteractive services to steer away from higher priced recordings and toward lower priced recordings (or threaten to do so) serves as a buffer against the supranormal pricing that arises from the impact of complementary oligopoly pricing that was well-documented and admitted in the filings with the Federal Trade Commission (FTC) by Universal, its economic expert and its counsel in connection with the Universal-EMI merger. Thus, the Judges must (to borrow language from the CARP decision in *Web I*) "import a device" – a steering adjustment derived from Pandora's benchmark, as discussed at length *infra* – to lower Dr. Rubinfeld's interactive subscription benchmark to reflect the effect of price competition and thus excise the complementary oligopoly power and reflect an effectively competitive noninteractive subscription market. This adjustment is not unlike the adjustments the Judges make to proposed benchmarks in proceedings under section 114, in that the adjustment is made to align the benchmark rate with the statutory rate.

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[100] The concept of "steering" is discussed at length in connection with Pandora's rate proposal.

4. Other Critiques of Dr. Rubinfeld's Interactive Benchmark.

a. Dr. Rubinfeld's Use of Revenues Instead of Service Profits

According to Dr. Katz, the "ratio equality" assumption is also contrary to a fundamental economic principle. The buyer, *i.e.*, the noninteractive service, will determine its valuation based on the *profits* it expects to realize from using the input, *i.e.*, the sound recording, not merely the *revenue* it may earn. Of course, the buyer's consideration of profits necessitates the buyer's consideration of "cost," since, broadly stated, profits equal revenues less costs. Katz AWRT ¶¶ 50-51, 70-71; 5/11/15 Tr. 2861 (Katz). Utilizing Pandora's non-license fee costs as an example (other noninteractive services' cost data were not readily available), and assuming that the non-licensing costs of interactive services were the same, Dr. Katz concluded in rebuttal that Dr. Rubinfeld's interactivity adjustment would increase to 7.9 to equalize the ratio of profits per play to royalties per play across the two markets. Katz AWRT ¶¶ 74-76 and Tables 6 and 7; 5/11/15 Tr. 2870-73 (Katz); 5/12/15 Tr. 3123-25 (Katz)[101]

The Judges reject this criticism as it pertains to the narrow segment of the market to which the Judges apply the interactive benchmark. When the segment of the market at issue consists of willing buyers/licensees who are providing access through *subscription*-based listening to listeners who have a WTP for either interactive or noninteractive services that are close substitutes, then Dr. Rubinfeld's "ratio equivalency" is reasonably based on revenues. Dr. Katz's critique of the revenue-based approach notes that Dr. Rubinfeld failed to factor into his analysis how profit, or lack thereof, to be realized by the noninteractive service would affect the royalty it would agree to pay in the hypothetical market.

However, in the segment of the marketplace described above, a "willing seller" would not be concerned with the service's calculus of its own profits. If those profits were too low to pay a royalty as a percentage of revenue equal to the royalties paid by the interactive services, the "willing seller" simply would not supply the noninteractive service in that hypothetical subscription marketplace. That decision by the "willing seller" may foreclose one or more services from participation in the subscription market, but, as the Judges noted in the *Web II*, they are not obliged to set the statutory rate at a level that permits a noninteractive service to realize any particular profit in the market.[102] 72 *Fed. Reg.* at 24088, n.8.

b. Failure to Adjust for Supposed "Noninteractive" Services Prohibited by the DMCA

Dr. Katz further criticized Dr. Rubinfeld's attempt to rely on the equivalence of the aforementioned ratios because Dr. Rubinfeld's noninteractive numerator [C] is calculated from

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[101] Dr. Katz did not claim that his own cost estimates or assumed equivalencies across the two markets were necessarily accurate. Rather, he emphasized that his cost-based/profit-based adjustment was premised on his estimates showed the invalidity of Dr. Rubinfeld's decision simply to "assume[] the costs were zero." 5/12/15 Tr. 3123-24 (Katz).

[102] Even in the ad-supported market, the Judges are not setting a rate in order to provide a service with any level of profits or revenues.

revenue received by services that were not actually "noninteractive," but rather offered functionality that rendered them non-DMCA compliant and hence "interactive." 5/16/15 Tr. 2042-50 (Rubinfeld) (Rhapsody unRadio offered on-demand plays, caching, and unlimited skips, and two other services; Slacker Radio Plus and MixRadio Plus, offered caching as well as unlimited skips). Thus, Dr. Katz, argues, the numerator [C] should have been adjusted downward to reflect an additional interactivity adjustment, which, *ceteris paribus*, would have reduced the noninteractive royalty rate proposed by Dr. Rubinfeld.

Dr. Katz correctly notes that the numerator in Dr. Rubinfeld's so-called "noninteractive" ratio contains revenues from services that are not DMCA-compliant. Dr. Rubinfeld should have made a further interactivity adjustment to reflect whatever marginal value was attributable to the additional functionality of his stand-ins for the services that he used as proxies for truly DMCA compliant services. However, the Judges find that, given the degree of convergence among all services in terms of functionality, as discussed *supra*, as it pertains to this subset of the noninteractive market in which listeners subscribe– the marginal additions to functionality that Dr. Rubinfeld may have improperly captured in his "noninteractive" revenue numerator do not disqualify the use of that benchmark in this subscription market context.[103]

c. Failure to Rely on the Advertising-Based Noninteractive Model that Predominates in the Market

An important and fundamental problem with Dr. Rubinfeld's analysis, according to Dr. Katz, lies in Dr. Rubinfeld's failure to acknowledge in his benchmark analysis that the advertising-based revenue model, rather than the subscription-based revenue model, is the dominant business model for noninteractive services. Katz AWRT ¶ 53 (quoting Rubinfeld CWDT ¶ 170 (stating that Dr. Rubinfeld's "analysis does not explicitly account for 'free' ad-supported services."). Katz AWRT ¶55.

This criticism was also leveled by one of iHeart's economic experts, who testified that "certainly there is no basis to assume that subscribers are a reasonable proxy for all listeners to noninteractive services," given that subscribers account for only four percent of Pandora's listenership and zero percent of iHeart's. Fischel/Lichtman WRT ¶55; 5/15/15Tr. at 3989-90 (Lichtman).[104]

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[103] The Judges find that such differences in functionality are of relatively low importance *in the subscription market* in light of the evidence of downstream functional convergence. In this regard, it is noteworthy that even Pandora's expert Dr. Shapiro (the only Service expert to propose a separate subscription rate) has proposed a rate quite similar to the rate proposed by Dr. Rubinfeld based on a purely subscription-based model (Those rates are even closer to each other after an "effectively competitive" steering adjustment is applied to Dr. Rubinfeld's proposed subscription rate). If there was truly a material issue as to how WTP, convergence and functionality gradations impacted royalty rates in the noninteractive subscription market, the Judges would have expected to see a much wider gulf between the SoundExchange and Pandora subscription-based proposals.

[104] Dr. Rubinfeld declined to use advertising-only interactive services as benchmarks in his original WDT. He noted that interactive services use ad-supported (free-to-the listener") alternatives as tools to convert listeners into paid subscribers (the so-called "freemium" model), thereby distorting (through "upsell incentives") the reliability of ad-supported interactive service agreements as benchmarks. Rubinfeld CWDT ¶¶ 126, 128; *see also* Rubinfeld CWRT at 39, n.128 (no "apples to apples" comparison could be made between noninteractive services, on the one hand,

Dr. Katz also criticized Dr. Rubinfeld's attempted rebuttal of this criticism. Dr. Rubinfeld, in rebuttal, noted that he had estimated a 1:1.01 ratio of *advertising-only* revenue to royalties in the interactive service market, which he concluded was confirmatory of SoundExchange's proposed rates as determined by the interactive *subscription* revenue: royalty ratio. Rubinfeld CWRT ¶¶ 161-169.

According to Dr. Katz, it is incorrect to compare only the revenues of the ad-supported tiers of the two types of services. Rather, the proper approach, according to Dr. Katz, would be to compare the *overall revenue* (ad-supported *and* subscription) per play as between the interactive and noninteractive services. Otherwise, gross disparities in average revenue per play (resulting from the number of plays in each model (ad-based or subscription) and in revenue per play in each such model) would be camouflaged. 5/11/15 Tr. 2854-57 (Katz).

When such an overall revenue approach was applied by Dr. Katz to the actual service data, he found that the ratio of interactive service revenue to noninteractive service revenue per play was not 1:1, but rather 3.96:1. Katz AWRT ¶ 58, Table 2. This adjustment alone would have the effect of reducing the proposed rate derived by Dr. Rubinfeld from $0.002668 to $0.001347, approximately a 50% reduction. Katz AWRT ¶ 59, Table 3. In similar fashion, iHeart's experts compared overall per play (or performance) data for Spotify and Pandora and calculated an interactivity adjustment of 3.2, Fischel/Lichtman WRT ¶ 69, also reducing the rate below the rate implied by the 1.01 adjustment calculated by Dr. Rubinfeld when he utilized advertising revenue alone in his rebuttal testimony.

As already noted, the Judges acknowledge the validity of this criticism by limiting Dr. Rubinfeld's noninteractive benchmark analysis to the segment of the market in which listeners are *subscribers* to noninteractive services. Accordingly, there is no reason to apply this criticism further to reduce the interactive benchmark in the segment where it is otherwise applicable.

d. The Alleged Circularity of Dr. Rubinfeld's Methodology

Pandora's economic expert, Dr. Shapiro, levies another overall criticism of Dr. Rubinfeld's interactive benchmark, characterizing it as "circular" and thus "uninformative." Dr. Shapiro noted that Dr. Rubinfeld asserted that the royalty rates contained in the interactive benchmark agreements "can be expected to reflect the incremental value of the granted functionality over-and-above what can be achieved with the statutory rights." Rubinfeld CWDT ¶ 145. Thus, according to Dr. Shapiro, backing out the incremental value to make an interactivity adjustment would simply return the analysis to the subscription rates and royalties that are predicated on the existing statutory rates. Therefore, Dr. Shapiro criticizes Dr. Rubinfeld's entire interactive benchmarking exercise as circular, revealing nothing about the rate

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and, on the other, interactive services that offered an ad-supported (free-to-the listener) service using obtrusive advertising as a tool to convert listeners to subscription services.) However, in his 11th hour supplementation to his WDT, Dr. Rubinfeld attempted to analyze certain ad-supported services, contained in section "III.E" of his CWDT, that he classified as more like statutory noninteractive services. The Judges' analysis of SoundExchange's arguments relating to these so-called "III.E" licenses is set forth in section IV.B.4.*l*.ii, *infra*.

that would be set absent the statutory rate. Shapiro WRT at 28-29; 5/8 Tr. 2723-24 (Shapiro); *accord*, 5/5/15 Tr. at 4047-4048 (Lichtman) (iHeart's' economic expert noting that the noninteractive service revenue figure that is the numerator in Dr. Rubinfeld's noninteractive ratio is (and must be) dependent upon the statutory rates that serve as an input cost).

The Judges need to consider this criticism in tandem with the Services' prior criticism that the so-called "noninteractive" webcasters selected by Dr. Rubinfeld actually offered non-DMCA compliant features as well. Consequently, when Dr. Rubinfeld backs out the interactive value of these non-DMCA compliant services (by comparing the ratio of interactive to noninteractive subscription prices) he is not simply returning to the existing statutory rates, as Dr. Shapiro asserted, because the royalty rates for those non-DMCA compliant services (as the Services argue) are not merely predicated on the prior statutory rates. Simply put, the Services cannot have it both ways. If Dr. Rubinfeld's "noninteractive" services have some features that render them imperfect benchmarks, then the Judges must consider whether and how to weigh those imperfections. But those imperfections also cut in the other direction, and indicate that the royalty rates negotiated by those services reflect market forces in the subscription sector, rather than merely the statutory rates for DMCA-compliant noninteractive services.

e. Assumed Equivalence of Demand Elasticities in the Interactive and Noninteractive Markets

Dr. Katz notes that Dr. Rubinfeld at one point conceded that the "elasticities of demand" by the interactive services and the noninteractive services would differ *inter se.* However, Dr. Rubinfeld failed to address or account for this difference. Moreover, according to Dr. Katz, Dr. Rubinfeld later equivocated as to whether, in his methodology, he was assuming an equal elasticity of demand for both types of services. Katz AWRT ¶ 47; *compare* 5/16/15 Tr. 2029-2034 *with* NAB Ex. 4233.

Given that the Judges have dichotomized between the subscription and the ad-supported (free-to-the-listener) markets, the Judges do not believe that there are any significant uncertainties regarding the approximate equivalence of the elasticities between the interactive and noninteractive upstream markets for the right to acquire licenses to play sound recordings for subscribers.[105] As Dr. Rubinfeld testified, when the downstream subscription market is competitive, the "Hicks/Marshall relationship"[106] provides that if the elasticities in the downstream market are the same then, *ceteris paribus*, pursuant to the Lerner Equation the mark-up of price over cost will be the same in both the upstream and downstream subscription

[105] In fact, when the dichotomy in WTP is applied, a discussion of overall differences in elasticities is beside the point. Elasticity measures percentage change in quantity demanded divided by percentage change in price. For the ad-supported services, the listeners have already demonstrated an unwillingness to pay for internet webcasting. Economically, their demand curve is far below the demand curve for subscription listeners (reflecting the differences in WTP). It is the difference in location of the demand curve, not just the difference in elasticities that is important. In the subscriber market though, the price-elasticity of the listeners vs. the noninteractive listeners is of some relevance.

[106] *See supra*, note 107.

markets, thereby supporting Dr. Rubinfeld's "ratio equivalency" in the subscription market. 5/28/15 Tr. 6310-11 (Rubinfeld).

In the present case, because: (1) the WTP downstream is positive (which it is by definition in the subscription market); *and* (2) the products are converging in terms of functionality; *and* (3) an interactivity adjustment is applied to reflect the critical limits of convergence (no on-demand plays on statutory services), it was not unreasonable for Dr. Rubinfeld to conclude that the elasticities of demand would be approximately the same in both the interactive and noninteractive subscription markets.[107] However, although this likely approximate equivalence in downstream elasticities would tend to equalize the upstream impact on the derived demand of the noninteractive services, it would not be the only factor affecting the upstream market, *i.e.*, the market for which the Judges are setting rates. More particularly, the inability of listeners to statutory services to select a particular song, combined with the noninteractive services' ability to (competitively) steer music toward or way from record companies, serve to distinguish the hypothetical noninteractive subscription rate from the benchmark interactive subscription rate proposed by Dr. Rubinfeld.

f. Failure to Use a Mix of All Interactive Revenues (Advertising and Subscription) in the Ratios

The Services argue that Dr. Rubinfeld, rather than isolating subscription revenue ratios from ad-supported ratios, should have determined the value of his interactivity adjustment by comparing *all* of the actual revenue in both markets (*i.e.*, a mix of subscription and advertising revenue. *See* Katz AWRT ¶¶ 58-59 NAB PFF ¶ 368. The Judges would find that argument meritorious if they were to attempt to apply Dr. Rubinfeld's "ratio equivalency" outside of the subscription market. The criticism is inapposite, however, given the Judges' application of Dr. Rubinfeld's methodology only to subscription services. In the subscription market where a positive WTP is self-evident from the presence of subscribers, convergence and downstream competition are particularly relevant. Record companies would want to equalize marginal returns across the interactive and noninteractive spaces, which would be accomplished by focusing on subscription revenues. Thus, given the Judges' finding that the market is segmented by a dichotomized WTP, this criticism is simply not relevant to the Judges' determination.

g. Dr. McFadden's Survey Results are Unnecessary to Confirm the Value of Dr. Rubinfeld's Interactivity Adjustment, Based on the Limited Applicability of Dr. Rubinfeld's Benchmark

The Services offered numerous criticisms of Dr. McFadden's conjoint survey, which was intended by SoundExchange to confirm Dr. Rubinfeld's interactivity adjustment. *See, e.g.*,

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[107] Dr. Shapiro acknowledged that the Hicks/Marshall relationship would serve to import the downstream elasticities into the upstream market (the "derived demand" effect), unless the price effects of those downstream elasticities were swamped by other factors. *See* 5/20/15 Tr. 5044-45 (Shapiro). The principal "swamping factor" is the unwillingness of a substantial segment of streaming listeners to pay a positive price to listen to noninteractive services. Since, by definition, subscribers have a positive WTP, that "swamping factor" does not come into play if the analysis is limited to the market for subscription services.

Peterson Corrected WRT ¶ 110 (survey measures potential subscribers' WTP rather than actual subscription prices); 4/29/15 Tr. 924, 926, 929-33, 936, 938 (McFadden) (survey does not measure value of certain features); 5/22/15 Tr. 5562-63, 5572-73, 5579-80, 5588-89 (Hauser) (survey contains confusing feature descriptions); *id.* at 5570-71 (survey had a high participant attrition rate, especially among teenagers); IHM Ex. 3124 ¶ 12 (Hauser WRT) (survey participants were confused by incentive alignment language). The Services asserted that Dr. McFadden's survey would have supported a rate much lower than the benchmark rate proposed by Dr. Rubinfeld had he corrected for Dr. McFadden's purported errors. Fischel/Lichtman WRT ¶ 75 and IHM Ex. 3060 (Fischel/Lichtman WRT, Ex. E.).

The Judges note initially that, in this narrow context of this subscription market, Dr. Rubinfeld's methodology for calculating the interactivity adjustment is not inappropriate. Dr. Rubinfeld reasonably determined the concept of a "ratio equivalency" between revenues and subscription royalties in a market with both: (1) a WTP sufficient to generate subscriptions in each market; and (2) a downstream convergence of features as between the two markets, except for the nonconvergence arising from the statutory restrictions on noninteractive services.[108] Thus, Dr. McFadden's attempt to confirm Dr. Rubinfeld's 2.0 interactivity adjustment is unnecessary.[109] Consequently, the Judges need not address the Services' criticisms of Dr. McFadden's conjoint survey.

h. Dr. Rubinfeld's Equalization of the Number of Plays in the Interactive and Noninteractive Markets was Appropriate

Dr. Katz asserts that Dr. Rubinfeld underestimated the number of "skips" for which an interactive service is not required to pay a royalty under the typical interactive service contracts with record companies. By contrast, a statutory service must pay a royalty for all plays, including such "skips." (SoundExchange requests that the Judges continue this requirement. *See* SoundExchange Proposed Rates and Terms, Attach. A at 2-3.). Dr. Rubinfeld utilized an adjustment factor of 1.1 for skips, but, according to Dr. Katz, actual data revealed in discovery demonstrated that the adjustment factor should have been 1.2, a 9.1% increase in the adjustment that would further lower the rate proposed by SoundExchange. Katz AWRT ¶¶ 101-102

The Judges find that Dr. Rubinfeld accurately adjusted for the number of plays across the interactive and noninteractive spaces. The criticism leveled by Dr. Katz focused only on the number of "skips." However, Dr. Rubinfeld made a further adjustment for the fact that interactive services typically paid royalties for pre-1972 recordings, whereas the noninteractive services did not. This fact required an increase in the noninteractive royalty rate relative to the interactive royalty rate (*i.e.*, a smaller interactivity adjustment in the denominator [D] in the ratios discussed in section I.A.1.c, *supra*).

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[108] Also by way of repetition (and emphasis), the existence of a sharp dichotomy between listeners with a positive WTP for streamed music and those who have essentially a zero WTP for streamed music precludes an extension of this "ratio equivalency" beyond the subscription market.

[109] Of course, Dr. McFadden's conjoint survey and his findings regarding the bimodal nature of listeners' WTP are relevant to this determination, and have been considered in this determination.

For example, assume there were 100 plays in each market and in each market 10 of those plays were pre-1972 recording. If the royalty rate (assumedly) was 0.3 cents in each market, then the interactive average rate would be 0.3 cents. However, in the noninteractive market, where no royalty was paid on the 10 pre-1972 recordings, the average royalty rate was only 0.27 cents.[110]

Thus, to equalize the markets on a per-play basis, the noninteractive average rate must be increased. That increase made the downward interactivity adjustment smaller, when it was combined with the fact that – on the other side of the coin – the noninteractive services were required to pay royalties for skips as though they were plays, unlike the typical interactive service.

i. Incorrectly Weighting Average Royalties by Revenue Instead of by Play

Another defect in Dr. Rubinfeld's approach, according to Dr. Katz, was Dr. Rubinfeld's decision to compute his average per-performance royalty by weighting that average according to the revenue per play earned by a service. *See* Rubinfeld CWDT ¶ 203; 5/5/15 Tr. 1824 (Rubinfeld). According to Dr. Katz, weighting the per-play average by service *revenue*, as done by Dr. Rubinfeld, created an upward bias compared to the revenue actually earned by on-demand services that comprised Dr. Rubinfeld's benchmarks. Katz AWRT ¶¶ 42-44, 162; 5/11/15 Tr. 2830-34; 2837-40 (Katz).

Dr. Katz maintained that the more realistic approach would have been to weight the individual on-demand services in the benchmark market by *the number of plays per service*, not by the revenue per service. Applying actual data, Dr. Katz demonstrated that using Dr. Rubinfeld's revenue weighting approach would have implied that in the period considered by Dr. Rubinfeld, the on-demand services would have received $112.2 million more (42% more) in revenues than they actually received. Katz AWRT ¶ 162.

The Judges find this criticism irrelevant as applied to the subscription market. In the interactive sphere, record company agreements with interactive services are configured pursuant to the "freemium" model, designed to convert "free" listeners into paying subscribers, who generate user revenue. *See* 5/7/15 Tr. 2401-02 (Wilcox); 5/13/15 Tr. 3509 (Herring). In the subscription market where the positive WTP and functional convergence engenders strong competition for paying listeners, a willing seller in the subscription market seeks to maximize subscriber revenue and focuses on average revenue per user (ARPU), not revenue per *play*. *See, e.g.,* 4/28/15 Tr. 374 (Kooker); 4/30/15 Tr. 970 (A. Harrison); *see also supra*, section IV.B.2.c.

j. The Number of Adjustments Does Not Disqualify Dr. Rubinfeld's Interactive Benchmark

One of the economic experts for iHeart, Dr. Lichtman, asserted that the sheer number of adjustments, as discussed *supra*, needed "to draw any analogy" between the interactive and

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[110] (90 royalty bearing songs × 0.3 cents) + (10 pre-1972 songs × 0 cents) = (0.27 cents + 0 cents) = 0.27 cents.

noninteractive markets is so “overwhelming” that the result is a “mess” and not reliable. 5/15/15 Tr. 4053-54.

The Judges reject the notion that there may be some quantum of adjustments to proposed benchmarks that disqualifies them from consideration. Some variant of a “three strikes and you’re out” approach seems decidedly devoid of legal or economic reasoning. The Judges are more concerned with the importance, or weight, of any given criticism of a benchmark than they are with the number of potential adjustments. Trivial or measurable adjustments may be relatively great in number, yet pale in comparison to one or two critical assumptions that might necessitate the qualification or rejection of a benchmark.

This determination is evidence of that point. Dr. Rubinfeld’s benchmark fails to account for the fact that a large cohort of the listening public simply will not pay for streamed music. Thus, his subscription benchmark fails to capture the very market of listeners who flock to ad-supported (free-to-the-listener) noninteractive services. That single qualification circumscribes the usefulness of Dr. Rubinfeld’s benchmark. One other criticism of his benchmark, *viz.*, its failure to capture an “effectively competitive” market, permits an adjustment within the subscription market rate and does not require the Judges to reject the use of Dr. Rubinfeld’s benchmark in the noninteractive *subscription* market.

k. SoundExchange’s Proposed Annual Rate Increases from 2016-2020 are not Supported by the Evidence

The Services object to annual increases in the royalties as arbitrary and incompatible with the willing buyer-willing seller standard, for the following reasons.

First, the Services contend that there is no basis to assume, without supporting theory or evidence, that rates would necessarily increase during the next rate period. In that regard, the Services note that Professor Rubinfeld admitted that there is no “theoretical reason why we would expect prices just to go up.” 5/5/15 Tr. 1761 (Rubinfeld).

Second, he acknowledged the absence of any basis for his self-described “‘empirical judgment’ where we think rates are likely to be going for competing products.” *Id.* Moreover, as Dr. Rubinfeld, testified, his proposed escalating rates are not based on anticipated inflation, anticipated increases in music industry inputs, or the consumer price index. 5/6/15 Tr. 2226 (Rubinfeld).

Third, none of the benchmarks on which SoundExchange relied contained annual rate escalators. Moreover, out of all the potential benchmarks that SoundExchange examined, only one has an escalating rate provision. *Id.* at 2227-28. That lone agreement with an escalating rate provision – the iHeart/Warner Agreement – was the subject of substantial criticism and ultimate rejection by Dr. Rubinfeld, as inappropriate for use as a benchmark in the current proceeding. *Id.* at 2229.

Fourth, the record evidence indicates that rates in SoundExchange’s own proposed benchmark market, interactive streaming services, have *decreased* in recent years. Rubinfeld WDT, Ex. SX 0017, ¶ 140; 5/8/15 Tr. 2736-37 (Shapiro); 5/15/15 Tr. 4142 (Lichtman); 5/19/15 Tr. 4611 (Shapiro). Further, Dr. Rubinfeld testified that he “actually saw … decreases in the noninteractive rate” in the data he reviewed. 5/6/15 Tr. 2231 (Rubinfeld). Thus, if there were to be annual rate changes, the Services argue, the record supports a decrease in webcasting rates during the upcoming rate period.

The Services do note Dr. Rubinfeld's assertion that interactive and noninteractive services are converging, *id.* at 2225-2226, but they respond by arguing that this purported (and dubious) convergence does not support the conclusion that the Judges should impose on noninteractive webcasters what Dr. Rubinfeld himself characterized as a "serious increase" during the rate period. *Id.* at 2223. Moreover, Dr. Rubinfeld admitted that his proposed annual increases were not due to past convergence, but to his "anticipation that the technology will create even more convergence going forward." 5/5/15 Tr. 1829 (Rubinfeld). He admitted that this "anticipation" was "not based on hard data," and he conceded that "I can't prove to you for sure where we're going to be because we are talking about the future." *Id.* 1829-30.

For the foregoing reasons, the Services conclude that SoundExchange's interactive benchmark does not provide a basis to set the statutory rates for commercial webcasters in this proceeding.

The Judges find that SoundExchange has failed to make a sufficient factual showing that would support the linear $0.00008 annual rate increase proposed by Dr. Rubinfeld. The Judges find it dispositive that Dr. Rubinfeld acknowledged that his opinion in this regard was neither based on theory nor on empirical analysis. Further, the fact that some agreements in the benchmark markets have annual escalators and some do not renders those agreements unhelpful, absent some explanation as to the bases for the inclusion or exclusion of such escalators.

Additionally, market forces in the future may cause rates to move in either direction, or to stay constant, and the record does not suggest a basis for a credible prediction. So too is the record devoid of any sufficient predictive evidence as to whether there will be further convergence and/or competition between interactive and noninteractive services or, if so, how that will impact the rates. That is, the record does not indicate why convergence would not occur through a reduction in interactive rates, rather than through (in whole or in part) an increase in noninteractive rates. In sum, the record does not contain a sufficient basis to adopt any prediction about the future direction of noninteractive rates.

l. Dr. Rubinfeld's Analysis of Noninteractive Agreements does not Corroborate his Interactive Benchmark

The Services oppose SoundExchange's use of agreements with Apple and several interactive services for what Dr. Rubinfeld described as noninteractive offerings, and argue that if the Judges consider the agreements, a proper analysis corroborates their own rate proposals and not SoundExchange's. *See, e.g.*, Pandora PFF ¶344; Shapiro SWRT, at 12-16 & Table 1.

For the reasons set forth below, the Judges will not consider these agreements in establishing or corroborating a willing-buyer, willing-seller royalty rate.

i. Apple Agreements

The Services contend that Dr. Rubinfeld's analysis of the Apple agreements is deeply flawed and unreliable for several reasons. First, the Services argue that Dr. Rubinfeld improperly allocates [redacted] and other compensation to the licenses for the iTunes Radio service rather than to other licensed services that Apple provides. *See, e.g.*, Fischel/Lichtman SWRT ¶ 36. Second, the services argue that Dr. Rubinfeld should have analyzed the parties' *ex ante* expectations, rather than *ex post* performance, in determining what a willing buyer and seller would agree to. *See, e.g.*, 5/19/15 Tr. at 4526 (Shapiro). Finally, the services critique other adjustments that Dr. Rubinfeld makes (or fails to make) to the headline rates in the Apple agreements to account for non-statutory functionality in Apple's service.

The Judges credit Dr. Shapiro's observation that Dr. Rubinfeld's conclusion that Apple was willing to pay substantially in excess of the statutory license rate for what is essentially a statutory service "just doesn't make any sense." 5/19/15 Tr. at 4526 (Shapiro). Economists for both licensors and licensees agreed that the statutory rate effectively sets a ceiling on rates for statutory services, since a service can always fall back on the statutory rate if it is unable to negotiate an equal or lower rate with the copyright owner. *See, e.g., id.*; 5/27/15 Tr. at 6025-26 (Talley). The fact that Dr. Rubinfeld concludes that the effective rates under the Apple agreements are substantially higher than the statutory rates strongly suggests that something is amiss in his analysis.

One possible reason Dr. Rubinfeld's analysis finds effective rates under the Apple agreements that exceed the statutory rates is that he attributes compensation to the iTunes Radio service that should have been attributed to other services licensed by Apple. The license agreements for the iTunes Radio service between Apple, on one hand, and Sony and Warner, respectively, on the other, are one part of a complex business relationship between Apple and the record companies, covering a number of different services. At or near the time that Apple entered into its iTunes Radio agreements with Sony and Warner, the parties amended some of their existing agreements for other services, and specified that some compensation that Apple was to have paid out under other agreements would be characterized as payments for the iTunes Radio service. Shapiro SWRT at 4; SX Ex. 2072 ¶ 2 (Amendment [redacted] to Apple/Warner Sound Recording cloud Service Agreement); Ex. 2073 ¶ 2 ([redacted] Amendment to Amended and Restated Apple/Sony Digital Music and Video Download Sales Agreement).

SoundExchange argues that the Judges are bound by the parties' characterization of these payments as unambiguously expressed in their agreements. SoundExchange Reply PFF ¶ 487. If the Judges were resolving a contract dispute between the parties, SoundExchange's argument might have merit. However, the Judges' task is to determine the economic significance of the compensation that changed hands between the parties, and the contracts are but one (albeit vitally important) piece of evidence of that economic significance. Where, as here, a transaction is part of a complex, interlocking business relationship, it is appropriate—even necessary—for the Judges to consider other evidence and analysis to determine the true economic value of the transaction. *See* Fischel/Lichtman SWRT ¶ 31. This is particularly true when one party is agnostic as to how certain payments should be characterized, and the other party has a strong incentive to characterize the payments in a particular way to influence the course of a future rate proceeding.

That additional evidence is lacking here. The Services raise sufficient doubt as to the characterization of the compensation flowing from Apple to Warner and Sony to persuade the

Judges that they cannot rely on Dr. Rubinfeld's analysis of the Apple agreements. There is insufficient evidence in the record to support SoundExchange's analysis and use of the Apple agreements.[111]

The uncertainty resulting from a lack of evidence cuts both ways. The Judges will not consider the licensee services alternative analyses that seek to demonstrate that the Apple agreements support their rate proposals. *See*, *e.g.*, Pandora PFF ¶ 344; Shapiro SWRT, at 12-16 & Table 1.

ii. Other Noninteractive Agreements

The Services urge the Judges to reject Dr. Rubinfeld's analysis of four additional agreements for allegedly noninteractive services: Beats Music's The Sentence; Spotify's "Shuffle" service; Rhapsody's "Unradio"; and Nokia's "MixRadio." The Services argue that each service has features that exceed what a service operating under the statutory license would be permitted to offer. The Judges agree, and also find that, as with the Apple agreements, there is insufficient record evidence to support a useful analysis of these four agreements.

(A) Extra-Statutory Functionality

(1) Beats "The Sentence"

The Sentence was a free (to the user) feature offered by Beats Music (Beats) as a means of encouraging users to pay for Beats' subscription service.[112] Rubinfeld CWRT ¶ 179. It allowed users to generate a playlist by providing contextual inputs such as location, mood, setting and genre. It was subject to limited functionality, such as limited skips, no use of off-line or cached content, and no rewind feature. *Id*. at ¶ 179-180. Dr. Rubinfeld describes The Sentence as "effectively a noninteractive service involving functionality that is closely comparable to other statutory services." *Id*. at ¶ 180.

The Services contend the record demonstrates that The Sentence includes extra-statutory functionality. Specifically, the record company agreements with Beats [redacted]. Fischel/Lichtman SWRT ¶ 11. This additional functionality would be expected to push the royalty rates up. *See id*. ([redacted] adjusted rates upward expressly to account for additional functionality that [redacted]) (quoting IHM Ex. 3543, at 8 (1/1/2014 Email from [redacted] to [redacted] and [redacted])). Dr. Rubinfeld does not account for extra-statutory functionality in his analysis of Beats' license agreements.

[111] In light of this determination, the Judges need not reach the licensee services other arguments concerning the Apple agreements.

[112] Beats was acquired by Apple and, as of December 1, 2015, no longer exists as a separate service.

(2) Spotify "Shuffle"

Spotify's Shuffle service is a free-to-the-consumer streaming service that permits the user to select a certain number of songs (a minimum of 20 songs or a single album) and hear only those songs in a random order. Fischel/Lichtman SWRT ¶ 14. The ability to select specific songs and be assured that only those songs will be played distinguishes Shuffle from noninteractive services. The increased degree of interactivity would be taken into account in setting royalty rates. *Id*. Dr. Rubinfeld does not account for this functionality in his analysis of Spotify's agreements with the record companies.

(3) Rhapsody "Unradio"

Rhapsody's Unradio service offers users personalized playlists based on the users' favorite artists or songs. It is a paid subscription service, with a 14-day free (ad-supported) trial period. Rubinfeld CWRT ¶ 196. Unlike statutory services, Unradio permits unlimited skips and permits users to play up to 25 favorites and seed tracks on an on-demand basis. Fischel/Lichtman SWRT ¶9. Again, this is extra-statutory functionality that would be expected to affect the royalty rate, and that Dr. Rubinfeld did not account for in his analysis.

(4) Nokia "MixRadio"

Mobile phone manufacturer Nokia bundled MixRadio, a free-to-consumer streaming service, with its handsets.[113] MixRadio provides customized, ad-free noninteractive streaming. Unlike statutory services, MixRadio permits users to play radio stations that are cached on their mobile phones. Rubinfeld CWRT ¶ 199. In addition, MixRadio permits users to share music with non-subscribers. Fischel/Lichtman SWRT ¶ 12.

MixRadio thus has significant extra-statutory functionality. Dr. Rubinfeld does not account for this in his analysis.

(B) Lack of Analysis of Business Context

Like the Apple agreements, the record companies' agreements with Beats, Spotify, Rhapsody and Nokia, respectively, are part of broader economic relationships that include other services. *Id*. at ¶30. Beats, Spotify and Rhapsody each license content from the record companies for their respective subscription services. Nokia at one time licensed music that it offered for unlimited download (bundled with its mobile phones). As discussed in connection with Apple, the Judges must consider evidence and analysis of context to determine the true economic value of a transaction when that transaction is part of a complex business relationship. Dr. Rubinfeld does not analyze that context.

(C) Conclusion regarding Corroborative Agreements

Because Dr. Rubinfeld failed to account for extra-statutory functionality, and failed to analyze the broader context of these services within the business relationship between the service

[113] The service is now simply "MixRadio," as a result of Microsoft's acquisition of Nokia, and subsequent sale of the MixRadio service to Line Corporation.

providers and the record companies, the Judges determine that they cannot rely on the analyses of these agreements to corroborate SoundExchange's interactive benchmark analysis.

5. Conclusion Regarding SoundExchange's Interactive Benchmark Per-Play Proposal

For these reasons, the Judges find that Dr. Rubinfeld's interactive benchmark is only applicable when:

- revenues in both markets are derived from subscription revenues and are thus reflective of buyers with a positive WTP for streamed music;
- functional convergence and downstream competition for potential listeners indicate a sufficiently high cross-elasticity of demand as between interactive and noninteractive services, provided the noninteractive subscription rate is reduced to reflect the absence of the added value of interactivity; and
- a steering adjustment is made to eliminate the complementary oligopoly effect and thereby provide for an effectively competitive market price. 114

The rate derived from this analysis is set forth in the Rates Conclusion, *infra*.

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[114] The Judges find as well that Dr. Rubinfeld's interactivity analysis failed to cure all of the defects that the Judges found to exist in the similar interactivity analysis proffered by Dr. Pelcovits and rejected by the Judges in the *Web III Remand*. First, and of greatest importance, Dr. Rubinfeld's interactivity model fails to take account of, or adequately adjust for, the dominant ad-supported (free-to-the-listener) segment of the noninteractive market. *See Web III Remand*, 79 Fed. Reg. at 23118. This defect has even greater resonance in this proceeding, given the abundant evidence, discussed *supra*, that the vast majority of listeners do not have a positive WTP for access to sound recordings on streaming services. However, the Judges have "ring-fenced" this defect by limiting the applicability of Dr. Rubinfeld's analysis to the noninteractive *subscription* market. Second, the Judges also criticized Dr. Pelcovits in the *Web III Remand* for failing to analyze agreements between the interactive services and independent labels. *Id.* As discussed *supra*, Dr. Rubinfeld looked at certain independent deals, but only made an adjustment on the assumption that Indies' royalties would be lower by the absence of the value of [redacted] found in some of the Majors' agreements with interactive services. Third, the Judges also criticized Dr. Pelcovits in the *Web III Remand* for failing to adjust for the downward trend in rates in the interactive benchmark market. *Id.* Both Dr. Pelcovits and Dr. Rubinfeld used periods ending during the year in which the proceeding started (2009 and 2014 respectively). Dr. Pelcovits used an 18-month period, while Dr. Rubinfeld used a 12-month period. *Compare id*. *with* Rubinfeld CWDT ¶ 32. However, Dr. Rubinfeld acknowledged – but failed to account for – the continuing downward trend in his interactive benchmark rates. Instead, he merely assumed that the interactive and noninteractive rates would converge through *an increase in noninteractive rates* in the hypothetical market and a *decrease in rates in the interactive market*. Again, such an assumption may be reasonable in the subscription market, where convergence in functionality appears to exist (as nonetheless limited by the DMCA performance complement). Again, the Judges' decision to "ring-fence" a subscription rate eliminates any improper use of this assumed convergence in the ad-supported (free-to-the listener) noninteractive market. Finally, in the *Web III Remand*, the Judges also observed that the value of Dr. Pelcovits' benchmark analysis was "diminished by [the] lack of sufficient data" relating to the number of noninteractive performances per subscriber. *Id.* Dr. Rubinfeld essentially avoided this problem by not accounting for differences in the number of performances made by subscribers to interactive and noninteractive services, respectively. Again, the Judges find that because a willing seller in the streaming subscription markets would seek to equalize Average Revenue per User (ARPU) (through Dr. Rubinfeld's ratio equivalency approach) this issue as well has been adequately addressed by the Judges through their "ring-fencing" of Dr. Rubinfeld's benchmark analysis to the subscription market only.

C. GEO's Rate Proposals

In this *Web IV* proceeding, the Judges had the opportunity to hear directly from a singer-songwriter who produces and markets his own music. Mr. George Johnson, dba GEO Music, filed a Petition to Participate in the proceeding. He filed all the necessary papers and testified on both direct and rebuttal, as well as delivering opening statement and closing argument.

Mr. Johnson eloquently stated the plight of the singer-songwriter-artist who is self-published and self-produced. He also proposed an overarching reform to the way in which rights owners of music—written, published, performed, recorded, broadcast—would be paid for their artistic creations. However, the current law thoroughly segments both the copyrights and the licensing mechanisms. The rights and their treatment have evolved over time, barely keeping pace with the technology that uses them. Further, part of the music royalty process, *i.e.*, royalties for use of published "musical works" is managed by a U.S. District Court in New York, with statutory admonitions to both the court and the Judges that neither is to consider the effect of the rates set by the other. The complete picture urged by Mr. Johnson can only come into focus with a new copyright law.

Nonetheless, by comparing an artist's revenues from physical phonorecords to the current ten-thousandths of a cent "per spin" calculations for digital performances, Mr. Johnson highlighted very effectively one of the paramount factors complicating this proceeding. The music makers, the music recorders, and the music "consumers"—both broadcasters and listeners—are struggling with how to address and "monetize" the change of the music product paradigm from an ownership model (purchase of physical recordings) to an access model (log in to Internet services and use as much or as little control as one wants to direct the music programming).

GEO makes three separate rate proposals.

1. GEO Proposal 1

GEO proposes that royalty rates for nonsubscription webcasting be the greater of a per-performance rate and a percentage revenue rate:

Year	Per-Performance Rate	Percentage of Revenue
2016	$0.10	70%
2017	$0.12	68%
2018	$0.14	66%
2019	$0.16	64%
2020	$0.18	62%

Introductory Memorandum to the Amended Testimony and Written Direct Statement of George D. Johnson, at 4 (Jan. 13, 2015).

GEO proposes that royalty rates for subscription webcast streams be the greater of a per-performance rate and a percentage revenue rate:

Year	Per-Performance Rate	Percentage of Revenue
2016	$0.22	70%
2017	$0.24	68%
2018	$0.26	66%
2019	$0.28	64%
2020	$0.30	62%

Id.

2. GEO Proposal 2

As an alternative, GEO proposes a combination of a one-time fee (described as a "cloud locker" fee) and a "usage" fee that is the greater of a per-performance royalty and a percentage of revenue. As with Proposal 1, GEO proposes separate rates for subscription and nonsubscription webcast streams.

GEO's proposed nonsubscription rates are:

Year	Copyright Cloud Locker - One Time Fee	Per-Performance Rate	Percentage of Revenue
2016	$0.50	$0.01	70%
2017	$0.55	$0.02	68%
2018	$0.60	$0.03	66%
2019	$0.65	$0.04	64%
2020	$0.70	$0.05	62%

Id. at 5.

GEO's proposed subscription rates are:

Year	Copyright Cloud Locker - One Time Fee	Per-Performance Rate	Percentage of Revenue
2016	$0.50	$0.10	70%
2017	$0.55	$0.12	68%
2018	$0.60	$0.14	66%
2019	$0.65	$0.16	64%
2020	$0.70	$0.18	62%

Id.

3. GEO Proposal 3

As a third alternative, GEO Proposal 3 consists of a one-time "cloud locker" fee and a per-performance rate. Proposal 3, which GEO describes as being derived from the inflation-adjusted cost of a record album in 1964, would apply to both subscription and nonsubscription web streams. *Id*. at 6-7.

Year	Copyright Cloud Locker - One Time Fee	Per-Performance Rate
2016	$0.50	$0.01
2017	$1.00	$0.02
2018	$1.50	$0.03
2019	$2.00	$0.04
2020	$2.50	$0.05

Id. at 6.

4. Judges' Conclusions with respect to GEO's Rate Proposals

GEO requests that the Judges adopt either Proposal 3 or Proposal 2, "or in between." *Id*. at 23.[115] As discussed above, the Judges conclude that the evidence in the record before us supports a greater-of rate structure or a percentage-of-revenue rate in the current proceeding. GEO provided no evidence to change that holding.

Likewise, the Judges find no persuasive evidence to support a "cloud locker" fee of the type that GEO (and only GEO) proposes. Mr. Johnson presented no expert testimony to support a "cloud locker" rate, nor did he provide any evidence that such a rate structure even exists in the market. What he did provide is his statement: "The streamer's economic model leaves out one crucial element—the customer, and the bundled copyright cloud locker or 'streaming account' forces payment for all music copyrights up-front, one time, like all other products." *Id*. at 5-6. The rates the Judges adopt must be based on substantial evidence in the record. As Mr. Johnson is the only participant to propose a cloud locker rate and he provided no evidence to support such a rate, the Judges find that there is insufficient evidence in the record to support a cloud locker rate.

Therefore, the Judges are left with Mr. Johnson's proposed per-performance rates. The per-performance rates he proposes range from a low of $0.01 per stream ((2016 in Proposal 2 (nonsubscription) and Proposal 3) to $0.30 per stream (2020 Subscription). As with the cloud locker proposal, Mr. Johnson provides no evidence, other than his personal view, that such rates are reasonable, or reflect what a willing buyer and a willing seller would agree to.[116] In the

[115] *See also id*. at 5 ("the Per-Performance Rate and Copyright Cloud Locker One-Time Fee Rate are what GEO is proposing").

[116] *See, e.g., id*. at 7 ("[w]hoever says that songs are too expensive in this rate hearing at $.00 are nothing more than con-men since they expect American music creators to work literally for $.00 per-song when a song really costs $5 dollars [sic] per song using government low-end inflation calculations and a real world 1964 benchmark."). To establish his proposed cloud locker rate, Mr. Johnson requests that the Judges adopt as a benchmark a 2-cent mechanical (section 115) license rate for musical works in effect in 1909, which Mr. Johnson would then adjust for inflation and round to 50 cents per song). *Id*. at 7-8. Mr. Johnson also estimates that a Beatles record purchased for $5 in 1964 would have cost, after adjusting for inflation, $38 in 2014. *Id*. at 6. Since the Judges decline to adopt a cloud locker rate, they need not decide whether the mechanical rate in effect in 1909, adjusted for inflation, would be a suitable benchmark for Section 114 and 112 rates for 2016-2020. Interestingly, the Beatles released two albums in 1964, "Beatles for Sale" and "A Hard Day's Night," both of which are still (or again) available, in vinyl,

absence of such evidence, the Judges cannot adopt Mr. Johnson's proposed per-performance rates.

D. Pandora Rate Proposal

1. Proposed Royalties

Pandora is a noninteractive licensee, and it represents itself as "the leading Internet Radio Service in the United States." PAN Ex. 5002 ¶ 5 (Fleming-Wood WDT). Like SoundExchange, Pandora proposes a greater-of rate structure. Commercial webcasters would pay the greater of 25% of revenue from eligible transmissions and a range of per-performance royalty rates. Pandora proposes separate ranges of royalty rates for subscription and nonsubscription (advertisement supported) commercial webcasting as follows:

Low End of Proposed Range[117] A royalty equal to the greater of (i) or (ii) below:		
(i) Per-Play Rate:		
YEAR	**Per-performance (Nonsubscription)**	**Per-performance (Subscription)**
2016	$0.00110	$0.00215
2017	$0.00112	$0.00218
2018	$0.00114	$0.00222
2019	$0.00116	$0.00226
2020	$0.00118	$0.00230
(ii) 25% of Revenue from Eligible Transmissions		

High End of Proposed Range A royalty equal to the greater of (i) or (ii) below:		
(i) Per-Play Rate:		
YEAR	**Per-performance (Nonsubscription)**	**Per-performance (Subscription)**
2016	$0.00120	$0.00224
2017	$0.00123	$0.00228
2018	$0.00125	$0.00232
2019	$0.00127	$0.00236
2020	$0.00129	$0.00240
(ii) 25% of Revenue from Eligible Transmissions		

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on Amazon.com for prices generally ranging from $15 to $20. *See* beatlesbible.com, referenced on Dec. 14, 2015; Amazon.com, referenced Dec. 14, 2015.

[117] The low and high ends of the proposed range correspond to levels of overspinning (or "steering") of Merlin-member tracks under Pandora's benchmark agreement. The issue of steering and the rate calculations derived from steering are described elsewhere in this determination.

Pandora's Second Amended Proposed Rates and Terms, at 2-3.

2. Pandora's Noninteractive Benchmark

Pandora relies upon the Pandora/Merlin Agreement to support its rate proposal. On June 16, 2014, Pandora and Merlin entered into the Pandora/Merlin Agreement, which established terms and conditions under which Merlin granted Pandora the right to perform of all the sound recordings in the catalogs of those Merlin record companies that would ultimately decide to opt-in to the Pandora/Merlin Agreement. PAN Ex. 5014; Shapiro WDT at 23, 26; PAN Ex. 5007 ¶24 (Herring WDT).

a. Merlin

Merlin is a global rights agency that represents and collectively negotiates on behalf of thousands of independent record companies in the United States and 38 other countries. Van Arman WDT at 10; 6/1/15 Tr. 6865 (Lexton); *see also* 5/18/15 Tr. 4204 (Herring). Merlin's members include numerous prominent independent labels, which produce commercially and critically successful music. *See* Pandora PFF ¶¶ 123-126 (and record citations therein).

These independent record companies negotiate with digital services collectively through Merlin in order to obtain more favorable terms and transaction cost savings than they otherwise could achieve on an individual basis. Van Arman WDT at 10; 4/28/15 Tr. 626-7 (Van Arman); 6/1/15 Tr. 6856-7 (Lexton). Pandora notes that one of the Majors has acknowledged that Merlin is a "virtual [] major." PAN Ex. 5349 at 9 [redacted]); 5/5/15 Tr. 1969:19-23, 1975:8-1977:4 (Rubinfeld).

Merlin established a procedure for its members to either opt-in or opt-out of the Pandora/Merlin Agreement (most members could [redacted], whereas a small number of members reserved the right to [redacted]). Members who were represented by independent distributors (*i.e.*, distributors unaffiliated with the Majors) delegated the decision as to whether to opt-in to these distributors. In total, [redacted] of approximately [redacted] members, covering approximately [redacted] tracks—opted in to the Pandora/Merlin Agreement. 5/18/15 Tr. 4221, 4235 (Herring); 6/1/15 Tr. 6870 (Lexton).

Pandora notes that, by statute, the opting-in Merlin members could have declined to enter into the Pandora/Merlin Agreement and thus remained bound in 2014 and 2015 by the statutory rates that incorporated the Pureplay settlement rates. *See* PAN Ex. 5014 ¶ 1(r); Herring WDT ¶25.[118]

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[118] The statutory Pureplay settlement rates for 2014 and 2015, respectively, are 13¢ and 14¢ for advertising-supported services (or 25% of revenue, whichever is greater), and 23¢ and 25¢, respectively, for subscription services in 2014 and 2015. *Notification of Agreements Under the Webcaster Settlement Act of* 2009, 74 Fed. Reg. 34796, 34799 (July 17, 2009).

b. Key Provisions of the Pandora/Merlin Agreement.

According to Pandora, the key terms of the Pandora/Merlin Agreement are those that set forth the rate structure, royalty payments, and steering provisions:

Rate Structure and Royalty Payments:

- The agreement employs a greater-of royalty structure, with Pandora paying the greater of a per-play prong and a percent-of-revenue prong. The percent-of-revenue prong specifies 25% of Pandora's revenue, prorated based on the share of performances on Pandora accounted for by the Merlin Labels.
- The 2014 "headline" per-play rates are $0.[redacted] for each ad-supported performance and $0.[redacted] for each subscription performance. The 2015 "headline" per-play rates are $0.[redacted] for each ad-supported performance and $0.[redacted] for each subscription performance. PAN Ex. 5014 at ¶ 3(a); Herring WDT at ¶ 26; Shapiro WDT at 26.[119]

Steering Provisions:

Steering is the term Pandora uses to describe a licensee's "ability to control the mix of music that's played on the service in response to differences in royalty rates charged by different record companies." 5/8/15 Tr. 2683-4 (Shapiro). Just as the "ratio equality" is foundational to SoundExchange's rate proposal, the concept of "steering" is foundational to Pandora's rate proposal. Shapiro WDT at 27 ("This reduced per-play rate in exchange for increased plays is the central piece of the Merlin Agreement.").

According to Pandora, steering and the concomitant discounting terms are feasible in the noninteractive market because Pandora has *now* tested and proven its ability to modify its playlist-selecting algorithms to rely more or less heavily on the music of particular record companies so that it can steer its listeners toward or away from the music from any one record company, thereby permitting "workable competition" to emerge in the relevant, noninteractive webcasting market. 5/19/15 Tr. 4557 (Shapiro). By contrast, Pandora notes, no evidence of such a steering capability existed at the time of the *Web II* or *Web III* proceedings. Shapiro WDT at 16.

Pursuant to the Pandora/Merlin Agreement, the "headline" per-play rates can be reduced by steering as follows.

For Pandora's Ad-Supported Nonsubscription Service	
2014	
Headline Rate $ 0.[redacted]	**Steered Rate** $ 0.[redacted]
2015	
Headline Rate $ 0.[redacted]	**Steered Rate** $ 0.[redacted]

[119] There is no separate fee in the agreement for ephemeral copies of the recordings; such copies are covered under and included within the performance fees above. PAN Ex. 5014 at ¶ 3(d); Herring WDT at ¶ 26.

For Pandora's Subscription Service	
2014	
Headline Rate $ 0.[redacted]	**Steered Rate** $ 0.[redacted]
2015	
Headline Rate $ 0.[redacted]	**Steered Rate** $ 0.[redacted]

Thus, Pandora claims that steering reduced the headline rates for its ad-supported, nonsubscription service by [redacted]% in 2014 and would reduce those headline rates by [redacted]% in 2015. Moreover, Pandora claims that steering reduced the headline rates for its subscription service by [redacted]% in 2014 and would reduce that headline rate by [redacted]% in 2015. PAN Ex. 5014 at ¶ 4; Herring WDT at ¶ 27; Herring AWRT at ¶ 48; Shapiro WDT at 27.

The calculation of these effective steered rates is explained in paragraph 4 of the Pandora/Merlin Agreement, which sets forth the following provisions for calculating the rates resulting from steering, using the 2014 ad-supported headline rate of $0.[redacted] as an example.

Pandora promises to increase "quantity" (spins) by at least [redacted]% in the aggregate above Merlin's "Natural Performance Rate."120 However, Pandora will not pay a "price" equal to the $0.[redacted] headline rate for these additional spins. Instead, in exchange for its promise to play at least [redacted]% additional spins, Pandora will receive a "discount" on the price paid for [redacted].

That discount is calculated as [redacted] PAN Ex. 5014 at ¶ 4(a)-(c).

In support of a statutory rate based on the steering aspects of the Pandora/Merlin Agreement, Pandora advances several arguments. First, Pandora maintains that steering embodies "price competition at work," and therefore reflects an "effectively competitive" market. 5/19/15 Tr. 4561-64 (Shapiro). Effective competition results from the power to steer because, according to Dr. Shapiro, a streaming service that possesses an ability to "steer" towards certain recordings, and away from others, will have "much more bargaining power and be able to negotiate a lower royalty rate." Shapiro WRT at 19. In theoretical terms, a service's ability to steer increases its price elasticity of demand, reducing the extent to which a licensor

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[120] The Pandora/Merlin Agreement defines "Natural Performance Rate" as [redacted] PAN Ex. 5014 ¶ 1(k). More specifically, Pandora promised an *aggregate* increase of Merlin-label spins of at least [redacted]%, while promising to [redacted] to increase the spins of individual Merlin member labels by at least that amount. *Id.* at ¶ 4(a).

can mark up its price over marginal cost. 5/19/15 Tr. 4561-64 (Shapiro); 5/8/15 Tr. 2725-27 (Shapiro); Pandora PFF at ¶¶ 147-148, 152-157 (and record citations therein).[121]

Second, Pandora asserts that steering is not only theoretical and a contractual commitment, it is occurring under the Pandora/Merlin Agreement. Specifically, Pandora is actually steering [redacted]% above Merlin's "natural performance rate" of sound recordings, greater than the [redacted]% it has contractually committed to steer — evidencing that Pandora's steering behavior is motivated by "price differences," not merely by the contractual "steering commitment." Shapiro WRT at 41; *see* 5/18/15 Tr. 4229 (Herring); Herring AWRT at ¶ 50.

Dr. Shapiro noted that when steering is possible, the mere *threat* (explicit or implicit) by the service to divert performances from one record company to another gives the service negotiating leverage." Shapiro WRT at 20 (emphasis added). In such a market, he opines, "[a] record company facing a webcaster with considerable ability to steer customers away from its music has a strong incentive to discount its music to increase the number of performances of its music made by that webcaster." Shapiro WDT at 9-10. Thus, according to Pandora, the ability to steer creates price competition that can obviate the need for any actual steering in the hypothetical market. Shapiro WDT at 9 ("The net result in a workably competitive market may well be relatively little actual steering ….").

Pandora avers that the Pandora/Merlin Agreement's steering provisions reflect these competitive forces, *i.e.*, a supplier offering a lower price in an attempt to gain volume. Shapiro WDT at 27 ("This reduced per-play rate in exchange for increased plays is the central piece of the Merlin Agreement. This feature plainly demonstrates that the Merlin Agreement is embracing the workings of a competitive market."); Shapiro WRT at 19; *see* 5/19/15 Tr. 4574-5 (Shapiro).

According to Pandora, from the "willing buyer" perspective, the ability to steer provides Pandora with the "competitive incentive to play directly-licensed tracks more heavily than [it] would otherwise." Herring AWRT at ¶ 48. On the other side of the transaction, according to Pandora, the record shows that for a "willing seller," *i.e.*, a Merlin member who opted-in, this steering-based agreement, constituted a "good competitive move," taken in the record company's "self-interest." 4/28/15 Tr. 610-11 (Van Arman).

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[121] The relationship among elasticity, price and costs as a basis to measure market power is described by the Lerner Equation (or Lerner Index) – a fundamental economic pricing rule. Shapiro WDT at 5. The Lerner Equation states that there is an inverse relationship between the firm's margin (the gap between price and marginal cost) and the firm's elasticity of demand. That is, the increase in a buyer's (licensee's) own elasticity of demand (*n*) reduces the price (*P*) paid by the licensee over the licensor's marginal cost (*MC*) pursuant to the Lerner Equation. In mathematical terms, the Lerner Equation can be expressed as:

$$\frac{P - MC}{P} = \frac{1}{n}$$

Thus, an increase in own-elasticity *n* (holding *MC* constant) reduces the value of each side of the equation. *See generally* Edwin Mansfield and Gary Yohe, *Microeconomics* 376 (11th ed. 2004) ("Economists often use the Lerner Index … to measure monopoly power or market power.").

Pandora further avers that its “overspinning” of Merlin tracks by [redacted]% has not resulted in any negative feedback from Pandora listeners or any negative financial impact. 5/18/15 Tr. 4229-33 (Herring) (explaining that Pandora increased plays of Merlin tracks, on an aggregate basis, by approximately [redacted]% in 2014, but this change in the mix of spins did not cause any increase in “complaints about song quality from Pandora listeners).

c. Pandora’s Steering Experiments

In support of its assertion that the effects of potential steering can be pervasive in the noninteractive market, Pandora relies in part on its own internal “steering experiments.” More particularly, in 2014, at Dr. Shapiro’s direction, Pandora conducted a set of steering experiments to test its ability to overspin recordings owned by each of the Majors.

The 2014 steering experiments were conducted by Pandora’s in-house “Science Team” which has primary responsibility for designing and analyzing “controlled experiments.” PAN Ex. 5020 ¶ 7 (McBride WDT). Pandora witness Dr. Stephen McBride is a member of Pandora’s Science Team, which performs research and analyses to measure the effectiveness of features offered by Pandora. McBride WDT ¶¶ 1, 5. The Science Team is composed of 15 individuals, 13 of whom hold doctorate degrees in computer science, engineering, statistics, or economics from leading academic institutions. *Id.* at ¶ 5.

Pandora’s controlled experiments (including the steering experiments) consist of comparisons between randomly selected groups of listeners, one group receiving a manipulated experience (the “treated” group) and the other group receiving the standard Pandora experience (the “control” group). *Id.* These experiments are randomized, controlled, and blind. *Id.*[122]

Pandora initiated the steering experiments because: (1) it had the general technological capability to perform more of one record company’s sound recordings and/or fewer of another record company’s sound recordings; and (2) it recognized that, as a noninteractive service it has the economic incentive to “steer” its performances toward music owned by a particular record company if that music is available at a lower royalty rate. Shapiro WRT at 22-25. Therefore, Pandora decided to determine through its steering experiments whether and to what extent it could use this technological ability to steer performances *without negatively affecting listenership*. Herring WDT ¶¶ 22, 31-32; McBride WDT ¶¶ 12-22; Shapiro WDT at 27; Shapiro WRT at 22-25.

Thus, from June 4, 2014, to September 3, 2014 (13 weeks), Dr. McBride and his colleagues at Pandora conducted a series of steering experiments in order to answer two questions: (1) whether increases or decreases in performances of sound recordings owned by a particular record company would have a measurable impact on a key listener metric (average

[122] “Randomized” means listeners are assigned randomly to either the “treated” group or the “control” group, to ensure valid causal inference. *Id*. at n.1. “Controlled” means the outcome is a comparison between those receiving the exposure and those not receiving the exposure, to account for the “placebo effect.” *Id.* “Blind” means experimental subjects are unaware of their participation in an experiment and, therefore, are also unaware of whether they have been assigned to the treatment group or the control group. *Id.*

hours listened per registered user; and (2) whether Pandora's engineers could precisely manipulate the share of music played according to the record company that owns the recordings. McBride WDT ¶¶ 7, 12, 15.

- The Steering Experiments consisted of a group of 12 experiments. Each experiment involved a combination of one of three target ownership groups (UMG, Sony or WMG) and a target "deflection" in share of spins (treatment group) as compared to spins that would occur according to the standard Pandora music recommendation results (control group). McBride WDT ¶ 15.[123] The spin share deflections (the "steering") were: -30%, -15%, +15%, and +30% for each of the three ownership groups manipulated. Id. The experimental subjects of the Steering Experiments were all Pandora listeners, each of whom was randomly assigned to one of the 12 treatment groups, to the single control group, or were included in the portion of listeners excluded from all experiments. McBride WDT ¶ 16.

The experiments demonstrated that Pandora was able to steer -15% or +15% for all three Majors without causing a statistically significant change in listening behavior. McBride WDT ¶ 21. However, Pandora was unable to steer -30% or + 30% for Universal or Sony without creating a statistically significant change in listening behavior. *Id*.

d. Additional Terms in the Pandora/Merlin Agreement[124]

The Pandora/Merlin Agreement contains the following additional terms that are specifically addressed by Dr. Shapiro in his benchmark analysis:

- [redacted]: Pandora also agreed to provide the Merlin members who opted in with a [redacted] in the event Pandora [redacted]. PAN Ex. 5014 at ¶ 3(e); Herring WDT ¶ 26; Shapiro WDT at 28-29. This provision has not been triggered, 6/1/15 Tr. 6897 (Lexton), and Merlin's negotiators understood it was unlikely ever to be triggered. *Id.* at 6956-57; PAN Ex. 5110.
- **Compensable Performances**:
- Performances of [redacted] are non-compensable. All other performances are subject to a fee. 5/18/15 Tr. 4227 (Herring).
- Certain tracks designated as [redacted] are compensable at only [redacted] the headline rates. 5/18/15 Tr. 4227 (Herring).

[123] The Steering Experiments operated through Pandora's "A/B Framework," by which the Science Team intentionally changes one aspect of the Pandora experience for a sample group of listeners (the "B" group, or treated group) and then compares the effects to groups of listeners who did not experience the change (the "A" group, or control group). McBride WDT ¶¶ 7-8 and 16.

[124] Dr. Shapiro's decision as to whether and to what extent to adjust his benchmark to reflect such additional terms is considered elsewhere in this determination.

- [redacted] The Merlin members who opt-in are [redacted] to receive a specified [redacted]. PAN Ex. 5014 at ¶ 5; Herring WDT ¶ 29.
- **Ancillary Promotional Benefits**: Additional non-pecuniary promotional benefits for Merlin, including [redacted] *See* PAN Ex. 5014 at ¶¶ 6-11.

See Herring WDT ¶ 30; Shapiro WDT at 29.

e. Pandora's Conclusion Regarding the Benchmark Status of the Pandora/Merlin Agreement

Based on the foregoing, Pandora asserts that the Pandora/Merlin Agreement is the best benchmark in this proceeding because

- it constitutes a competitive and arms-length direct license between a noninteractive webcaster and thousands of record companies;
- it concerns the same rights as are covered by the statutory license;
- it covers the same type of products at issue in this proceeding – public performances of sound recordings on noninteractive Internet radio; and
- it involves the same "willing sellers" (record companies that own sound recording copyrights) and a "willing buyer" (Pandora) that exist in the hypothetical market.

PAN Exs. 5014-5015; Shapiro WDT at 24-25; *see also* 5/28/15 Tr. 6323-24 (Rubinfeld) (agreeing that the Pandora/Merlin Agreement satisfied each such criterion).

3. Pandora's Calculation of Royalty Rates Implied by Its Proposed Benchmark

Pandora and its economic expert, Dr. Shapiro, did not simply apply the steering-adjusted rates implied by the Pandora/Merlin Agreement, but rather also considered potential further adjustments that might be required for an "apples-to-apples" comparison of the terms in the Pandora/Merlin Agreement with the statutory terms applicable to noninteractive licenses. *See* Shapiro WDT at 20-21, 23-37, Appendix D ("Analysis of Merlin Agreement").

a. Potential Additional Adjustments

The three principal aspects of the Merlin Agreement that Dr. Shapiro considered for potential additional adjustments were:

1. differences in the determination of which performances are compensable as compared to the statutory license (*i.e.*, consistent treatment of [redacted] and [redacted]);
2. additional financial terms of the Pandora/Merlin Agreement, including [redacted] and
3. non-pecuniary terms in the Pandora/Merlin Agreement.

5/19/15 Tr. 4592-930 (Shapiro); Shapiro WDT Appendix D at D-1-D-9; *see* 5/19/15 Tr. 4592-4593; Shapiro WDT Appendix D at D-1-D-9; Shapiro WDT at 30.

i. Adjustment for Royalty Bearing Plays [redacted])

This adjustment is required, according to Dr. Shapiro, because, on the one hand, the Pandora/Merlin Agreement treats [redacted] as non-compensable and the performance of [redacted] as compensable, but the statutory licenses takes the opposite tack on both issues – treating [redacted] as compensable and the performance of [redacted] as non-compensable. *Id.* To adjust for both of these factors. Dr. Shapiro took the following steps.

First, he calculated the total payment Pandora expected to make to the opting-in Merlin members for all sound recordings under the Pandora/Merlin Agreement.

Second, he divided that total payment by the number of performances of Merlin Label recordings that would be compensable under the statutory license (as currently defined). Shapiro WDT at 30-31; Appendix D.

Dr. Shapiro describes this calculation as yielding a per-play rate that the Pandora/Merlin Agreement would establish if Pandora and Merlin had negotiated an agreement with a fixed per-play rate that treated [redacted] as compensable and performances of [redacted] as non-compensable. *Id.* To make the point more clearly, Dr. Shapiro offered the following example:

	Calculation	Value
Pandora Performances of Merlin Music	[a]	1,000,000
Number of [redacted]	[b]	200,000
Number of [redacted]	[c]	100,000
Compensable Performances Under Merlin License	[d] = [a] - [b]	800,000
Payment Per Compensable Play Under Merlin License	[e]	$0.00125
Total Royalty Payment Under Merlin License	[f] = [d] x [e]	$1,000
Compensable Performances Under Statutory License	[g] = [a] - [c]	900,000
Effective Per-Play Rate Under Statutory License	[h] = [f] ÷ [g]	$0.00111

Shapiro WDT at 30-31; 5/19/15 Tr. 4589-92 (Shapiro); *see id.*at 4594 (noting that $0.[redacted] rate was "an illustrative example," and "not a rate proposal").[125]

ii. Potential Adjustments for Additional Financial Terms

The Pandora/Merlin Agreement contains additional financial terms not permitted in the statutory license. Dr. Shapiro attempted to determine whether it was appropriate to increase his proposed rate to reflect values for these items. Dr. Shapiro ultimately found no basis to increase

[125] Dr. Shapiro also made a small adjustment in his effective royalty rate calculation to reflect that certain tracks [redacted]. PAN Ex. 5014 (1)(c) and 3(c) . Dr. Shapiro assumed that [redacted] would represent [redacted]% of Merlin tracks overall. Shapiro WDT at App. D-7.

his proposed rates to reflect these items. Shapiro WDT at 28-29 (Appendix D); *see* 5/19/15 Tr. 4592-93 (Shapiro). Broadly, Dr. Shapiro found no value in these additional terms because neither Pandora nor Merlin had calculated or even estimated any value attributable to these items. More particularly, Dr. Shapiro analyzed these additional financial terms in the following manner.

(A) The [redacted] Provision

Dr. Shapiro assigned no separate value to Merlin's contractual right to receive [redacted]. According to Dr. Shapiro, he made no adjustment to his proposed rate to reflect this term because Pandora's financial projections did not show that Pandora would [redacted] in 2014 or 2015. *Id*. at 4689-90.

(B) The [redacted]

Dr. Shapiro also assigned no separate value to the [redacted], that provided Merlin with [redacted] He testified that he declined to add a separate value for [redacted] because:

> [The] rate proposal is based on payments that Pandora is making and will be making to Merlin where the guarantee is binding. So the insurance is coming in. And those payments are included and, of course, raise the amounts of money that Pandora is paying and, therefore, they raise the rate that's in my proposal, so it includes that.

Id. at 4696.

iii. Potential Adjustments for Non-Pecuniary Terms

The Pandora/Merlin Agreement also contains non-pecuniary financial terms that are not permitted in the statutory license. Dr. Shapiro attempted to determine whether it was appropriate to increase his proposed rate to reflect any values for these items. Shapiro WDT at 29-31; Appendix D at D-10-19 ("Non-Pecuniary Terms in the Merlin Agreement"); *see* 5/19/15 Tr. 4595-98 (Shapiro).

(A) [redacted] on Pandora

Dr. Shapiro did make an adjustment to increase his calculated "steered" rate by 0.0002¢ (i.e., $.000002) per-performance to reflect [redacted] made available by Pandora to Merlin in [redacted] of the Pandora/Merlin Agreement. Shapiro WDT at 31; Shapiro WDT at 31; Appendix D, at D-11 to D-12.

(B) [redacted]

Pursuant to the Pandora/Merlin Agreement, Pandora agreed to allow each Merlin member that had opted-in to [redacted] PAN Ex. 5014 § 7. Dr. Shapiro did not make an adjustment to increase the value his benchmark for this non-statutory benefit, because Pandora personnel told him that "[redacted] are mutually beneficial to the Merlin Labels and to Pandora." Shapiro WDT at D-12. With regard to the benefit to Pandora, Dr. Shapiro was informed by Pandora personnel that

"Pandora considers that [redacted] strengthen artist engagement with Pandora and thereby drive incremental listening and listeners to the service, build brand loyalty, and enhance listener retention." *Id*.; *see* Westergren WDT ¶ 38. Accordingly, Dr. Shapiro could not determine that the value of such [redacted] was greater to the Merlin members than to Pandora, and, consequently, he concluded that no adjustment to the effective royalty rate was necessary. Shapiro WDT at D-13.

(C) [redacted]

Each Merlin member that opted-in to the agreement could elect to [redacted] PAN Ex. 5014 (Pandora/Merlin Agreement § 8).

According to Dr. Shapiro, [redacted] are mutually beneficial to the opting-in Merlin members and to Pandora. Shapiro WDT at D-13. Dr. Shapiro took note that Pandora believed the presence of [redacted] might be "accretive to the listener experience" as well as a form of advertising, and that Pandora was in fact planning controlled tests to measure listener responses and solicit listener feedback in order to determine the appropriate nature and frequency of [redacted] on [redacted] stations." *Id.* In light of the mutually beneficial nature of [redacted] Pandora personnel informed Dr. Shapiro that, even without a contractual obligation to do so, Pandora offered [redacted], gratis, along with Pandora Premieres tracks. Shapiro WDT at D-13 & n.26.

In light of the foregoing, Dr. Shapiro could not conclude that the [redacted] provision on balance created more value for Merlin than for Pandora, and therefore he made no adjustment to his proposed effective royalty rate on that basis.

(D) Access to Pandora Metrics

Pursuant to the Pandora/Merlin Agreement, opting-in Merlin members will receive [redacted] metrics regarding [redacted] PAN Ex. 5014 § 9 (Pandora/Merlin Agreement) see also Shapiro WDT at D-14 & n.29); Herring WDT ¶ 30.

However, Dr. Shapiro noted that, at the time he prepared his testimony, Pandora was also developing a service called the Artist Marketing Platform ("AMP"), expected to launch in October 2014, through which Pandora proposed to provide these same metrics to all artists, not only to artists on the labels of Merlin members. Pandora did not plan to charge for AMP. Shapiro WDT at D-14 & n.30; *see* Herring WDT ¶ 30.

Since Pandora stated that it intended to make its AMP available to all artists at no charge, Dr. Shapiro concluded that no adjustment to the effective royalty rate was necessary to account for the Pandora Metrics to which Merlin Labels would have access. Shapiro WDT at D-14.

(E) [redacted]

Under the Agreement, Pandora, [redacted], may create a [redacted]

[redacted] PAN Ex. 5014 § 10 (Pandora/Merlin Agreement); *see also* Shapiro WDT at D-14, D-15 7 n.31.

Pandora personnel explained to Dr. Shapiro that such [redacted] were potentially mutually beneficial to the Merlin members and to Pandora. *Id.* at n.32. The Merlin members benefit from [redacted], generating benefits to the Merlin members in the form of enhanced royalties and discovery of their other artists. *Id*. For Pandora, these [redacted] offer another context for engaging listeners and, by increasing the number of Merlin member plays on Pandora, these [redacted] work in tandem with the steering provisions in the Pandora/Merlin Agreement.

By way of comparison, Dr. Shapiro noted that Pandora is working with another entity to [redacted] that will feature specific artists. *Id.* at n. 34; *see* Herring WDT ¶ 30, n.11. Pandora personnel informed Dr. Shapiro that neither Pandora nor the entity [redacted] is [redacted], which suggested to Dr. Shapiro that such [redacted] create "mutual and roughly equalized benefits for both Pandora and the [redacted] creator." Shapiro WDT at D-15.

For these reasons, Dr. Shapiro concluded that no adjustment to the effective royalty rate was necessary to account for the [redacted] provision in the Merlin Agreement. *Id*. at D-15 to D-16.

(F) Pandora Presents and Pandora Premieres Events

Pursuant to the Pandora/Merlin Agreement, opting-in Merlin members receive [redacted] in "Pandora Presents" and "Pandora Premieres" events. PAN Ex. 5014, § 11 (Pandora/Merlin Agreement). Dr. Shapiro considered these two types of events separately.

(1) Pandora Presents

Pandora Presents is a program launched in December 2011, through which artists perform live before an audience of fans that Pandora identifies and invites without charge. Fleming-Wood WDT ¶ 29. Each of these events is designed for and sponsored by an advertiser. Pandora essentially plays the role of a concert producer and promoter, choosing artists to feature in Pandora Presents events that will best speak to the target audience of the sponsoring advertiser. *Id.* Pandora identifies and matches advertisers and artists that appeal to a particular demographic, then books a location for the event and markets the event to Pandora listeners with a demonstrated interest in the featured artist. Pandora [redacted]. Pandora [redacted]; sometimes Pandora [redacted]. Shapiro WDT D-17 n.43.

There have been between [redacted] Pandora Presents events per year featuring artists on Merlin labels. *Id.* Pandora estimates that Merlin member artists [redacted]. *Id.*

Pandora acknowledges that Pandora Presents generates promotional benefits for the featured artists. However, Pandora also understands that Pandora Presents also generates marketing benefits for Pandora with respect to advertisers, listeners, artists, and labels. *Id.* More particularly, Pandora not only views the program as a marketing platform that adds value for

Pandora's service, but Pandora has also required that Pandora Presents events [redacted]. Fleming-Wood WDT ¶ 29 & n.5; *see* Westergren WDT ¶ 38. Pandora Presents events thus generate additional advertising revenue for Pandora as well as promotion of the Pandora brand with Pandora listeners. Over the long run, Pandora considers that Pandora Presents events lead to increased listener satisfaction and retention, and thus to greater advertising and subscription revenue. *Id.*

Because of the foregoing, Dr. Shapiro likened Pandora's role in coordinating Pandora Presents events to that of an independent concert producer and promoter. Therefore, Dr. Shapiro concluded that the [redacted] Pandora Presents events, on balance, did not call for any adjustment to the effective royalty rate he had calculated. Shapiro WDT at D-17.

(2) Pandora Premieres

Pandora Premieres is a program through which Pandora promotes albums in the week prior to their release. Fleming-Wood WDT ¶ 30. Pandora sends an email inviting certain listeners (selected based on their listening tastes and profiles) to listen to a new album during the week prior to its release date. *Id.*; *see also* Shapiro WDT at D-17, n.45. When selecting albums to feature on Pandora Premieres, Pandora reviews albums and artists proposed by the record companies to ensure "a good fit with the program" and to "generate a high volume of listening." Fleming-Wood WDT ¶30. Pandora provides these selected Pandora Premieres listeners with "click-to-buy functionality." *Id.* at n.46.

Pandora requires the labels to waive royalties for the one-week period that an album is on Pandora Premieres. Shapiro WDT at D-18. Pandora personnel informed Dr. Shapiro that Pandora has never charged labels for their participation in Pandora Premieres and has no plans to do so. *Id.* at D-18, n.49.

Pandora Premieres features two to five albums per week, or about 150 albums annually. Fleming-Wood WDT ¶ 30. Pandora personnel informed Dr. Shapiro that approximately [redacted] percent of these albums are by artists whose labels are Merlin members and Pandora estimates that participation by artists whose labels are Merlin members will [redacted] to [redacted] percent. Shapiro WDT at D-18, nn.51,52. Pandora also estimates that the number of Merlin label albums featured on Pandora Premieres will [redacted] from around [redacted] per year to around [redacted] per year. *Id.* at n.53.

Dr. Shapiro acknowledges that Pandora Premieres generates promotional benefits for the featured artists and their labels, but that benefit is offset by (and evident from) the fact that labels waive royalties for the one-week period that an album is on Pandora Premieres. Shapiro WDT at D-18. Pandora also receives significant benefits from Pandora Premieres, because it offers a benefit to Pandora listeners, who receive an early opportunity to listen to entire new albums from artists they like and to buy the music. Fleming-Wood WDT ¶ 30.

On balance, therefore, Dr. Shapiro concluded that Pandora Premieres generates significant benefits both to the artists and label, on the one hand, and to Pandora as well. Because the program is mutually beneficial, and because Pandora [redacted], Dr. Shapiro concluded that the [redacted] in

Pandora Premieres does not call for an adjustment to the effective royalty rate he had calculated. Shapiro WDT at D-19.[126]

iv. Adjustments over the 2016-2020 Period.

Dr. Shapiro adjusted his proposed rates higher to reflect anticipated inflation over the 2016-2020 statutory period. Shapiro WDT at 35. However, at the hearing, Dr. Shapiro testified that he would have preferred not to predict future inflation, but rather to include a statutory term requiring the rates to be adjusted annually to reflect actual inflation. 5/19/15 Tr. 4608-10 (Shapiro). Dr. Shapiro did not make any other adjustments to reflect anticipated or predicted changes over the statutory period. His adjusted rates are set forth in the table below:[127]

Effective Per-Play Royalty Rates After Adjustments
2016 Through 2020
(¢)

	Inflation Rate*	Advertising-Supported	Subscription	Blended[128]
30% Steering				
2016	2.20%	0.1105	0.2146	0.1225
2017	1.73%	0.1124	0.2183	0.1246
2018	1.74%	0.1144	0.2221	0.1268
2019	1.76%	0.1164	0.2260	0.1290
2020	1.78%	0.1185	0.2300	0.1313
12.5% Steering				
2016	2.20%	0.1205	0.2238	0.1324
2017	1.73%	0.1226	0.2276	0.1347
2018	1.74%	0.1247	0.2316	0.1370
2019	1.76%	0.1269	0.2357	0.1394
2020	1.78%	0.1291	0.2399	0.1419

* The inflation rate reported for 2016 accounts for expected inflation from the mid-point of the period Q4 2014 through 2015 (May 2015) to the midpoint of 2016 (August 2016). The other inflation rates account for annual expected inflation to the mid-point (August) of each calendar year listed.

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[126] Dr. Shapiro also considered two factors enumerated in the statutory willing buyer/willing seller formulation – Pandora's potential role in promoting or substituting for other Merlin label revenue streams, and Pandora and Merlin's "relative contribution." He concluded that, as rational economic actors with access to information regarding such factors, the parties would attempt to make sure that such elements were "fully baked in" and "automatically included" in the negotiated rates. 5/19/15 Tr. 4605-06 (Shapiro). Given this fact, Dr. Shapiro made no further adjustments to the rates he derived from the Pandora/Merlin Agreement.

[127] The rates in the table differ from the rates proposed by Pandora because the proposed rates are rounded.

[128] Dr. Shapiro blended the ad-supported and subscription rates to create his "blended" rate. However, Pandora does not propose that the Judges adopt such a "blended" rate,

Dr. Shapiro explained why he proposed two alternative rates: "[The rate selected] depends on how much steering Pandora is doing. If they do more steering, that lowers the rate they're going to be paying, in fact, and so then that lowers the corresponding statutory rate derived from the Merlin Agreement." 5/19/15 Tr. 4603-04 (Shapiro).

a. Pandora's Proposed Greater-of Rate Structure Including a 25% of Revenue Prong

In addition to the proposed per-play rates, Dr. Shapiro's rate proposal employs a greater-of structure, with the second prong set at "25 percent of the revenue attributable to the licensed music," as such revenue is defined in the regulations proposed by Pandora. Shapiro WDT at 20 and n. 30; 5/19/15 Tr. 4608:16-23 (Shapiro). This is the same greater-of rate structure adopted by the parties to the Pandora/Merlin Agreement. PAN Ex. 5014 at ¶ 3(a). According to Dr. Shapiro, a greater-of formula with a "percent-of-revenue" prong is proper for the following reasons.

> [T]he Merlin Agreement …specifies that Pandora's royalty payments to the participating Merlin Labels … will be at least 25 percent of its revenue attributable to the music of those labels. These agreements show that, as a practical matter, royalties for recorded music can indeed be based on webcaster revenues, at least in the case of Pandora. Furthermore, webcasters and many other types of music users pay royalties to music publishers and composers, through ASCAP and BMI that are set as a percentage of revenue. For example, the ASCAP rate court recently established a royalty rate for Pandora of 1.85 percent of revenue for the period 2011-2015 for its performance of musical compositions in the ASCAP repertoire. This indicates to me that webcasting revenues can serve as a practical basis for royalty payments.

Shapiro WDT at 23.[129]

b. Pandora's Proposed Application of the Pandora/Merlin Rates to the Majors

Pandora avers that the effective rates established by the Pandora/Merlin Agreement are not only representative of the rates that *Indies* would receive as willing sellers in the hypothetical marketplace, but are also representative of the rates that the *Majors* would receive in the hypothetical marketplace. Pandora's explanation as to why this extrapolation is warranted is based on its distinction between greater revenue derived from a higher number of plays as opposed to greater revenue from a higher per-play rate. As Dr. Shapiro opined, Majors have a higher share of the overall plays on Pandora than the Merlin Labels do, and thus they receive

[129] Dr. Shapiro assigned no separate value to the 25% of revenue prong for adjustment of the per-play prong, because he understood that the per-play prong would result in a payment by Pandora to Merlin of approximately [redacted]% of revenue attributable to Merlin, thus not triggering the lower 25% prong. 5/19/15 Tr. 4683-4 (Shapiro). Further, because Dr. Shapiro included a second prong incorporating the 25% of revenue royalty payment, he concluded that it would be "double counting or just nonsensical" to add the value of that prong into the per-play prong. *Id.* at 4686.

more in royalty income because that "occurs automatically under a per-play rate structure or a percent-of-revenue structure with payments prorated according to label share." Shapiro WDT at 37-38. The relevant question for purposes of rate-setting, therefore, according to Dr. Shapiro, "is whether the repertoires of the [Majors] would command a higher rate *per play* or a higher percent-of-revenue than the Merlin Labels in a workably competitive market." *Id.*

Pandora answers this question in the negative, for two reasons. First, according to Dr. Shapiro, the empirical evidence demonstrates that there is no greater promotional effect on the sale of songs from the Majors (as compared to the Indies) from performances on Pandora to support an upward adjustment to the Merlin benchmark. 5/19/15 Tr. 4623-64 (Shapiro). Second, Pandora has the same ability to steer toward and away from the repertoires of each of the Majors, just as it has done with the Merlin Labels. *See* 5/19/15 Tr. 4624-30 (Shapiro); Shapiro WDT Appendix F, at F-6.[130]

To bolster this argument, Pandora notes that Dr. Rubinfeld's analysis vis-à-vis his own interactive benchmark reveals that Merlin receives essentially the same level of monetary consideration as the Majors in the interactive market. Pandora concluded therefore that the effective rates derived from the Pandora/Merlin Agreement indeed can serve as benchmarks for the rates to be paid by the Majors. *See* Pandora PFF ¶¶ 158-163 (and citations to the record therein).

4. SoundExchange's Criticisms of the Pandora Rate Proposal

SoundExchange opposes the use of the Pandora/Merlin Agreement as a benchmark in this proceeding. Its opposition is based upon several principal arguments, summarized below.

a. The Pandora/Merlin Agreement Creates New Rights and New Obligations that are Unavailable under the Statutory License.

SoundExchange asserts that the Pandora/Merlin Agreement does not cover the *same rights* that are available under the statutory license and also creates *new obligations* that are *unavailable* under the statutory license. Specifically, SoundExchange avers that the Pandora/Merlin Agreement contains the following extra-statutory rights and duties:

- [redacted];
- [redacted];
- [redacted];
- [redacted];
- [redacted];
- [redacted];
- [redacted]; and
- [redacted].

[130] Dr. Shapiro's conclusion that noninteractive services can steer away from the Majors as well as the Indies is based upon Pandora's "steering experiments."

See PAN Ex. 5014, §§ 1(c)(v), § 2(c) and 13; *see generally* SX PFF ¶¶ 559-562 (and record citations therein).

Given these differences between the Pandora/Merlin Agreement and the statutory license, SoundExchange concludes that the former at best is but a weak benchmark for the latter. *See* SX PFF ¶ 558 (quoting *SDARS II*, 78 Fed. Reg. at 23064 (Apr. 17, 2013)) (Additional considerations and rights granted in [a proposed benchmark] that are beyond those contained in the Section 114 license weaken the [benchmark's] "comparability as a benchmark.").

b. Dr. Shapiro Failed Adequately to Value the Non-Statutory Consideration and thus Wrongly Failed to Increase His Benchmark

According to SoundExchange, not only is the Pandora/Merlin Agreement a deficient benchmark, Dr. Shapiro also wrongly failed to increase the value of that benchmark to reflect the value of the non-statutory consideration in the Pandora/Merlin Agreement. SoundExchange asserts that Dr. Shapiro instead focused only on the lack of value attributed *by Pandora* to these other forms of consideration. *See* Shapiro WDT App. D at 1; 5/19/15 Tr. 4670 (Shapiro). However, SoundExchange notes that Dr. Shapiro acknowledged on cross-examination that he thought it would be important to know Merlin's expectations as to value in order to do a "proper analysis" of the value of the Pandora/Merlin Agreement." *Id*. at 467-71. Moreover, SoundExchange notes that the value analysis undertaken by Dr. Shapiro is not based on Pandora's expectations that existed *before* the execution of the Pandora/Merlin Agreement, but rather on the valuation evidence he obtained from Pandora *after* the Pandora/Merlin Agreement had been executed. *Id.* at 4669.

SoundExchange asserts that, had Dr. Shapiro considered the value placed on these extra-statutory elements of consideration by Merlin and its members, the total value of the consideration would have at least equaled the existing Pureplay statutory settlement rates for 2014 and 2015. In support of this point, SoundExchange relies in substantial measure on the testimony of one of Merlin's two chief negotiators of the Pandora/Merlin Agreement, Charlie Lexton, Merlin's Head of Business Affairs and General Counsel. SX Ex. 13 ¶ 1 (Lexton WRT). Mr. Lexton testified that, in Merlin's view, the consideration provided to Merlin members by the Pandora/Merlin Agreement was, "at worst, no lower than the compensation under the existing statutory rate paid by Pandora." *Id*. at 17.

More particularly, SoundExchange relies on the following evidence and testimony with regard to items of extra-statutory consideration.

i. The [redacted] Provision and Merlin's [redacted]

According to SoundExchange, the evidence shows that Merlin and its members placed a value on the [redacted] provision, because Merlin obtained this provision through its negotiations with Pandora. 6/1/15 Tr. 6894-95 (Lexton). Specifically, Merlin had initially asked for [redacted], which Pandora refused to provide, leading to this [redacted] provision as an alternative to [redacted]. *Id.* Further, Mr. Lexton testified that Merlin "definitely" would not have entered into the Pandora/Merlin Agreement if the [redacted] provision had not been part of the agreement. *Id.* at 6898-99.

Mr. Lexton said that this provision was important because Merlin believed, after considering [redacted], that there was a reasonable chance that [redacted]

[redacted] provision would be triggered, particularly during Pandora's fourth quarter of 2014. 6/1/15 Tr. 6896-98 (Lexton). Mr. Lexton further noted that Pandora offered Merlin the [redacted] the Pandora/Merlin Agreement as a counterproposal to Merlin's proposal to [redacted]. SX Ex. 310 at 1; 6/1/15 Tr. 6986 (Lexton). In the same vein, Mr. Van Arman, co-founder and co-owner of the Indie record company (and Merlin member) Secretly Group, testified that the presence of the [redacted] provision was one of the reasons his labels opted-in to the Pandora/Merlin Agreement. 6/2/15 Tr. 7172 (Van Arman).

ii. The [redacted] Provision

The Pandora/Merlin Agreement obliges Pandora to [redacted] to the opting-in Merlin members. PAN Ex. 5014 § 5. These [redacted] are not available under the statutory license and are not replicated in Pandora's rate proposal. SoundExchange notes that Mr. Lexton testified that Merlin would not have entered into the Pandora/Merlin Agreement if it had not contained these [redacted] commitments. 6/1/15 Tr. 6906 (Lexton). SoundExchange also notes that Pandora itself viewed the [redacted] as a valuable [redacted] provision. *See* SX Ex. 310 at 2 (a contemporaneous Pandora negotiating document, in which Mr. Herring wrote: "[redacted]").

iii. Advertising/Promotional Benefits

Mr. Lexton testified that Merlin would not have entered into the Pandora/Merlin Agreement if it had not included the advertising and promotion benefits ultimately embodied in the agreement. 6/1/15 Tr. 6909 (Lexton). According to Mr. Lexton, these benefits clearly were of value to Merlin's members. *Id.* at 6880. He explained that these advertising and promotion provisions "provided considerable value that could not be replicated by the statutory license." SX Ex. 13 ¶ 43 (Lexton WRT).

In like fashion, Simon Wheeler, Director of Digital for another Merlin member, Beggar's Group, testified that one of his company's motivations for opting-in to the Pandora/Merlin Agreement was that it afforded Beggar's Group the ability to "tap into" these promotional opportunities that were unavailable under the statutory license. SX Ex. 31 ¶ 23 (Wheeler WRT).

SoundExchange also notes that Mr. Herring, one of Pandora's negotiators, likewise recognized that these promotional tools had potential value to Merlin, and, indeed, he acknowledged his awareness that "Merlin believed that [these provisions] added value." 5/18/15 Tr. 4275-76 (Herring). He further acknowledged his awareness that Merlin had "sold" the promotional benefits of the Pandora/Merlin Agreement "pretty strongly" to its members. *Id.* at 4279; *see* SX Ex. 2237 at 1.

iv. Access to Data

When Pandora first proposed a direct license to Merlin, Pandora offered Merlin and its members access to Pandora's internal data. SX Ex. 104 at 5. The right to such access was embodied in the final Pandora/Merlin Agreement. PAN Ex. 5014 § 9. Mr. Lexton testified that licensors do not have access to this type of data under the statutory license. Lexton WRT ¶ 40.

Both Pandora and Merlin acknowledged that such data are valuable to record labels generally. Westergren WDT at 16-17; SX Ex. 1736 at 5; 6/2/15 Tr. 7157 (Van Arman); *see* 6/1/15 Tr. 7099-7100, 7106-7 (Simon Wheeler) (Access to data is something Beggar's Group "expect[s] of [its] major direct licenses" and is "a part of every negotiation.").

SoundExchange also criticizes the usefulness of the Pandora/Merlin Agreement as a benchmark for more general reasons:

c. The Pandora/Merlin Agreement is Unrepresentative of the Larger Market

SoundExchange asserts that the Pandora/Merlin Agreement pertains only to record companies that represent less than [redacted]% of Pandora's performances and therefore cannot represent what the record companies--including all three Majors--comprising Pandora's other [redacted]% of performances, would negotiate for in the hypothetical marketplace. SX RPFF ¶ 753; SX PFF ¶ 507 (both relying on Shapiro WDT at 76). SoundExchange also avers that the Pandora/Merlin Agreement is not sufficiently probative of the rates that Indies would agree to voluntarily because the bulk of the Indies who opted-in [redacted]. 6/1/15 Tr. 6860, 6865-66 (Lexton). SoundExchange also notes that roughly 30% of the Merlin labels that opted-in do not regularly operate in the United States. 6/1/15 Tr. 6863-64 (Lexton). Additionally, Mr. Lexton estimates that of the [redacted] or so Merlin members that opted-in directly (rather than through distributors or aggregators), approximately [redacted] have been affirmatively rejected by Pandora for inclusion in the Merlin license, based on Pandora's [redacted]. *Id.* at 6871.

d. The Pandora/Merlin Agreement Applies Only to a Single Webcaster with Substantial Market Power

SoundExchange notes that the Pandora/Merlin Agreement applies to only one licensee, Pandora, and the terms of that license were not replicated in any other contract with any other licensee. SoundExchange finds this point relevant because of Pandora's "significant competitive strengths" among webcasters, including its 77.6% share of internet radio listening. PAN Ex. 5012 at 11. According to SoundExchange, this large market share afforded Pandora with market power that was a meaningful factor in the negotiations of the license with Pandora. *See* SX Ex.19 at 6, 24-27 (Talley WRT) (noting that Dr. Shapiro failed to perform any analysis of meaningful allocations of buyer-side power, including, for instance, whether Pandora's unique position in the market affected the terms of the Merlin license.).

e. The Pandora/Merlin Agreement was "Experimental"

SoundExchange asserts that the Pandora/Merlin Agreement was merely an "experimental" modification of the restrictions created by the sound recording performance complement. SX PFF ¶¶ 576-580 (and record citations therein). At the hearing, Merlin characterized the Pandora/Merlin Agreement as "experimental. SX Ex. 13 ¶ 27 (Lexton WRT) (describing the license as "an exercise in *experimenting* with direct licensing derived from the existing statutory rates.); *see id.* ¶ 25 ("Due to the fact Pandora offered us so many additional benefits and other added value that is not required by their statutory license, we understood this as an opportunity for *experimentation* given and within the constraints imposed by Pandora's existing statutory rates.); Wheeler WDT ¶ 9 ("We knew from the start that this was a short-term *experiment*….") (emphases added).

f. No Major Has Accepted a Similar Direct License with Pandora

SoundExchange emphasizes the absence of what might otherwise be an important piece of evidence: No major record company has agreed to a direct license with Pandora or any other webcaster on the same rates and terms of the Merlin license. SoundExchange notes that this is unsurprising, in that Pandora's C.F.O, Mr. Herring, acknowledged that Pandora regularly had conversations with the Majors, but did not replicate the terms of the Pandora/Merlin Agreement. 5/18/15 Tr. 4203 (Herring). In fact, Mr. Herring recognized that Pandora would have been unable to negotiate the same terms with the Majors and would have to offer the Majors better terms. 5/18/15 Tr. 4253 (Herring) (acknowledging that he "expected [to] …have to give more favorable economic terms to a major record company than you would have to give to an independent record company.").

To drive home this point, SoundExchange contrasts the absence of evidence of any agreement between a Major and Pandora with the record evidence of the iHeart/Warner Agreement. SoundExchange notes that, pursuant to the iHeart/Warner Agreement, SX Ex.33, per-play rates (*i.e.*, even before any potential inclusion of the value of other consideration) range from $0.[redacted] to $0.[redacted] over the [redacted] period, greater than the rates in the Pandora/Merlin Agreement. [1] From this evidentiary distinction, SoundExchange concludes that the Services have not demonstrated that the rates in licenses between noninteractive services and Majors would match the lower rates in the Pandora/Merlin Agreement. SX PFF ¶ 654; *see also Id.* at ¶ 656 (asserting that the iHeart/Warner Agreement "confirm[s] that major record companies receive more consideration than independent record companies when negotiating directly for licenses covering noninteractive services.").

g. The Steering Provisions in the Pandora/Merlin Agreement Are Not Useful in Setting the Statutory Rate

SoundExchange rejects Pandora's foundational assumption that the steering provisions of the Pandora/Merlin Agreement can be used to determine the statutory rate. SoundExchange's rejection of steering as a relevant benchmarking tool is based on several factors:

i. Steering Allegedly Creates "First Mover" Advantages that cannot be Replicated for All Licensees.

SoundExchange argues that as a matter of simple arithmetic a webcaster cannot commit to steer to every record company or label, because there is only a total of 100% subject to steering. As one of its economic experts noted:

> [A]n affirmative obligation to steer just can't be implemented on a market-wide basis. It's just not possible for a service to say I'm going to steer listenership towards each label that I contract with.

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[131] SoundExchange also notes that [redacted]'s licenses with [redacted] [redacted] and independent record companies for its [redacted] service likewise demonstrate that the major record companies receive considerably more consideration than independent record companies. SX PFF ¶ 655, and Section XI.A therein (and record citations therein).

5/27/15 Tr. 6070 (Talley).

Similarly, SoundExchange notes that an iHeart, executive, Mr. Cutler, recognized the impossibility of promising steering to all record companies: “Certainly, the share has to–its math has to add up to – a hundred, so if someone goes from 20 to 30, the rest of the pool must–those ten points must come from somewhere else.” 6/2/15 Tr. 7239 (Cutler).

Thus, as Dr. Rubinfeld noted, the steering provisions provided Merlin with “first mover” advantages. Rubinfeld CWRT ¶ 70. SoundExchange concludes therefore that Pandora cannot escape from this “quandary” by discarding the [steering commitment], yet retaining the [discounted rates] from the Pandora/Merlin Agreement. According to SoundExchange, discarding the [steering commitment] would separate the rate in the agreement from the specific bargained-for consideration that Merlin obtained in exchange for that rate. SX RPFF ¶ 764.

i. Revenue from Steering is a Valuable Benefit Not Available Under the Statutory License.

SoundExchange asserts that the steering provision provides Merlin with a financial advantage that cannot be duplicated under the statutory scheme. Therefore, SoundExchange avers, Pandora’s proposed benchmark must be adjusted upward to reflect that this non-statutory value – like all nonstatutory consideration – permitted a reduction in the benchmark royalty rate. *See* SX PFF ¶¶ 701-708 (and citations to the record therein).

ii. Pandora Has Not Provided Support for its Claim that a “Threat” of Steering Will Lead to Lower Rates.

SoundExchange challenges Dr. Shapiro’s assertion that, in the hypothetical market, the ability of a noninteractive service to steer among record companies would necessarily create a “threat” of steering that would cause rates to decline to an effectively or workably competitive level. SoundExchange asserts that the record is bereft of *any* benchmark agreement that reflects a “threat of steering,” let alone that a “threat of steering” had allowed a noninteractive service to obtain a lower rate. *See* SX PFF ¶¶ 609, 709.

iii. Pandora Did Not Test Steering Under “Real-World” Conditions.

SoundExchange argues that Pandora failed to test steering under real-world conditions, because there is no evidence that listeners were ever aware that steering was occurring. More particularly, SoundExchange points out that Pandora has yet to experience any potential negative listener reaction that may arise if and when competitors advertise that Pandora has modified its algorithm in a manner that contradicts its long-standing claim to play “only the music listeners want”[132] in order to save money on royalty rates. *See* 5/19/15 Tr. 4775 (Shapiro) (admitting that Pandora did not test how people would react to learning “that Pandora was factoring in royalty

[132] Timothy Westergren, Pandora’s founder, had publicly stated that Pandora’s recommendations would “be based on the genome, they will never be based on somebody buying the space.” SX Ex.2369 at 1. In fact, Mr. Westergren explained in 2013 that “[t]he only thing that drives what song [Pandora] play[s] next for a listener is trying to deliver the best possible listening experience for that individual.” *Id.* at 3.

rates [in] how they constructed the playlist.”). Indeed, Dr. Shapiro “worried about” the question whether a competitor could use such an advertisement to “magnify” a negative reaction to steering. *Id.* at 4635-36. Because successful steering in the real world depends on consumer reactions, SoundExchange concludes that Pandora has failed to demonstrate a credible threat of steering.

Additionally, SoundExchange notes that Pandora has been unable to generate as much “real world” steering as it intended under the Pandora/Merlin Agreement. Specifically, the evidence actually shows that Pandora has not achieved the [redacted]% steering target for most Merlin labels. 5/19/15 Tr. 4676-16 (Shapiro). Dr. Shapiro also admitted that, as of November 2014, Pandora had been unable to achieve the [redacted]% target for “a good number” of record labels. *Id.* Moreover, for [redacted]% of Merlin labels, Pandora’s steering has been negative. SX Ex. 2310.

From these facts, SoundExchange concludes that Pandora has failed to provide sufficient real world evidence regarding its ability to steer, demonstrating a disconnect between the theoretical case it has presented and the realities it faces in the marketplace.

iv. A Record Company Could Rebuff a Steering Proposal by Withholding its Entire Repertoire.

SoundExchange argues that a record company could respond to a steering threat by refusing to license 100% of its repertoire to Pandora. In support of this position, SoundExchange quotes Dr. Shapiro, who acknowledged that “a record company with market power” could use that power to disable a webcaster’s threat of steering. 5/19/15 Tr. 4576-77 (Shapiro). Dr. Talley similarly noted that, “in the hypothetical market where there is no background statutory rate … a label might say, okay, if you’re going to [steer against us], we may just walk away ….” 5/27/15 Tr. 6074 (Talley); *see also* 5/1 Tr. 1429 (Harleston) (“If a service were to say we’re just not going to play your records because it costs too much, the reality is we can go – we have other choices. We could lean into other services.”).

SoundExchange finds support for this position because the Services’ economic experts declined to conclude that the Majors were not “must haves” for noninteractive service. *See* 5/11/15 Tr. 2989-90 (Katz) (“Q. Is it fair to say that you … believe that the [M]ajors are must-haves for customized services such as Pandora? A. I would say I believe that's a possibility, yes.”); 5/19/15 Tr. 4582 (Shapiro) (Dr. Shapiro testified that he was “offering no opinion whether the [M]ajors are must-have for Pandora.”).

v. Record Companies Can Utilize Contract Clauses to Thwart Steering

SoundExchange asserts that it can contract around a noninteractive service’s proposal or threat to steer by insisting upon a specific anti-steering clause or a more general “Most Favored Nation” (MFN) clause.[133] *See* SX Ex. 25 ¶¶ 14-19 (A. Harrison WRT) (“UMG has long recognized in our negotiations with interactive services that they have the ability to steer users

[133] “In general, an MFN clause is a contractual provision that requires one party to give the other the best terms that it makes available to any competitor.” *U.S. v. Apple, Inc.*, 791 F.3d 290, 304 (2d Cir. 2015).

away from UMG music through the music they feature and recommend through the service thereby decreasing our plays on the service and the revenue that flows to UMG and its artists …. We therefore have negotiated for protections against such steering …. [I]f we did not have these commitments the interactive services could effectively steer users toward other record labels artists and sound recordings through the music they highlight.”); *accord*, 4/28/15/15 Tr. 455-6 (Kooker); 4/30/15/15 Tr. 1144-5 (Harrison); 6/2/15/15 Tr. 7202-5 (Harrison); 5/7/15/15 Tr. 2487-88, 2490-93 (Wilcox) (all acknowledging on behalf of major record companies that anti-steering provisions are commonly used in their agreements with the on-demand services).

Several such anti-steering contract clauses were in evidence in the proceeding:

- The agreement between [redacted] and [redacted] contains an anti-steering clause that prevents [redacted] from steering towards lower-priced music, including on playlists, if that steering would result in lowering [redacted]’s share of total plays to a level that is less than [redacted]’s market share. SX Ex. 37; *see also* 6/2/15 Tr. 7202-6 (Harrison);
- The agreement between [redacted] and [redacted] contains an anti-steering provision to prevent [redacted] from steering listeners away from [redacted] content and towards that of another label. 4/30/15 Tr. 1145 (Aaron Harrison);
- Mr. Harrison testified that [redacted] 6/2/15 Tr. 7206 (Aaron Harrison); *see* Harrison WRT ¶¶ 15-16; SX Ex. 36 ¶ 7;
- The agreement between [redacted] and [redacted] prohibits [redacted] from promoting another label’s repertoire if it would then exceed its market share, unless Spotify offers the same increase in market share to [redacted] SX Ex. 80 at 25537-38; *see* 4/28/15 Tr. 455-56 (Kooker). The practical effect of the clause is to prohibit [redacted] from increasing another label’s promotional opportunities above its market share if that would lower [redacted]’s promotional opportunities to below its market share. 4/28/15 Tr. 456 (Kooker);
- The agreement between [redacted] and [redacted] contains an anti-steering provision that guarantees [redacted] will get [redacted], equivalent to its market share [redacted]. The provision further provides that if any other record company receives an “uplift” over its Soundscan market share, [redacted] will receive the same “uplift.” SX Ex. 343 at 20 ; SX Ex. 1814 at 26; SX Ex. 346 at 5; *see* 5/7/15 Tr. 2490-93 (Wilcox).

More broadly, as noted above, SoundExchange asserts that, as in the interactive market, the Majors could insist upon a general MFN clause in each contract with a service, which would ensure that each Major gets the benefit of the rates and terms set forth in the service’s contracts with the other Majors. *See* 4/28/15 Tr. 449-450, 542(Kooker) ; 4/30/15 Tr. 1142 (Harrison); 5/7/15 Tr. 2473 (Wilcox). Several such anti-steering contract clauses were in evidence in the proceeding:

- The agreement between [redacted] and [redacted] contains an MFN provision providing that if [redacted] enters into an agreement with another major record label that provides more favorable terms for that label regarding specified key provisions (including [redacted]), then [redacted] must notify [redacted] of those more favorable terms and give [redacted] the option to avail itself of those terms. SX Ex. 80 at 25542-43; PAN Ex. 5091; *see also* 4/28/15 Tr. 447-50 (Kooker);

- The agreement between [redacted] and [redacted] contains an MFN providing that if [redacted] grants another label more favorable financial terms, then [redacted] must also offer those terms to [redacted] SX Ex. 36; *see also* 4/30/15 Tr. 1142-44 (Harrison) ("[redacted]");
- The agreement between [redacted] and [redacted] contains the equivalent of an MFN provision (an "equal treatment" clause) by which [redacted] warrants that it has not provided [redacted] to another label. In the event that [redacted] has violated this warranty, the [redacted] clause permits [redacted] to receive an immediate [redacted] to match the superior terms. SX Ex. 343; *see also* 5/7/15 Tr. 2474-79 (Wilcox).

vi. Record Companies Could Thwart Steering by Requiring Up-Front Lump Sum Royalties.

SoundExchange notes that, as Dr. Katz candidly acknowledged, a record company could neutralize a steering threat by seeking a lump sum payment instead of per-play rates. 5/11/15 Tr. 3015-6, 3019-20 (Katz).[134]

h. Merlin's Economic Interests Were Not Fully Aligned with Those of its Members

SoundExchange addresses what it suggests may be conflicts of interest as between Merlin and its distributor/aggregator-members, on the one hand, and the Merlin label members, on the other. First, Merlin and the distributors/aggregators typically receive [redacted] from members only if that member has opted-in. Second, Pandora paid Merlin a license fee directly that would vary, up to $375,000 (but in any event no less than $250,000), depending upon the Merlin members [redacted]. SX Ex. 13 ¶ 56 (Lexton WRT). Thus, SoundExchange avers that Merlin had economic incentives to complete the Pandora/Merlin Agreement and to urge its members to opt-in – incentives that were not necessarily consistent with the interests of its members.

i. Pandora Has Been Unable to Perform its Contractual Obligations.

SoundExchange avers that, even assuming the Pandora/Merlin Agreement otherwise had merit as a potential benchmark, Pandora has been unable to perform its contractual obligations. In this regard, SoundExchange notes the following problems that have hindered Pandora's ability to perform its contractual duties.

- staffing and capacity constraints;

[134] The dynamic economic effect of an up-front lump-sum royalty payment is discussed elsewhere in this determination.

- lack of reporting and payments,
- a low fraction of labels who are receiving payments pursuant to deal;
- a low participation in the [redacted] program; and
- a low percentage of labels receiving steering at or above [redacted]%.

SX Ex.1748 at 2 ; SX Ex. 2310.

SoundExchange further notes that Mr. Herring candidly acknowledged that Pandora had waited until after it executed the Pandora/Merlin Agreement to determine the actual cost to Pandora of performing its contractual duties. 5/18/15 Tr. 4280 (Herring). Afterward, Pandora's Chief Scientist estimated that Pandora would incur an annual cost of $[redacted] for the "initial build" and $[redacted] annually in "ongoing support maintenance." *Id.* at 4282; SX Ex. 1706 at 1. Pandora calculated internally that, just to provide the opting-in Merlin members with the contractually promised access to data, Pandora would incur $[redacted] in initial costs and $[redacted] in ongoing annual costs. *Id.* at 20. Similarly, Pandora would need to spend almost [redacted] dollars in initial costs and $[redacted] in annual costs to allow opting-in Merlin members to [redacted], two of the advertising benefits contained in the Pandora/Merlin Agreement. *Id.*

SoundExchange notes that these implementation issues have "impacted negatively" the willingness of Merlin members who opted-in to consider entering into this license in any future period. For example, Mr. Van Arman testified that, [redacted] 6/5/15 Tr. 7158 (Van Arman); *see also* 6/1/15 Tr. 7104-10 (Simon Wheeler) (detailing implementation issues and concluding [redacted].

5. Judges' Conclusions regarding Pandora's Benchmark Evidence

For the reasons set forth below, the Judges find that the noninteractive benchmark proposed by Pandora is informative as to the rates they shall set in this proceeding for a particular segment of the noninteractive marketplace. That is, the Pandora benchmark is probative of *the two distinct royalty rates* that a noninteractive service would pay *to Indies* in the: (1) ad-supported (free-to-the-listener) market; and (2) the subscription market, respectively.

Pandora's proposed benchmark is premised principally on the provisions of the Pandora/Merlin Agreement. SoundExchange raises two principal challenges to Pandora's benchmark: (1) the ability, *vel non*, of a noninteractive service to "steer" or credibly "threaten" to steer in the hypothetical market; and (2) the potential value of other (non-steering) elements of consideration Pandora provided to Merlin that might offset the lower stated rates, thus leaving the effective rate unchanged from the nonprecedential statutory Pureplay Settlement rate.

In light of the importance of these two issues, the Judges first analyze these two contentious points, followed by a discussion of SoundExchange's other objections to Pandora's benchmark proposal.

a. “Steering” as a Mechanism for Achieving Effective Competition in the Hypothetical Market

i. Could a Noninteractive Service Steer and Credibly Threaten to Steer in the Hypothetical Market?

SoundExchange argues that steering creates merely a “first mover” advantage for those licensors who are able to enter into steering arrangements before their competitors are able to obtain such advantages. This argument is seductively simple: In its essence, it is based on the elementary proposition that no noninteractive service can steer more than 100% of its sound recordings. To take a simple example, assume there are three Majors, U, S, and W, and one Indie, M. Assume the *ex ante* steering allocation of plays was 40% for U, 30% for S, 20% for W and 10% for M, and all plays were priced at $0.0020. Now, the noninteractive service strikes a deal with M to increase plays of M’s sound recordings by 50% over the *ex ante* percentage, in exchange for, say, a 10% reduction in per-play rates to only M. Then, M’s noninteractive market share increases by 50% from 10% to 15% (while its per-play rate declines by only 10%, resulting in more revenue for M *ex post* steering). As a “first mover,” M thus benefits.

However, the noninteractive licensee cannot promise all three other licensors, U, S, and W, the same 50% increase in plays via steering in the same contract period. If it did, U would realize a market share increase from 40% to 60%; S would realize a market share increase from 30% to 45%; and W would realize a market share increase from 20% to 30%. All four licensors, including M, would thus be promised 60% + 45% + 30% + 15% = $150%.

SoundExchange’s point is that, by definition, it is mathematically impossible for a noninteractive licensor to allocate more than 100% of its plays. Thus, SoundExchange concludes, steering can only work in a non-statutory setting and, even then, never for all licensors. *See* 5/28/15 Tr. 6301 (Rubinfeld); *see also* 5/27/15 Tr. 6070 (Talley) (“[I]t’s almost like a Lake Wobegon effect, that not everyone can be above average, not everyone can receive steering.”).

This argument of course, in the static sense, is mathematically correct. But, in the dynamic sense, is it *economically* correct? Dr. Shapiro, for Pandora, responded to this argument in the following colloquy with the Judges regarding the “threat” of steering:

> [THE JUDGES]
>
> Let’s … take … the market we’re dealing with here [and] address the first-mover criticism … that well, sure, you can steer to… record company A … but you can’t steer to all of them because you can’t play more than 100 percent of the music. Is it … the threat of steering that pushes everybody … towards their original percentages to avoid being that odd man out who was the holdout for the higher price?
>
> [DR. SHAPIRO]
>
> That’s exactly – yes, absolutely. The competitive outcome is when each of the record companies is at a rate where they’re … not disadvantaged relative to the other guys.… This notion that you can’t steer, the 100% thing, it’s kind of offensive to an antitrust economist … because it’s basically saying … price competition is some horrible thing.

5/19/15 Tr. 4561-63 (Shapiro); *see* Shapiro WDT, at 9 (noting that the "net result" of steering "in a workably competitive market may well be relatively little actual steering."). Dr. Shapiro further notes that, in the absence of steering, "[y]ou would be basically going to the rate that a cartel or monopolist would set." 5/19/15 Tr. 4575 (Shapiro).

The Judges find that steering in the hypothetical noninteractive market would serve to mitigate the effect of complementary oligopoly on the prices paid by the noninteractive services and therefore move the market toward effective, or workable, competition. Steering is synonymous with price competition in this market, and the nature of price competition is to cause prices to be lower than in the absence of competition, through the ever-present "threat" that competing sellers will undercut each other in order to sell more goods or services.

This process does not result, as some record industry witnesses suggested, in a "race to the *bottom.*"[135] Rather, it typifies a "race" to a workably or effectively competitive price. On the *licensees'* side of the market (the buyers' side), the limit on the demand for lower rates through steering is reached when the noninteractive service is no longer in a position to make further substitutions of one record company's sound recordings for another's because the potential for lost revenues exceeds the cost savings.[136] On the *licensors'* side of the market (the sellers' side), the limit on the willingness to supply recordings at reduced rates is reached when the licensor determines that any further reduction in the rate will not be sufficiently to cover all marginal and recurring fixed costs (including opportunity costs) for its particular repertoire. (This is essentially stating in words the fundamentals of the Lerner Equation discussed at note 121 *supra*).

Because the Judges are utilizing the benchmark approach to rate setting – as both SoundExchange and Pandora endorse – the limits to steering (like the value of promotion and substitution) are implicit in ("baked-in") the terms of the relevant benchmarks. That is, Pandora and Merlin entered into their agreement because each concluded that its steering terms were advantageous.[137]

SoundExchange argues that, even if the threat of steering could cause a reduction in rates in the hypothetical noninteractive market, the Services have not provided any proof of an actual threat of steering in the direct noninteractive licensing market, but rather have presented only evidence of actual (not threatened) steering. *See, e.g.,* 5/27/15 Tr. 6076 (Talley) ("[N]ot one of these transactions … is either negotiated in the shadow of a threat to steer away or negotiated with an undertaking to steer away. It's in the opposite direction … a promise to steer towards … as opposed to away from ….").

[135] *See, e.g.,* Van Arman WDT at 14.

[136] The existence and identification of such a limit was the point of Pandora's steering experiments.

[137] Likewise, iHeart and Warner entered into their steering-based agreement because it was mutually advantageous. By "advantageous," the Judges are noting the essence of the willing buyer/willing seller paradigm – that sophisticated commercial buyers and sellers are presumed to act rationally in their self-interest when entering into agreements that are not coercive.

SoundExchange's argument is unpersuasive, for two reasons. First, the evidence shows that Merlin members opted-in to the Pandora/Merlin Agreement specifically because they anticipated that Pandora might enter into steering agreements with other record companies, including the Majors. In fact, SoundExchange's' own witness testified that it was in his record company's self-interest to act "defensive[ly]" to enter the Pandora/Merlin Agreement, in light of the fact that Pandora might enter into "similarly structured deals" with other record companies. 4/28/15 Tr. 610-11 (Van Arman); *see* 6/1/15 Tr. 6963 (Lexton). These facts reflect the general power of steering as a threat in the marketplace.

The Judges also find unpersuasive the criticism by SoundExchange that there is no record evidence of direct noninteractive agreements that were forged *solely* through a threat of steering. The point of the steering argument is to demonstrate what would transpire in the hypothetical effectively competitive market in which no statutory rate existed – not to demonstrate that a particular form of agreement is pervasive in the market with the extant statutory rate.[138] It is imperative not to confuse the hypothetical market with the actual regulated market.[139]

Moreover, the Judges find the economic opinion expressed by Dr. Shapiro—equating steering with price competition—to be correct. The ability of noninteractive services to steer toward lower priced recordings (and, by necessity therefore, away from higher priced recordings) is the essence of price competition. With Pandora (and iHeart) having demonstrated the capacity and willingness to steer in this manner, it would be economically irrational for the other record companies (that had not agreed to steering) to maintain their position and incur losses. To assume that record companies would ignore the "opportunity cost" of steering away from their repertoires would be a fundamental economic mistake. *See* 5/4/15 Tr. 1516-17(Lys) (emphasizing that "opportunity costs are real costs").

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[138] One reason why steering is not yet more widespread in the market, as Dr. Shapiro noted, is that noninteractive services have developed the steering technology only in the past few years since the *Web III* proceeding. Shapiro WDT at 15 ("Pandora has *now* tested and proven its ability to modify its playlist-selecting algorithms to rely more or less heavily on the music of particular record companies.") (emphasis added). Now that this technological genie is out of the bottle, the Judges cannot minimize its impact in the hypothetical market.

[139] By way of comparison, Dr. Rubinfeld's "ratio equality" benchmark royalty rate likewise does not "exist" in the *actual* market. Rather, he derived that benchmark rate by: (1) looking at market data from direct licenses; and (2) applying his economic expertise to express certain economic opinions regarding the necessary equality of the revenue-to-royalty ratio in the interactive and noninteractive markets. (As noted *infra*, Dr. Rubinfeld's "assumption" was revealed at the hearing to be premised on a model that serves to limit its applicability.). So too the steering-based proposed royalty rate is based on a benchmark analysis that is tied to certain expert economic opinions regarding market behavior. The Judges must weigh and apply "economic … information presented by the parties" as the bases for their rate determinations, 17 U.S.C. § 114(f)(2)(B), and therefore the expert opinions set forth by the parties' economists as to how the hypothetical market will perform are vital aspects of the record to be considered by the Judges. More broadly, the Judges note that the benchmarking approach, while highly instructive, is not the sole method for ascertaining the statutory rate – indeed, the statute does not require the Judges to utilize the benchmark approach. Here, the threat of steering has been demonstrated by a *combination* of benchmarks, experiments and expert economic theorizing using fundamental principles of profit maximization and opportunity cost. This combination of proofs and arguments is actually *more persuasive* to the Judges than a mere benchmark standing alone.

Dr. Shapiro's point regarding the economic "threat" posed, now that steering is technologically possible, can be made clear through a hypothetical example:

- Assume a Licensee was paying a market price of $0.0020 and historically ("naturally") played 1,000,000 of its total number of songs from Licensor A, thus paying $2,000 to Licensor A.
- Now, assume the Licensee and Licensor A enter into a "steering" deal, whereby Licensee promises to play an additional 200,000 songs whose copyrights are owned by Licensor A, representing a 20% increase over the historical ("natural") quantity of 1,000,000 noted above.
- In exchange, Licensee demands, and Licensor agrees, that Licensor A will receive less than $0.0020 per play, specifically, 10% less, *i.e.*, only $0.0018.

Compare the two scenarios:

- Before steering, the money exchanged equaled $2,000.
- After steering, the money exchanged is more, $2,160 (1,200,000 units x $0.0018).

That is clearly a benefit to Licensor A, who has made an additional $160 ($2160-$2000).

The corresponding benefit to Licensee arises from the fact that it can now – *ex post* steering – play 1,200,000 songs at $0.0018 per song for a total cost of $2160. *Ex ante* steering, Licensee would have been required to pay the old market price of $0.0020 per song to another Licensor (call it Licensor B) for those 200,000 songs (which equals $400), plus the $0.0020 Licensee also paid to Licensor A *ex ante* steering for 1,000,000 songs (which equals $2,000), for a sum of $2,400 for 1,200,000 songs. Thus, Licensee has saved $240 in costs ($2,400 - $2,160). Since there is no "free lunch," who loses? The loser is Licensor B, who has lost the revenue from the foregone licensing of 200,000 songs.

How can Licensor B avoid this loss? By responding to this steering by competing on price and lowering its own price to $0.0018.

How can Licensee obtain the lower price of $0.0018 without any actual steering? By *threatening* to steer and thereby compelling Licensors A and B to compete for Licensee's business by offering to accept a price of $0.0018. Moreover, if Licensor B incurs the loss described above in one contracting period, that loss serves as the "threat" necessary to avoid such losses in the subsequent contracting periods by also entering into an appropriate steering arrangement.

Will there be a "race to the bottom?" No. The so-called "bottom" will be marked by the rate that equates: (1) an acceptable return to the Licensors given their costs (including opportunity costs) and the differentiated values of their repertoires; and (2) an acceptable return to the Licensee by steering as far as possible (but no further), as limited by the potential loss of revenue if steering interferes with revenue as a consequence of an inferior mix of sound recordings.

ii. Is Steering in the Hypothetical Market Sufficient to Establish an "Effectively Competitive" Rate?

The Judges conclude, based on the record evidence and expert testimony, that the injection of steering into the hypothetical market provides for the "effective competition" that the law requires. Both Dr. Shapiro and Dr. Katz opined, and the Judges agree, that effective or workable competition arises when licensees have the reasonable (albeit still constrained) ability to select sound recording inputs based upon price.

The injection of steering into the hypothetical market can occur in two ways, as it has in this determination. First, as in the case of the Pandora/Merlin Agreement (and the iHeart/Warner Agreement discussed *infra*), steering is incorporated by adopting a benchmark that explicitly includes steering. Second, a steering adjustment can be made to a benchmark rate that is not otherwise effectively competitive. Such is the case with SoundExchange's interactive benchmark, which needs a steering adjustment in order to eliminate the "complementary oligopoly" effect discussed *supra*. The Judges note that adjustments to benchmark rates have regularly been made in section 114 proceedings – and indeed are required to be made – in order to allow the benchmark to correspond to the hypothetical market required by the statute. Here, as concluded *supra*, the Judges have found as a matter of law that section 114 requires that they set a rate which is effectively competitive. Thus, the steering adjustment is of a class with any other adjustments necessary to harmonize the benchmark rate with the statutory requisites. *See Web II*, 72 Fed. Reg. at 24092 (noting the Judges' duty "to determine if the benchmark agreements require any further adjustments based on any evidence of differences between the benchmark market and the target hypothetical market.").

It is important to emphasize the limited nature of this sort of effective competition. Price competition through steering does not diminish the stand-alone monopoly value of any one sound recording. Further, effective competition through steering does not diminish the firm-specific monopoly value of each Major's repertoire taken as a whole. Although Dr. Katz urged the Judges to reduce the statutory rate to eliminate that market power as well, Katz WDT ¶ 43, the Judges decline to do so. There is absolutely no record evidence to suggest that the market power that a Major enjoys individually by ownership of its collective repertoire is in any sense the consequence of improper activity or that it is being used *individually* by a Major to diminish competition. That is, the Judges have no evidence before them to demonstrate that the Majors' size and *individual* market power is not the result of the efficiencies and economies of scale and/or their superior operations. *See generally,* Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J.L. Econ. 1, 3 (1973) (noting that "scale economies," [n]ew efficiencies and "superior ability" can form a 'competitive basis acquiring a measure of monopoly power"). In the absence of evidence that the Majors' market shares preclude effective competition, the Judges have no basis on this record to adjust rates lower to reflect that market concentration.

This holding must not be confused with the Judges' holding regarding the anticompetitive effects of the complementary oligopoly that exists among the Majors. Because the Majors could utilize their combined market power to prevent price competition among them by virtue of their complementary oligopoly power—as proven by the evidence of the pro-competitive effects of steering and the admissions of Universal and its agents discussed *supra,* section IV.B.3 – the Judges must establish rates that reflect steering, in order to reflect an "effectively competitive" market.[140] Indeed, even economists quite unwilling to assume that a given monopoly or oligopoly structure is inefficient and anticompetitive bristle at the idea that supranormal pricing arising from a complementary oligopoly is reflective of a well-functioning competitive market. *See, e.g.*, Francesco Parisi and Ben DePoorter, *The Market for Intellectual Property: The Case of Complementary Oligopoly* in *The Economics of Copyrights: Developments in Research and Analysis* (W. Gordon and R. Watt eds. 2003) (noting the economic benefits of blanket licenses in reducing the greater-than-monopoly pricing of complementary oligopolists); Mark Lemley and Philip Weiser, *Should Property or Liability Rules Govern Information?* 85 Tex. L. Rev. 784, 786-87, 824 (2007) (comparing the "hold up" ("rent seeking") strategies of copyright owners seeking supranormal complementary compensation and of the owner of a parcel of real property that is complementary to multiple other parcels required for a large scale development, and noting that a compulsory license with a royalty rate set by a regulatory authority (*noting the CRB by name*) can "minimize the opportunity for rent-seeking behavior").

iii. Did Pandora Test Steering Under "Real World" Conditions?

The Judges do not agree with SoundExchange's criticism that the impact of steering is uncertain because listeners were unaware that such steering was being undertaken. The Judges reach this conclusion for three reasons.

First, there is no evidence that Pandora, or any noninteractive service, obtains and retains listeners by describing in any detail the technical methodology it uses to select songs. The purpose of a streaming service is to provide songs to listeners – if they enjoy the music they will be satisfied, if they do not enjoy the music they will be unsatisfied, to the commercial detriment of the service. While it is true that Pandora promotes its service as playing only the music the listener wants to hear, the proof of the pudding – so to speak – is in the listening – not in the puffery used in advertising.

Second, it is clear that Pandora has not taken any steps to conceal that it has engaged in such steering or that it intends to do so going forward. In the present proceeding, the parties had the ability – which they exercised with regularity – to enter into closed session to avoid public disclosure of commercial information they intended to maintain as confidential. However, at no time did Pandora attempt to close the proceedings to prevent the public from learning of the introduction of steering into its music delivery model. The Judges note that no competing service has advertised against Pandora or iHeart, attacking its use of steering. 5/19/15 Tr. 4775-76 (Shapiro). Thus, the evidence is not sufficient to indicate that Pandora would suffer an economic loss merely from listener awareness that Pandora engages in steering.

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[140] The Judges' findings on this issue are not only consonant with the expert opinions of Drs. Shapiro and Katz, but are also consistent with the expert economic testimony of SoundExchange's own witness in *Web III*, Dr. Ordover. *See Web III Remand* at 23114 (summarizing Dr. Ordover's testimony as concluding that "if the repertoires of all [Majors] were each required by webcasters (*i.e.*, if the repertoires were necessary complements) … each [Major] would have an incentive to charge a monopoly price to maximize its profits … constitut[ing] *higher monopoly costs* … paid by webcasters to each of the [Majors].") (emphasis added). The Judges in this determination adopt this economic reasoning and will not allow such complementary oligopoly power to be incorporated into the statutory rate.

Third, although the extent of the steering may be economically significant to the licensors and licensees, the extent of steering at issue in this proceeding may have little noticeable impact on listeners. For example, consider the result if, hypothetically, a noninteractive service were to steer away from Major A (which had a pre-steering natural (historic) play rate of 40% on that service) by 12.5 %.

Ex ante steering, the copyright on 4 in every 10 songs played on that noninteractive service was owned by Major A. Steering away from Major A by 12.5% would reduce Major A's play rate by 5 percentage points (12.5% of 40% is 5 percentage points). Thus, *ex post* steering, Major A's songs would constitute 35% of the plays on this noninteractive service instead of 40% of the plays.

Consider a consumer who listened to this noninteractive service for a period of time sufficient to hear 20 songs.

> *Ex ante* steering, the consumer would have heard 8 songs from Major A's repertoire (40% × 20 songs = 8 songs).
>
> *Ex post* steering, the consumer would have heard 7 songs from Major A's repertoire (35% × 20 songs = 7 songs).

The one replacement song from another record company's repertoire would not be a random song, but rather would be the song the algorithm or tastemaker selected after disqualifying the eighth song from Major A.[141] The issue thus is whether such a change in song delivery would diminish listenership to a noninteractive service to a point that would be economically harmful to the service, thus dissuading the service from steering. In fact, Pandora presented evidence regarding this issue, to which the Judges now turn.

iv. What is the Impact of Pandora's Steering under the Pandora/Merlin Agreement and in Pandora's Steering Experiments?

Pandora's steering under the Pandora/Merlin Agreement, which guarantees a [redacted]% level of steering, has not resulted in any negative feedback or other deleterious consequence for Pandora. Likewise, the series of steering experiments conducted by Pandora indicated that Pandora could steer away from or toward a Major's repertoire by a change of +/- 15% without causing a statistically significant change in listening behavior. McBride WDT ¶ 21.

Importantly, SoundExchange levels no criticisms at Pandora's steering experiments, save to make the point, rejected above, that the experiments did not reflect "real world" conditions.

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[141] In his oral testimony, Dr. Shapiro utilized another example, assuming a 15% steering "boost" to a Major with a prior "natural" performance rate of 20%. According to Dr. Shapiro, such a steering change would have "almost no perceptible impact on the listening experience, as it would entail a change in "one [song] out of 30" or "one song every couple hours." 5/19/15 Tr. 4630-35 (Shapiro) (and also explaining that steering need not result in a change with regard to the seeded song or artist, but rather would affect only subsequent songs played on the listener's station).

See SX RPFF ¶¶ 780-784 (and record citations therein).[142] The Judges likewise fail to identify any problems with regard to Pandora's steering experiments. Thus, the evidence is undisputed that Pandora can steer at least +/- 15% of its music toward or away from the Majors without a negative impact on listenership.[143]

v. Is the Value of Steering Available Under the Statutory License?

SoundExchange argues that any benefits from steering must be treated like any other consideration in a direct license that is not authorized under the Act. That is, SoundExchange asserts that steering must be independently valued, and the separate value must be added to the statutory rate. The Judges disagree.[144]

Steering, as Dr. Shapiro emphasized, is simply an example of price competition at work. Further, section 114(f)(2)(B) of the Act and prior decisional law require that the commercial rate reflect an "effectively competitive" market. Therefore, the value of steering is a *component* of the statutory license – not extraneous to it – and should not be excluded through an adjustment process or otherwise from the rate ultimately set by the Judges.[145]

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[142] This is a curious criticism of an economic experiment. By its very nature, an economic experiment, or an economic model, is intentionally *not* designed to replicate real world conditions, but rather to isolate certain conditions of the real world for testing and to hold the other conditions constant. The particular condition that SoundExchange claims the steering experiments held constant – listener knowledge of steering in the algorithm – seems wholly beside the point to the Judges. To state the obvious, consumers listen to noninteractive services because of the quality of the music, not because of their interest in what goes into the algorithmic "black box." If the music is of poor quality, then listeners will vote with their feet – or, more correctly, – with their ears.

[143] iHeart did not run experiments regarding its steering of sound recordings [redacted]. However, iHeart [redacted] and received complaints from noninteractive custom listeners that [redacted] *See* 6/2/15 Tr. 738-51 (Cutler); SX Ex. 1037 [redacted].

[144] The Pandora/Merlin Agreement allows for a very limited and conditional [redacted] *See* PAN Ex. 50141(c)(v) and (2)(c). However, there is no evidence in the record to suggest that such a limited and conditional [redacted] would be exercised and, if so, how often. There is also no evidence in the record to demonstrate the extent to this [redacted] would impact the effective rate under the Pandora/Merlin Agreement. Therefore, this contractual safeguard does not constitute a basis to adjust the Pandora/Merlin benchmark.

[145] SoundExchange attempts to impeach Dr. Shapiro on this point by seeking to use his rebuttal testimony against him. *See* SX PFF ¶ 705 ("[Dr.] Shapiro also acknowledged that steering commitments have value. In response to [Dr.] Rubinfeld's statement that "a direct license containing a binding steering commitment is unsuitable as a benchmark unless some adjustment is made to reflect the value of the commitment to the record company," [Dr.] Shapiro agreed with [Dr.] Rubinfeld that "some adjustment is appropriate." Shapiro WRT at 41. However, SoundExchange omitted the remainder of Dr. Shapiro's testimony, which omission seriously distorts his opinion: Without the omission, Dr. Shapiro's full testimony on this point states: "[Dr.] Rubinfeld takes the position that a direct license containing a binding steering commitment is unsuitable as a benchmark unless some adjustment is made to reflect the value of the commitment to the record company. I agree that some adjustment is appropriate, *but only to the extent that the steering commitment exceeds the amount of steering that the webcaster would engage in just based on price differences*. *Id*. (emphasis in original).

b. Does the Pandora/Merlin Agreement Contain Non-Statutory Value that either (i) Disqualifies the Pandora/Merlin Agreement as a Benchmark; or (ii) Diminishes the Value of Steering in the Pandora/Merlin Agreement?

i. The Potential Presence of Non-Statutory Value does not disqualify the Pandora/Merlin Agreement as a Benchmark

SoundExchange and Pandora both note that several additional elements of *potential* value are present in the Pandora/Merlin Agreement. Dr. Shapiro, on behalf of Pandora's direct case, went through each item of additional consideration and explained why he either adjusted his benchmark value higher (as in the case of certain advertising consideration) or declined to adjust the benchmark for other elements of potential value.

The Judges do not find that the mere presence of other items of potential value serves to disqualify the Pandora/Merlin Agreement as a suitable benchmark. Benchmarks may be imperfect in the sense that they include features that are ill-suited for adoption in the statutory rate. To reject a proposed benchmark for that reason alone would be – to put it colloquially – throwing out the baby with the bathwater. Because there is no single undifferentiated market for the statutory service, benchmarks must be borrowed from other markets or sub-markets and will always be imperfect to some degree and either in need of adjustment or limited in their applicability. But to ignore a benchmark for that reason alone would be an inappropriate indictment of the benchmarking process itself.

Further, Dr. Shapiro testified that he found these elements of additional consideration to either: (1) provide joint value to Pandora as well as Merlin members; (2) be unlikely to be achieved; or (3) be already incorporated into his valuation. There was no sufficient rebuttal by SoundExchange witnesses to these points. As the Judges explain *infra* in their discussion of the same issue in connection with the iHeart/Warner Agreement, an important general consideration relating to this issue is the absence of evidence of value from a party with regard to such additional terms, when that party has the incentive (as well as the means) to provide the Judges with such evidence.

Additionally, SoundExchange's assertion that the additional items created sufficient value to offset the lower rate in the Pandora/Merlin Agreement strikes the Judges as economically irrational. If the supposed additional value of the non-steering items in the Pandora/Merlin Agreement equals the difference between the non-steered rates and the lower steered rates, then what is the point of the parties incurring the transaction costs associated with negotiating such a deal? Why would Pandora commit to incur significant expenses to begin to set up an infrastructure necessary to perform the steering function?

ii. The Evidence does not Support a Lessening in the Usefulness of the Pandora/Merlin Agreement as a Benchmark for the Rates Indies Would Pay in the Hypothetical Market beyond the Adjustments Made by Dr. Shapiro

In rebuttal to Dr. Shapiro's item-by-item consideration of the potential additional items of value in the Pandora/Merlin Agreement, SoundExchange did not introduce expert testimony to establish alternative values. Rather, SoundExchange relied on the narrative testimony of industry witnesses Glen Barros, Darius van Arman and Simon Wheeler to support the position that these other items had some *unquantified value* to the Merlin members. Although such after-the-fact assertions can carry some weight, the Judges find such testimony to be inconsistent with Merlin's conduct during the negotiations.

More particularly, although Merlin has the ability to negotiate and evaluate agreements in a sophisticated manner, it failed to value these additional elements of consideration. *See, e.g.*, 5/1/15 Tr. 125-52 (Simon Wheeler) (Merlin, is "just as capable of understanding the complexity of the rights and licenses at issue in digital streaming as major record labels."); 5/28/15 Tr. 6513 (Barros) (agreeing that independent label "Concord's assessment of the value it receives from licensing its repertoire is just as sophisticated as any other label."); 6/1/15 Tr. 6924-25 (Lexton) ("Merlin brings expertise to bear on its negotiations with digital music services."). If the extra-statutory items were of particular and essential value to Merlin, the Judges would have expected to be presented with evidence as to how Merlin valued these several items. However, as noted, no such evidence was presented.[146]

Additionally, one Merlin member presented as a witness by SoundExchange, Glen Barros, President and C.E.O. of Concord Record Group, testified that "in all likelihood" he would have opted-in to the Pandora/Merlin Agreement *even if these other elements of value had not been included in that agreement*. 5/28/15 Tr. 6537-39 (Barros) (emphasis added).[147]

Although Mr. Barros represents only one Indie, SoundExchange selected him as a representative of the Indies' position regarding the value of the Pandora/Merlin Agreement. Clearly, SoundExchange could not present the testimony of more than [redacted] opting-in Merlin members, and the Judges therefore find the testimony against interest by this Merlin member selected by SoundExchange to be particularly probative.

Additionally, a May 15, 2014 internal e-mail written by Mr. Lexton appeared to the Judges to reference Merlin's strategy to attempt to obfuscate the usefulness of the Pandora/Merlin Agreement as a benchmark in this proceeding:

> [redacted]

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[146] In fact, with regard to one of the unquantified items of alleged value – the [redacted] provision – contemporaneous correspondence among Merlin members and personnel discounted any value in the [redacted] provision in the Pandora/Merlin Agreement. PAN Ex. 5110 at SNDEX0374284 (Correspondence from [redacted] stating that [redacted]").

[147] SoundExchange asserts that Mr. Barros' subsequent testimony that he found the ability for his record company to receive royalties on pre-1972 royalties to be a "gating" issue and that such testimony undercut the testimony quoted in the text, *supra*. The Judges find Mr. Barros' testimony as cited in the text, *supra*, to be credible, and they find that his subsequent attempt to qualify that testimony to be lacking in credibility.

SX Ex. 102. Thus, it appears to the Judges that Merlin's negotiation of additional terms was intended (at least in part) "to facilitate" the very argument SoundExchange now asserts through Mr. Lexton's testimony regarding the purported significance of the unvalued additional terms.

In a subsequent e-mail to Pandora dated June 3, 2014, Mr. Lexton made Merlin's position in this regard even more explicit, by asking Pandora to include the following proposed language in the final agreement:

[redacted]

PAN Ex. 5116 at SNDEX0315243. That request was rejected by Pandora and the requested language was never included in the final Pandora/Merlin Agreement. *Id.* Nonetheless, Merlin proceeded to enter into the Pandora/Merlin Agreement, anticipating that it would be used by Pandora as evidence in this proceeding. *See*, *e.g.*, 6/1/15 Tr. 6962, 6966 (Lexton); *id*. at 7095 (Wheeler); SX Ex. 102 at 3 (5/14/15/14 email among Merlin executives); PAN Ex. 5117 at SNDEX0437582 (6/9/14 internal email from Mr. Lexton).

The foregoing emails and testimony, combined with Merlin's and SoundExchange's failure to separately value the other elements of consideration either during negotiation or during the proceeding, strongly indicate to the Judges that Merlin found the value in the Pandora/Merlin Agreement to lie in the steering – that is, the trade-off of more plays at a lower rate for more total revenue.

In sum, if there was any additional value to Merlin from the other items sufficient to reduce the overall value of steering as adopted for a statutory license, the record evidence fails to provide a basis for such an adjustment. For these reasons, the Judges decline to increase the Pandora/Merlin benchmark to reflect any extra-statutory consideration that was not already accounted for by Dr. Shapiro.

b. Is Merlin Sufficiently Representative of a Segment of the Sound Recording Market?

The Judges reject SoundExchange's argument that Merlin is not sufficiently representative of the independent sector of the sound recording industry. The Judges rely on several facts in reaching this conclusion.

First, the Judges note that between [redacted] and [redacted] Merlin members, out of approximately [redacted] total members opted-in to the Merlin Agreement. Thus, it is accurate to state that the evidence regarding the Pandora/Merlin Agreement relates – to use Dr. Talley's term – to [redacted] to [redacted] "dyads" between licensors and a licensee. The Judges find this quantity of contracts to be significant and probative with regard to: (1) steering rates that Indies would accept; and (2) the principle that steering can be utilized as means of price competition in the noninteractive market.

In addition, the Judges do not find persuasive SoundExchange's argument that a majority of Merlin members who opted-in to the Pandora/Merlin Agreement did so through their agreements with aggregators and/or distributors. These opting-in members delegated the decision whether to opt-in to these distributors and aggregators and there was certainly no evidence or testimony to suggest that these arrangements were coerced or that any Merlin members who opted-in through this process disagreed with the decision. Thus, the decision by Merlin members to delegate the decision whether to opt-in to its agents is a component of the business model these Merlin members chose to follow. The Judges cannot criticize the decision of these Merlin members, and by extension, call into question their intention to be bound by the Pandora/Merlin Agreement, merely because they have arranged their licensing affairs in this manner. By way of analogy, just as SoundExchange's criticism of Pandora's business model is not relevant to the setting of rates in this proceeding, the Judges do not find relevant the business judgments of Merlin members to utilize aggregators and/or distributors as their agents in this regard.

Relatedly, the Judges find that the fact that Merlin negotiated collectively on behalf of its members does not diminish the value of Merlin as a party capable of entering into an agreement that is otherwise an appropriate benchmark. Merlin members utilize the collective capacities of Merlin in order to transact licensing business in a more efficient manner, as described by a Merlin's testifying executive, Mr. Lexton:

> Merlin's purpose is to allow independent record companies to benefit from direct deals negotiated by Merlin on a collective basis. As such Merlin is a one stop shop for recorded music rights licensing. It represents recorded music rights owned and/or controlled by independent record labels and distributors who are eligible and choose to join Merlin. … Merlin's core remit is to represent its members in negotiating licenses with digital music services in the hope of overcoming market fragmentation issues that have historically challenged the independent music sector particularly in the digital domain.

Lexton WRT ¶¶ 11-12 . Indeed, Merlin apparently is sufficiently successful in this endeavor that one of the Majors, [redacted] has characterized Merlin as the "fifth Major." PAN Ex. 5349 at 9 ([redacted] approvingly noting to [redacted] that Merlin publicly presents itself as a "fifth major").

Further, the Judges reject SoundExchange's assertion that Merlin as a collective had different incentives than its members that somehow diminish the value of the Pandora/Merlin Agreement as a benchmark. These incentives included financial and status benefits to Merlin if its members opted-in, which were distinct from whatever benefits individual members might obtain by opting in to the Pandora/Merlin Agreement. The Judges understand this criticism to be based upon the classic principal-agency problem, in which the interests of the principals (Merlin members) may not be fully aligned with the interests of the agent (Merlin). However, this is a common problem when principals delegate functions to agents. Unless the evidence demonstrates that the agent (Merlin) has engaged in a breach of duty toward its principals (Merlin members), the lack of a complete alignment of interests does not invalidate the

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[148] At the time, there were four Majors, Universal, Sony, Warner, and EMI.

benchmark status of the agreement entered into by the principal. Indeed, because this is the principal-agent arrangement that the Merlin members *voluntarily* created – including whatever misalignments in incentives might theoretically exist – it is especially representative of a marketplace transaction. The fact that approximately [redacted]-[redacted]% of Merlin's [redacted] members opted-in to the Pandora/Merlin Agreement is compelling evidence that the Merlin members found the terms of the agreement beneficial to them, notwithstanding any alleged separate benefits to Merlin as a collective organization.

The Judges also reject the criticism that Merlin has not uniformly represented its members because Pandora has used its editorial discretion to exclude (as of the time of the hearing) from its playlist sound recordings owned by some of the opting-in Merlin members. There is no allegation that Pandora promised to make all sound recordings available on its service, and therefore each Merlin member accepted the risk that Pandora, in its editorial judgment, might not include some or all of its sound recordings.

Finally, the Judges do not find merit in SoundExchange's argument that Merlin is not a sufficient representative of Indies in the marketplace. SoundExchange did not produce any witnesses from Indies who were not members of Merlin to testify to this effect. Rather, SoundExchange produced witnesses whose Indie record companies *did* opt-in to the Pandora/Merlin Agreement. Given Merlin's capacity to negotiate and its well-regarded industry status, the fact that non-Merlin Indies are not covered by the Pandora/Merlin Agreement, in the absence of other evidence, is not sufficient to call into question the usefulness of this benchmark.

c. Did Pandora Have Substantial Market Power that is reflected in Lower Effective Rates in the Pandora/Merlin Agreement?

The Judges reject SoundExchange's assertion that Pandora had significant market power that caused the effective rates in the Pandora/Merlin Agreement to be lower than effectively competitive rates. Initially, the Judges note that this assertion is not supported by any empirical market data, analysis, or comparison with other negotiated comparable interactive rates.

More importantly, the issue of Pandora's "market power," *vel non*, was anticipated and addressed by Pandora's economic expert, Dr. Shapiro, who explained:

> Pandora is the largest noninteractive webcaster. I have considered specifically whether Pandora had undue market power in its negotiations with Merlin. In the language of antitrust economists, I have considered whether Pandora has monopsony power over Merlin. Pandora's share of listening among noninteractive webcasters is *not* the key variable for determining whether or not Pandora has monopsony power over Merlin. Rather, the correct variable upon which to focus is the share of the Merlin Labels' revenues that comes from Pandora. If a very large share of the Merlin Labels' revenues came from any single music user, then that music user could well have monopsony power over Merlin. But this is demonstrably not the case for Pandora. The Merlin Labels generate revenues from many different users of their sound recordings, including other noninteractive webcasters, interactive services, and from the sale of physical albums and digital downloads. In fact, I estimate, based on data for the recorded music industry overall, that *Pandora accounted for roughly 5 percent of the revenues received by the Merlin Labels in 2013 for the licensing of their music in the United States.*

> *Thus, Pandora's share of the Merlin Labels' revenues is far short of the level that would be necessary for Pandora to have undue market power in its negotiations with Merlin.*

Shapiro WDT, at 24-25 (emphasis added). The Judges find this explanation sufficient to contradict the assertion that Pandora exercised undue market power in negotiating the terms of the Pandora/Merlin Agreement.

There is an additional and separately sufficient reason why SoundExchange's claim of Pandora's monopsony power cannot be adopted. The assertion that Pandora exercised market power in these negotiations ignores the fact that Merlin did not have to accept any of Pandora's terms – Merlin and its members could have fallen back on the Pureplay statutory settlement rates rather than accede to any demand by Pandora. That is, by this particular assertion, SoundExchange is assuming *arguendo* that the effective Pandora/Merlin rates are below an appropriate market rate because of Pandora's market power.[149] But why would Merlin and its members voluntarily enter into an agreement to accept rates lower than the statutory alternative and lower than what would exist in a competitive market?

Therefore, the Judges reject the assertion that Pandora exercised undue market power in negotiating the effective rates contained in the Pandora/Merlin Agreement.

d. Was the Pandora/Merlin Agreement Merely "Experimental?"

Two of SoundExchange's witnesses characterized the Pandora/Merlin Agreement as an "experiment," as distinguished from an actual marketplace agreement. The Judges reject this attempt to characterize this real agreement, involving the exchange of actual consideration, as an "experiment."

An economic experiment is undertaken under controlled laboratory conditions, as distinguished from market transactions that take place in the real world. *See* Guillaume R. Frechette and Andrew Schotter, Handbook of Experimental Economic Methodology 21 (2015) ((""[T]o run an experiment … experimenters are of necessity engaged in market design *in the laboratory*.") (emphasis added). Quite clearly, the Pandora/Merlin Agreement was not and is not an "economic experiment."

SoundExchange's witnesses may have used the word "experiment" to suggest a tentative or impermanent relationship between Pandora and Merlin. If so, that criticism proves too much, as all benchmark agreements – indeed virtually all agreements – could be characterized as "experiments," in that they have stated durations, and the parties are free to vary the terms of their economic relationship after the so-called "experiment" has expired. In this sense, the word "experiment" is misused to cast a wide disqualifying net on all benchmark agreements.

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[149] SoundExchange is thus assuming here that, under section 114(f)(2)(B), a benchmark rate must reflect an adequate level of competition.

e. Has Pandora's Performance under the Pandora/Merlin Agreement Compromised the Usefulness of that Benchmark?[150]

Even assuming that the Pandora/Merlin Agreement is, in principle, a useful benchmark, SoundExchange asks the Judges to look to Pandora's alleged poor performance of its obligations under the Pandora/Merlin Agreement. As detailed *supra*, SoundExchange alleges that Pandora has failed to perform certain contract obligations (such as, e.g., [redacted]) and that the cost of performance is daunting for Pandora, which combine to create what one might call "seller's remorse" among Merlin participants with regard to the licensing of rights under the Pandora/Merlin Agreement.

Pandora does not dispute that it had not (as of the hearing date) been able to implement all the benefits promised in the Pandora/Merlin Agreement. However, the Judges note that SoundExchange did not produce any correspondence from Merlin or its members complaining about the failure of Pandora to perform, or any threat to terminate the agreement or sue Pandora for nonperformance. Rather, the evidence suggests that Merlin recognized that the structuring of performance needed to be an ongoing and collaborative effort. As Pandora's Chief Financial Officer, Mr. Herring, testified:

> [redacted]

5/18/15 Tr. 4318 (Herring); *see also* PAN Ex. 5014 (Pandora/Merlin Agreement, "Feature Implementation Timeline"), Exhibit C thereto ([redacted]."

[150] A general issue of proof arose in this proceeding as to whether a benchmark's value can be measured by the parties' *performance* under a proposed benchmark agreement, in addition to the parties' *expectations* of value when the benchmark was created. This issue arose in a different context, regarding whether iHeart's "incremental" rate analysis of its iHeart/Warner Agreement benchmark should be analyzed by reference only to the parties' expectations at the time of contracting, or whether the Judges should also consider the parties' performance under the iHeart/Warner Agreement. As discussed in detail *infra*, the Judges have rejected iHeart's "incremental" rate analysis, thereby mooting the issue of whether the parties' performance under that agreement affected the so-called "incremental" rate. With regard to the Pandora/Merlin Agreement, SoundExchange argues that Pandora's *performance* under the Pandora/Merlin Agreement indicates that the agreement is not usable as a benchmark. Because – as explained in the text, *infra* – the Judges find that Pandora's performance does not cause them to reject the Pandora/Merlin Agreement as a usable benchmark, the question of whether evidence of performance is *generally* appropriate to consider when setting rates need not be decided by the Judges in this determination.

(emphasis added). SoundExchange did not produce evidence to call into question Pandora's performance under this [redacted] clause.

More importantly, the evidence indicates that Pandora has performed its core obligation under the Pandora/Merlin Agreement: the increase in spins of Merlin recordings, in the aggregate, by at least [redacted]%, above their collective "natural" rate. In fact the evidence shows that Pandora is overspinning Merlin member recordings collectively by [redacted]%. On the individual Merlin label level, the results have been uneven – some Merlin labels have been overspun by [redacted]-[redacted]% of their natural rate, *see* 5/18/15 Tr. 4229-30, 4291-4293 (Herring); SX Ex. 2310 (showing hundreds of Merlin Labels with rates of overspinning exceeding [redacted]%) – but other Merlin Labels are spinning at less than a [redacted]% increase their above their prior levels. SX Ex. 1748 at 2; SX Ex. 2310.[151]

However, the only specific promise by Pandora of increased spins in the Pandora/Merlin Agreement was its promise [redacted] to increase Merlin spins collectively by [redacted]%, and it appears undisputed that Pandora has performed this obligation and, in fact, has far exceeded the [redacted]% minimum. With regard to the underspinning of individual Merlin Labels, Pandora represented in the Pandora/Merlin Agreement only to [redacted] to increase spins by at least [redacted]% above the natural rate. Thus, the individual members objectively cannot complain about the level of overspinning at any point in time, unless they can also claim that Pandora had not been [redacted] As noted above, SoundExchange did not produce any evidence suggesting that any individual members had lodged such a complaint.

With regard to SoundExchange's claim that Pandora has incurred substantial unexpected capital costs in implementing a steering system, Mr. Herring testified that these investments, although motivated in the short-term and in part by the Merlin Agreement, in fact laid the groundwork for Merlin to implement steering more broadly across the non-interactive webcasting market. 5/18/15 Tr. 4313-4317 (Herring) ("some of these costs are fixed costs to be amortized over time with the anticipation of being applied to other direct licenses with other record companies, and expensed at the time that the costs are incurred, and therefore "spread over those deals."). Thus, the existence of these costs does not establish any fact to contradict the Judges' finding that the Pandora/Merlin Agreement is a useful benchmark. In fact, Pandora's commitment to incur substantial build-out costs to create the steering architecture underscores that this agreement (and the iHeart/Warner Agreement) represents the cutting-edge of a technological advance that can ameliorate the anticompetitive effects of a complentary oligopoly.

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[151] Labels owned by Beggars Group (whose officer, Simon Wheeler claimed the Pandora/Merlin Agreement was a failure) – including XL Recordings, Matador and Nation Records – are being overspun on Pandora by as much as [redacted]%. SX Ex. 2310.

f. Do the Steering Experiments and the Pandora/Merlin Agreement Demonstrate the Rate to Which a Major Would Agree?

The Judges find this SoundExchange criticism to be meritorious. These steering experiments reflect only a *quantity* adjustment that could be attempted with regard to the Majors, not a rate adjustment arising from steering to or from a Major. By contrast, the Pandora/Merlin Agreement does reflect the impact of steering on negotiated *rates* (as does the iHeart/Warner Agreement). Thus, while the Judges find the steering experiments to be probative of the general principle that steering can be effected to some extent without a negative impact on listenership, the Judges do not accept that this constitutes direct evidence sufficiently probative of the rates that would result from steering writ large in the marketplace.[152]

Moreover, Pandora's own witness testified in a manner that contradicts Pandora's attempt to bootstrap the Pandora/Merlin rates onto the Majors. Mr. Herring, Pandora's C.F.O., testified that Pandora would have to offer a higher steering-based rate to a Major than Pandora obtained in the Pandora/Merlin Agreement. 5/18/15 Tr. 4253 (Herring). The Judges have noted previously that the majors' repertoires must be distinguished from those of the Indies. *See SDARS II,* 78 Fed. Reg. at 23063 (the majors are distinguishable from the Indies "by virtue of the depth and breadth of their music catalogues [which] make up a critical portion of the sound recording market.").[153]

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[152] The use of benchmarking serves to tie the quantity aspect of steering to its impact on rates, and the absence of a relevant Majors' benchmark in *Pandora's* evidence prevents the Judges from determining a steered price for Majors from that evidence. Although Dr. Shapiro asserts that the steering experiments demonstrate that the Majors should receive the same rate as the Indies in a market with steering, that opinion is contradicted by the higher rate set forth in the [redacted] Agreement which also contains a significant steering component. Dr. Shapiro attempts to explain the higher [redacted] rate as a function of a so-called "focal point," "anchor" or "magnet" effect created by the extant applicable statutory rate, that allegedly raises the negotiated rate toward (yet still below) the statutory rate. However, although this theoretical effect is discussed in the economic literature, Dr. Shapiro acknowledged that it is not an "ironclad" economic law, and there is scant evidence in this proceeding why such a potential "focal point" or "magnet" effect would cause unconstrained licensors to eschew a lower market rate that would produce greater revenue.

[153] Dr. Shapiro opines that the Majors' advantage in the hypothetical market would be reflected economically *solely* through the greater number of noninteractive plays, rather than *also* in a higher per-play rate *See, e.g.,* 5/20/15 Tr. 5058 (Shapiro) (testifying that the larger repertoires of the Majors "does not mean" that the Majors deserve a "greater value per-performance."); 5/19/15 Tr. 4730 (Shapiro) (rejecting use of market share alone in determining "value per spin"). However, Dr. Shapiro ignores the fact that there is apparently a greater per-song value overall for songs in the Majors' repertoire, as evidenced by Pandora's own data – showing that the Majors account for [redacted]% of "top 5% weekly spins," [redacted]% of the "top 10% weekly spins," and [redacted]% of the "top 20% weekly spins" – despite the fact that the Majors account for only [redacted]% of the *total* spins on Pandora. *Compare* SX Ex. 269 at 74 *with* SX Ex. 269 at 73. These "top spin" figures are indicative of the "must have" aspect of the Majors' repertoire (leaving aside the anticompetitive complementary nature of their combined repertoires). Indeed, the record suggests to the Judges that the popularity of the Majors' spins is the reason why steering away from their repertoires cannot be pursued beyond a certain level, and why Dr. Shapiro candidly declined to reject the idea that the Majors' repertoires were "must haves" even though noninteractive services could steer away from them to an extent. To use an imperfect yet helpful analogy: A regular restaurant diner might prefer steak to chicken, to the extent that she orders steak 7 out of every 10 meals at the restaurant. This greater demand for steak versus chicken can result in both: (1) more revenue to the restaurant for *each* steak dinner compared with *each* chicken dinner; and (2) more total revenue attributable to the greater number of steak dinners arising from the patron's more frequent visits to the restaurant to eat steak. In more formal economic terms, the typical listener (or the restaurant patron) gets more "utility" from the Majors'

Therefore, the Judges consider the rate established by the Pandora/Merlin Agreement to establish only one guidepost (*i.e.*, a relevant financial point of reference) to a statutory rate. The Judges are informed as to the limited weight of this rate in the ultimate statutory rate they shall set, by the fact that Indie sound recordings reflect approximately [redacted]% of the sound recordings played on Pandora. SX Ex. 269 at 73.

g. Can the Majors Avoid Steering in the Hypothetical Market?

SoundExchange argues that any attempt by a noninteractive service to impose steering on the record companies would be rebuffed by the Majors. In particular, SoundExchange argues that the record companies would respond to a steering threat by: (1) withholding their entire repertoires; (2) imposing Anti-Steering or "Most Favored Nation" contract clauses; and/or (3) requiring up-front lump sum royalty payments from the noninteractive services.

i. Withholding the Entire Repertoire

A Major could respond to a threat of steering by threatening to withhold its entire repertoire from that noninteractive service. There appears to be a consensus that the repertoire of each of the three Majors is a "must have" in order for a noninteractive service to be viable. *See* 5/18/15 Tr. 4254 (Herring) (admitting that without the repertoire of a Major, it would be a much different service); 5/18/15 Tr. 4472 (Shapiro) (declining to state the majors are not "must haves" for noninteractive services); *see also* SX Ex. 269 at 74 (noting the disproportionate share of top spins from the Majors' repertoires).

However, the ability of the Majors to utilize such a boycott to defeat steering would be a function of their complementary market power. Simply put, demands by the Majors to prevent steering by insisting that a noninteractive service not deviate from an historical ("natural") division of market shares would be a classic example of anticompetitive conduct. *See, e.g.*, *Blue Cross & Blue Shield United of Wisconsin v. Marshfield clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, J.) (It would be a strange interpretation of antitrust law that forbade competitors to agree on what price to charge, thus eliminating price competition among them, but allowed them to divide markets, thus eliminating all competition among them.").[154]

While the Majors' individual market power is not in itself necessarily improper, the hypothetical exercise of that power in this manner in the noninteractive market would be antithetical to the "effective competition" requirement inherent in the section 114(f)(2)(B) standard. That is, each Major may well be entitled by its firm-specific market power to higher rates than the Indies, but the Majors cannot bootstrap that power into a further capacity to reap

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songs (or from the steak) each time one is "consumed," and also consumes those songs (and steaks) more often. The seller can benefit from *both* the greater "utility" and the frequency of purchases.

[154] The Judges emphasize that their analysis in the text, *supra*, is not intended to suggest any antitrust violations by any actor in the interactive or noninteractive market. The Judges' concern under section 114(f)(2)(B) is to set rates that reflect a hypothetical market that is effectively competitive. If the hypothetical market posited by one of the parties to this action would result in rates that were not effectively competitive, then such a hypothetical market must be rejected – even if it would be the result of tacit or other conduct that might not rise to the level of a violation of the antitrust laws.

the benefits of a complementary oligopolist by brandishing such power as a sword against steering.

Thus, in the present case, the hypothetical use by one or more of the Majors of its power to boycott a noninteractive service – one that had sought to inject some price competition into the market via steering – would undermine the "effective competition" standard that the D.C. Circuit, the Librarian of Congress and the Copyright Royalty Judges have declared to be an essential element of the section 114(f)(2)(B) standard.

ii. Anti-Steering or MFN Clauses

In the interactive market, the Majors commonly include anti-steering or MFN clauses in their agreements with the services. The Judges find that such clauses have no purchase vis-à-vis steering in exchange for lower rates in the *noninteractive* market. In the noninteractive market, an insistence by a Major that a noninteractive service abide by an anti-steering clause, or a MFN clause that has the same effect, is tantamount to importing the anticompetitive complementary oligopoly power of the Majors from the interactive market into the noninteractive market. Dr. Rubinfeld's rebuttal testimony at the hearing is telling:

> Q: Now [Dr.] Shapiro has testified that the threat of steering, alone, would lead to lower rates from record companies. What's your view of that opinion?
>
> [DR. RUBINFELD]
>
> I don't think it's likely to happen because I don't think the threat … is a credible threat – that would be the term we use in economics – and the reason is … that, first of all, *the record companies, as I have said a number of times before, do have substantial bargaining power* and they have responses to the threat that takes away its credibility. In the rather strong version, they could … look to other sources of listeners and say we're going to consider not using your service, but … they could say we're not going to feature all of the same artists, maybe we'll take some of our top artists off our offerings ….
>
> ***
>
> [THE JUDGES]
>
> Professor, do you think that the smaller independents have that same bargaining power … to respond to the threat of steering…?
>
> [DR. RUBINFELD]
>
> No. They wouldn't have … quite the same *bargaining power*.
>
> ***
>
> [THE JUDGES]
>
> What do the independents lack that the [M]ajors have that makes the independents unable to exercise that threat?
>
> [DR. RUBINFELD]
>
> [T]ypically, they're only going to have a few artists that have really the name recognition and *the power* to make a difference.

[THE JUDGES]

> So if the record company industry was more atomistic, the threat of steering would be more credible, but because it's not that atomistic … it makes the ability of the [M]ajors to rebut the threat … more likely to be successful?

[DR. RUBINFELD]

> I think that's true. … [T]hat's a harder world for me to imagine because I have been in the world of seeing *three or four major companies having a pretty big impact.*

5/28/15 Tr. 6302-05 (Rubinfeld) (emphasis added).

This testimony underscores the point that the Majors' capacity to undermine "price competition-via steering" is a function of their complementary oligopoly power. Once again, the Judges do not find that the mere size of the Majors or their share of the noninteractive market is in itself anticompetitive (especially on this record), but the Judges find that the ability of the Majors to *leverage* that market power to create the complementary oligopoly pricing problem can neither be imported into the noninteractive market nor assumed to be part of the hypothetical effectively competitive noninteractive market. Indeed, in the hypothetical market without a statutory rate, such anti-steering clauses (and other anti-steering tools) would be ripe for judicial invalidation. *See U.S. v. American Express Co.*, 88 F. Supp. 3d 143, 189, 194 (E.D.N.Y. 2015) ("anti-steering rules" can "block pro-competitive efforts" to the extent that "the market is broken," when such rules prevent "price competition," by not permitting buyers "to use their lowest cost supplier, as they can in other aspects of their businesses."); *United States v. Apple,* 791 F.3d at 320 ("we are breaking no new ground in concluding that MFNs, though surely proper in many contexts, can be "misused to anticompetitive ends in some cases."). The Judges likewise find the hypothetical use by the majors of anti-steering clauses in response to the threat of price competition-via-steering would thwart "effective competition."[155]

iii. Up-Front Royalty Payments

SoundExchange asserts that a record company could frustrate an attempt at steering by requiring noninteractive services to pay their royalties up-front in a lump sum, instead of on a per-performance basis. Such a lump-sum requirement would frustrate steering in the following manner: If a licensee has already paid Record Company A a required, large up-front fee (equal

[155] Dr. Rubinfeld also speculated that in the hypothetical market the Majors could "take some of our top artists off our offerings" in response to an attempt at price competition-via steering. 5/28/15 Tr. 6302 (Rubinfeld). But in that hypothetical market, such an attempt by an entity with rights to collectively license a substantial market share would invite scrutiny as anticompetitive. *See* "*Dept. of Justice Sends Doc Requests, Investigating UMPG, Sony/ATV, BMI and ASCAP Over Possible 'Coordination'*"Billboard.com (July 13, 2014). ("The Department of Justice has sent out CIDs (Civil Investigative Demand for Documents) to ASCAP, BMI, Sony/ATV Music Publishing and Universal Music Publishing Group in connection with their review of … whether partial withdrawals of digital rights should be allowed.") Thus, such behavior would not necessarily be consonant with "effective competition," but rather an anticompetitive leveraging of market power. The Judges thus decline to incorporate such licensor responses in the hypothetical effectively competitive market.

to its natural/historic play level multiplied by the old, higher per-play rate) then the marginal cost going forward to the noninteractive service of playing a sound recording from Record Company A would be zero. By contrast, Record Company B – even if it offered a reduced steering rate – would still be insisting on a rate greater than the marginal rate of zero the licensee would be paying to Record Company A. The noninteractive service would thus be compelled to either pay the up-front lump sum and lose the benefits of price competition, or refuse to pay the lump sum and lose access to 100% of the repertoire of Record Company A.

This up-front lump sum strategy in actuality is merely another way in which a Major could bootstrap its otherwise unobjectionable market power to preserve *complementary oligopoly power* in the noninteractive market. The Judges note that SoundExchange's expert economic witness, Dr. Rubinfeld, has written that "[i]n dynamically competitive industries, where new product and features are an important part of competition, *even licenses that include only fixed, or lump-sum payments, can result in an anticompetitive lessening of competition*". Daniel L. Rubinfeld and Robert Maness, "The Strategic Use of Patents: Implications for Antitrust," *reprinted in* Francois Leveque and Howard Shelanski, Antitrust, Patents and Copyright 85, 91-92 (2005). In the present context, the noninteractive service that would be compelled to pay to a Major an up-front lump-sum license based on the old per-play rate (or lose access to 100% of the Major's repertoire) would need to recover those fixed and sunk costs and thus forego price competition-via steering.[156]

In sum, each of the three contract devices relied upon by SoundExchange to defeat steering are dependent upon the exercise of market power to preserve the power of complementary oligopoly, which would thwart effective competition in the noninteractive market. Thus, all three contracting devices would be inconsistent with the statutory direction to set rates, based on competitive information, that would be set between willing buyers and willing sellers in an effectively competitive marketplace in the absence of a statutory license.

h. Conclusion Regarding the Pandora Benchmark

For the foregoing reasons, the Judges will utilize Pandora's steering-based benchmark as a guidepost to establish the zone of reasonableness for the noninteractive royalty rates that would be paid by Indies in the ad supported (free-to-the listener) and subscription markets. Pandora has proposed two sets of such benchmarks, depending upon the level of steering the Judges find to be appropriate for rate-setting purposes.

The Judges find that this guidepost should be established by applying a rate premised upon the lower of the two steering alternatives presented by Pandora – the [redacted]% steering figure – rather than the higher 30% figure.[157] The lower [redacted]% level is appropriate because it is the

[156] The Judges are not stating that a requirement of an up-front payment lump-sum royalty type provision is *per se* inconsistent with effective competition. For example, in the [redacted] Agreement, discussed *infra*, [redacted] is obligated to pay [redacted] to [redacted] even if [redacted]. SX Ex. 33 at 14-17, ¶¶ 3(a) and (d). However, there is no evidence that this provision would frustrate effective competition.

[157] The lower steering level results in a higher per-play rate.

level to which Pandora was willing to commit [redacted]. PAN Ex. 5014 ¶ 4(a). The Judges recognize the relatively nascent nature of steering. Although these factors certainly do not invalidate the Pandora/Merlin Agreement as a usable benchmark, they do suggest to the Judges that the more prudent course is to incorporate only the guaranteed 12.5% level of steering, and use the resultant rates as the appropriate guideposts for the rates attributable to the Indies portion of the statutory market.[158]

E. iHeart Rate Proposal

1. Introduction

iHeart proposes a per-play rate of $0.0005 for the § 114 license. In support of this proposal, iHeart relies on the analysis undertaken by its expert witnesses, Drs. Daniel Fischel and Douglas Lichtman, of rates set forth in certain agreements entered into by iHeart in the market for noninteractive services.

2. The Fischel/Lichtman Proposed Benchmark

a. The iHeart/Warner Agreement

Effective October 1, 2013, iHeart and Warner entered into an agreement (the iHeart/Warner Agreement) that addressed, *inter alia*, the rates that iHeart would pay to Warner for iHeart's plays of Warner sound recordings on iHeart's custom noninteractive service. SX Ex. 33 (iHeart/Warner Agreement). As it pertained to these noninteractive plays, the iHeart/Warner Agreement provided that iHeart would pay the greater of: (1) a per-performance fee on custom performances; and (2) Warner's *pro rata* share of a specified percentage of iHeart's non-simulcast noninteractive revenue. Specifically, the iHeart/Warner Agreement calls for the following rates:

iHeart/Warner Per-Performance Royalty Rates	
Calendar Year	**Per-performance Rate**

[158] Pandora attempted to corroborate its Pandora/Merlin benchmark by introducing, in rebuttal, its agreement with a classical music record company, Naxos of America, Inc. (Naxos),that had been entered into as of January 1, 2015. PAN Ex. 5018 (the Pandora/Naxos Agreement). However, the Judges reject the Pandora/Naxos Agreement as a corroborating benchmark for several reasons. First, Naxos, as a classical music label, is at best representative of a narrow genre and therefore its agreement cannot serve to be representative of a wider variety of sound recordings. 5/13/15 Tr. at 3512 (Herring). Second, the Pandora/Naxos Agreement does not contain any steering terms, but rather sets a statutory per-play rate ($0.[redacted]), lower than the default rate ($0.0014) established by the Pureplay settlement. PAN Ex. 5018. Although this difference, *ceteris paribus*, would create an incentive for Pandora to play more classical music owned by Naxos, there was evidence, *acknowledged by Dr. Shapiro*, that Pandora was constrained in any potential steering toward Naxos by the fact that there was only one other classical label, Decca, which would make it hard for Pandora to steer away from the latter given its share of the market. 5/17 Tr. 4706-07 (Shapiro) (considering Naxos's and Decca's presence in the classical music market and acknowledging that "there are issues with some specialized areas of music where it might be harder to steer.") Further, Pandora did not conduct any steering experiments with regard to steering away from Decca, as it did with regard to steering away from the Majors. Third, Dr. Shapiro opined that, if steering did occur at the 30% level, Naxos would pay two different rates for plays on Pandora's ad-supported and subscription services, respectively. Shapiro WRT, at 37-38. However, the Pandora/Naxos Agreement does not bifurcate rates in this manner, but rather sets a single per-play rate of $0.[redacted] that would apply to Pandora's ad-supported and subscription services. PAN Ex. 5018.

2013	$0.[redacted]
2014	$0.[redacted]
2015	$0.[redacted]
2016	$0.[redacted]
Each calendar year during the Renewal Term if any	$0.[redacted]

iHeart/Warner Percentage Revenue Royalty Rates	
Period	**Percentage**
First [redacted] months after Effective Date	[redacted]%
Months [redacted] after Effective Date	[redacted]%
Each month during the Renewal Term if any	[redacted]%

SX Ex. 33 at 15-16 (iHeart/Warner Agreement).

The iHeart/Warner Agreement incorporates the same economic steering logic as the Pandora/Merlin Agreement. Specifically, at the time of the execution of the iHeart/Warner Agreement, Warner's actual share of iHeart's custom noninteractive webcasts was approximately [redacted]%. However, under the iHeart/Warner Agreement, iHeart is obligated to [redacted]. Drs. Fischel and Lichtman concluded that this provision created an incentive for iHeart to increase Warner's share of performances substantially [redacted]. Fischel/Lichtman AWDT ¶ 36.

The iHeart/Warner Agreement also contains the following additional elements that, according to iHeart: (1) were not independently valued by the parties on a monetary basis; (2) benefited both parties; and (3) therefore had an uncertain net value:

- Warner's grant to iHeart of sound recording rights for [redacted]
- iHeart's commitment to provide Warner with no less than [redacted] percent of total airplay devoted to a music advertising campaign that iHeartMedia provides on its webcast stations, known as the Artist Integration Program ("AIP");[159]

[159] According to Drs. Lichtman and Fischel, under the AIP program, iHeartMedia dedicates airtime to promoting particular artists or songs, typically new artists or recently-released songs. These promotions may include [redacted]. SX Ex. 33 at 19.

- Warner's [redacted] right to [redacted], and iHeartMedia's [redacted] right to [redacted]); and
- iHeart's "most favored nation" protection *vis-à-vis* [redacted], such that, if Warner were to enters into an agreement to license sound recording rights for [redacted]'s [redacted] and provide [redacted] with terms that are more favorable than those offered to iHeart, then iHeart would be afforded the option to adopt those [redacted] terms.

Fischel/Lichtman AWDT ¶ 38.

Drs. Fischel and Lichtman described the [redacted] as an "insurance policy" that benefited iHeart in the event it would [redacted]. Likewise, they described the AIP provision as an "insurance policy" that benefited Warner, because iHeart's commitment to continue to provide the AIP benefit meant that Warner did not have to assume the risk that iHeart might charge Warner for the right to access the benefits of AIP. *See* iHeart PFF ¶¶179-180 (and record citations therein).

Drs. Fischel and Lichtman recognized the difficulty in quantifying the values of what they described as these "insurance policy" equivalents. However, they aver that neither party assigned any values to these (and the other) non-rate terms and that the *net* value of these items therefore can only be set at zero. Fischel/Lichtman AWDT ¶ 39. As Dr. Fischel further testified:

> We followed the … real-world example of the parties … who did not price any of these terms. … [T]here was no separate pricing in the agreement or separate valuation in the agreement in terms of the spreadsheets … that I reviewed as background for the contract. … For that reason … the best answer, given the real-world data that we have, is to place a net value of zero on them because that's what the parties themselves did.

5/21/15 Tr. at 5336-40 (Fischel).

Moreover, according to iHeart, even SoundExchange's economic expert, Dr. Rubinfeld, admitted that none of the experts in this proceeding likewise "actually put[] a numerical value on these additional items." 5/28/15 Tr. 6289 (Rubinfeld). In addition, iHeart notes, Dr. Rubinfeld acknowledged that several of these items were "terms that favor iHeart," and yet were not separately valued and priced by the parties. *Id.* at 6435.

However, iHeart does not conclude from the foregoing that the iHeart/Warner Agreement sets forth a usable benchmark rate that mirrors the stated rates of $0.[redacted] to $0.[redacted], or even the purported lower rates of $0.[redacted] to $0.[redacted] resulting from the [redacted] adjustment applied by Drs. Fischel and Lichtman (as discussed *infra*). Rather, according to Dr. Fischel, the foregoing rates reflect only the average rates in or derived from the iHeart/Warner Agreement. Dr. Fischel asserts that such an average rate "does not necessarily reflect the rate … that a willing buyer and willing seller would have reached in a marketplace" unconstrained by government regulation or interference." Fischel/Lichtman AWDT ¶ 44.

In an attempt to correct for this alleged defect, Dr. Fischel conceptualizes the Warner plays on iHeart as comprising two distinct economic bundles. Dr. Fischel states:

> As an economic matter, the [iHeartMedia]-Warner agreement reflects a bundle of two distinct sets of rights. The first set provides a license for iHeartMedia to play the same number of Warner performances as it would have played absent the agreement. The second set of rights provides a license for iHeartMedia to play additional Warner performances, above and beyond those it would have played absent the agreement.

Id. ¶ 45.

Accordingly, Dr. Fischel opines that compensation for the first "bundle" of rights is directly affected by the existing statutory rate, and therefore "provides essentially no information about the rate willing buyers and sellers would negotiate in the absence of government regulation." *Id.* ¶ 48.

However, Dr. Fischel opines that the second "bundle" he conceptualizes is "highly relevant to what willing buyers and willing sellers would negotiate if unconstrained by government regulation." *Id.* ¶ 49. In support of this opinion, Dr. Fischel testified:

> This part of the bundle involves a license for iHeart to play additional Warner performances, above and beyond those it would have played absent the agreement. Those additional performances are not directly influenced by the existing statutory rate, because absent the agreement, iHeart wouldn't play them and Warner wouldn't receive any compensation for them. The royalty rate negotiated for this second part of the bundle, therefore, is a more appropriate measure of what a willing buyer and a willing seller would negotiate if unconstrained by government regulation. Warner licensed the rights to those performances to iHeart, and iHeart compensated Warner for that license, at rates that were acceptably profitable for both parties. The rate here was not determined by regulation; it was determined by the give-and-take of a true negotiation.

Id.

Thus, Dr. Fischel needed to distinguish between the two bundles that he had conceptualized, which required him to consider the projected number of Warner plays in each bundle. To perform this analysis, he relied upon a set of projections that iHeart's Board of Directors used when evaluating and approving the iHeart/Warner Agreement. Fischel/Lichtman AWDT ¶ 40. (Thus, this set of projections also served as the basis for the iHeart Board's approval of the *stated* rates in the iHeart/Warner Agreement.) According to iHeart's Head of Business Development and Corporate Strategy, Steven Cutler, this set of projections – referred to by iHeart as the "Today's Growth" model – was [redacted], representing the parties' "best estimates" of performance under the iHeart/Warner Agreement. 6/2/15 Tr. 7247-48 (Cutler); *see also* Fischel/Lichtman AWDT ¶ 40; 5/21/15 Tr. 5365 (Fischel).

The Today's Growth model projected that iHeart would play [redacted] total performances of all labels' sound recordings over the [redacted] term of the agreement. Fischel/Lichtman AWDT ¶ 41 and Ex. A thereto ("Projected Performances During Initial Term of iHeartMedia Agreement with Warner"); IHM Ex. 3034 at 170. iHeart estimated Warner's share of those performances under two key scenarios: (1) the [redacted] scenario, which reflected iHeart's expectations if no agreement with Warner was reached; and (2) the "Warner Direct License Terms" scenario, which reflected its projections under the terms and conditions of the Warner agreement as signed. Fischel/Lichtman AWDT ¶ 42 and Ex. B thereto ("Projected iHeartMedia/Warner Royalty Rates"); IHM Ex. 3034 at 172.

Under scenario (1), iHeartMedia expected Warner music to constitute [redacted]% of total performances, or [redacted] performances, on the iHeart custom service. Under scenario (2), iHeart expected to increase Warner's share of performances to [redacted] percent, and thus expected to play [redacted] Warner performances over the duration of the agreement. Fischel/Lichtman AWDT ¶ 42; IHM Ex. 3034 at 172 ("Projected iHeartMedia-Warner Royalty Rates").

Under scenario (1) – *without* the steering of additional plays at lower average rates – iHeart expected to pay Warner a total of $[redacted] in royalties. Under scenario (2), *with* the steering of additional plays at lower average rates, iHeart expected to pay Warner a total of $[redacted]. Fischel/Lichtman AWDT ¶¶ 43, 51.

Dr. Fischel then divided the total expected compensation under the Today's Growth Model ($[redacted]) by the total number of performances projected in that model ([redacted]). This calculation projected an average per-play rate of $0.[redacted], rounded to $0.[redacted]. Fischel /Lichtman AWDT ¶43; IHM Ex. 3034 at 172 ("Projected iHeart Media/Royalty Rates").

Even before Dr. Fischel attempted to determine his "*incremental* rate" under the iHeart/Warner Agreement, he emphasized that this *average* rate itself was [redacted]% lower than the statutory rate of $0.0025 that iHeart would otherwise pay under the applicable NAB/SoundExchange settlement. Fischel/Lichtman ¶ 43.

Additionally, Drs. Fischel and Lichtman opined that this $0.[redacted] rate needed to be adjusted downward for a [redacted] adjustment, to reflect the fact that, under the iHeart/Warner Agreement, [redacted] are not subject to a royalty payment by iHeart to Warner. *Id.* at ¶ 35. They then noted that iHeart, had projected that an adjustment for [redacted] would reduce the effective average per-play rate under the iHeart/Warner Agreement "to between $0.[redacted] and $0.[redacted]. *Id.*

Dr. Fischel then turned his analysis toward the calculation of his so-called "incremental rate." He noted the simple math demonstrating that, according to the Today's Growth Model, the difference in the number of Warner *plays* on iHeart's custom noninteractive service between Scenario (2) ([redacted] plays) and Scenario (1) ([redacted] plays) equaled [redacted] plays. He further noted that the difference in *royalties* – again according to the Today's Growth Model – between Scenario (2) ($[redacted]) and Scenario (1) ($[redacted]) equaled $[redacted]. Fischel/Lichtman AWDT ¶¶ 50-51; IHM Ex. 3034 at 172 ("projected iHeart Media/Warner royalty rates.

Dr. Fischel then divided the $[redacted] additional revenue by the additional [redacted] plays to derive his "incremental rate" of $0.0005. *Id.* As noted *supra*, Dr. Fischel opined that his so-called "incremental rate – $0.0005 – was a better benchmark than the average rate of $0.[redacted] implied by the Today's Growth Model or the rates actually set forth in the iHeart/Warner Agreement – because the so-called "incremental rate" was not tainted by the upward influence of the statutory rate. Accordingly, Dr. Fischel opined that it was his opinion "that this $0.0005 per-performance rate is the best available evidence on the question at issue in this proceeding." Fischel/Lichtman AWDT ¶ 52.[160]

As noted at the outset of this section, the iHeart/Warner Agreement contains a greater-of rate structure. However, Drs. Fischel and Lichtman declined to incorporate any greater-of formula into their rate structure and they did not include any percentage-of-revenue alternative rate in their proposed benchmark. Dr. Lichtman explained this deviation from the iHeart/Warner Agreement: "[N]o one thought that provision would be binding. So they have a number that both parties looked at and said that number would never actually be used in the real world, so who cares what the number is ….") 5/15/15Tr. 4016-4017 (Lichtman); *see also* 5/21/15 Tr. 5334 (Fischel) (same).[161]

b. The 27 iHeart/Indies Agreements

iHeart also relies upon its separate agreements with 27 Indies that, as of July 2014, accounted for approximately [redacted] percent of performances on its custom service. Fischel/Lichtman AWDT ¶ 57 and Ex. C thereto; IHM Exs. 3340, 3342, 3343, 3345, 3347, 3349, 3351-3370; 3642. Despite this relatively small percentage of plays (compared to Warner), Drs. Fischel and Lichtman opine that "these 27 deals provide important additional evidence as to the rates negotiated by willing buyers and willing sellers." Fischel/Lichtman AWDT ¶ 57.

The principal custom noninteractive rate in these 27 agreements is [redacted]. Indeed, the 27 Warner/Indies Agreements contain the following provision:

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[160] Dr. Fischel then speculates as to whether even the non-incremental plays would be priced higher or lower than $0.0005, but he comes to no conclusion in that regard. Fischel/Lichtman AWDT ¶ 53.

[161] iHeart speculates that the percentage-of-revenue prong was added to the iHeart/Warner Agreement by Warner to set a precedent for future rate-setting proceedings for sound recordings and points to a document pertaining to Warner's negotiations with [redacted] for support. See IHM Ex. 3435 at 5; 5/15/15 Tr. 4024-25 (Lichtman). However, iHeart does not identify any sufficiently similar evidence that suggests the percentage-of-revenue prong in the iHeart/Warner Agreement was included for this reason.

See generally IHM Exs. 3340, 3342, 3343, 3345, 3347, 3349, 3351-3370; 3642. However, iHeart states that [redacted] of these 27 webcasters has paid royalties under the percentage of revenue prong, because the per-play rate has generated the higher royalty. Fischel/Lichtman AWDT ¶ 61.

Each of these 27 iHeart/Indies Agreements contains a [redacted]-year term. *Id.* These iHeart/Indies Agreements also contain other rates that are not applicable to custom noninteractive webcasting. *Id.*; *see* Fischel/Lichtman AWDT ¶ 58.

As in the iHeart/Warner Agreement, the iHeart/Indies Agreements contain various additional items, some of which iHeart claims inure to its benefit, and some of which benefit the labels. iHeart points, by way of example, to the provision in all 27 agreements that iHeart received a license for [redacted] and thereby avoided the risk of [redacted] Additionally, in many of those agreements, the Indies agreed [redacted] Fischel/Lichtman AWDT ¶ 62.

As they analyzed the iHeart/Warner Agreement, Drs. Fischel and Lichtman concluded that the value of these terms cannot be determined in isolation, and found that there was no evidence indicating that the parties had explicitly assigned value to them when analyzing whether to enter into these 27 agreements. Accordingly, they concluded that it is appropriate to assign a zero net value to the non-pecuniary terms. *Id.*

Therefore, Dr. Fischel proceeded to derive a so-called "incremental rate" for the 27 iHeart/Indies Agreements. He determined that, between 2012 and 2014, and *prior* to the execution of these 27 agreements, iHeart expected to pay to all these Indies $[redacted] (of which $[redacted] was for custom webcasts) covering [redacted] performances (of which [redacted] were custom webcasts), resulting in an *average* royalty rate of $0.[redacted] (iHeart was subject to the SoundExchange/NAB settlement rates). IHM Ex. 3034 (Fischel/Lichtman AWDT, Ex. D).

Dr. Fischel then determined that, after the execution of these 27 iHeart/Indies Agreements, total performances would increase to [redacted] (of which [redacted] were custom webcasts) and total royalties would increase to $[redacted] (of which $[redacted] was for custom webcasts), resulting in an *average* royalty rate of $0.[redacted]. *Id.*

As with the iHeart/Warner analysis, Dr. Fischel then calculated his so-called "incremental rate" by applying his "two bundles" approach. He noted that iHeart expected to play an additional [redacted] performances and expected to pay $[redacted] more in royalties. This incremental difference yielded the so-called "incremental rate" of $0.[redacted] ($[redacted]/[redacted] plays). Fischel/Lichtman AWDT ¶ 68; IHM Ex. 3034 (Fischel/Lichtman AWDT, Ex. D thereto).

Unlike the iHeart/Warner Agreement, these 27 Warner/Indies Agreements were not supported by an internal projection of expected increased plays, such as the "Today's Growth" model upon which Dr. Fischel relied for his iHeart/Warner "incremental" analysis. Rather, Dr. Fischel testified that he and Dr. Lichtman "assumed (consistent with our understanding) that iHeart believed that, after signing each of these deals, it would increase each label's share of all webcasts ([redacted]) by [redacted] percent." Fischel/Lichtman AWDT ¶ 66. Apparently, Dr. Fischel did not use iHeart's or his own "projections" of increased performances, as he did for his iHeart/Warner analysis, but rather "assume[d] iHeart approximately met its projections for … custom performances," and therefore "the projections in [this] category[y] [are] equal to the *actual* number of performances." Fischel/Lichtman AWDT ¶ 66 (emphasis added).

Drs. Fischel and Lichtman concluded from the foregoing that the $0.[redacted] "incremental rate" that they estimated for the 27 iHeart/Indies Agreements "demonstrates our main conclusion, regarding the $0.0005 per-performance rate." Fischel/Lichtman ¶ 69.[162]

3. SoundExchange's Criticisms of the iHeart Rate Proposal

a. Introduction

SoundExchange attacks the iHeart rate proposal on six separate fronts. First, SoundExchange sets forth an overview that purports to provide a different and more accurate understanding of the terms of the iHeart/Warner Agreement, compared with the presentation put forth by iHeart. Second, SoundExchange seeks to demonstrate the invalidity of Dr. Fischel's "incremental rate" approach. Third, SoundExchange avers that iHeart's analysis is also flawed because it fails properly to consider and give value to other elements of consideration in the iHeart/Warner Agreement, which would result in a significantly higher benchmark per-play rate. Fourth, SoundExchange takes issue with iHeart's failure to account for the parties' actual performance under the iHeart/Warner Agreement. Fifth, SoundExchange takes issue with iHeart's reliance on a single projection made by iHeart during negotiations (the "Today's Growth" model) to establish a benchmark in this proceeding, and its failure to consider other contemporaneous alternative projections. Sixth, SoundExchange seeks to discredit the 27 Warner/Indies Agreements as proper benchmarks.

b. SoundExchange's Overview of the iHeart/Warner Agreement

SoundExchange begins its critique by referring to the negotiation period *before* the iHeart/Warner Agreement was executed. It notes that iHeart originally offered Warner [redacted]. IHM Ex. 3114 at 10. Warner rejected that proposal and even according to Dr. Fischel, Warner ultimately achieved a "better deal than [redacted]. 5/22/15 Tr. 5542; 5551 (Fischel).

- When SoundExchange turns its attention to the several non-rate and non-steering aspects of the iHeart/Warner Agreement, it notes the following provisions that

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[162] Drs. Fischel and Lichtman acknowledged the obvious – that the $0.[redacted] "incremental" rate derived from the iHeart/Indies Agreements was lower than the $0.[redacted] "incremental" rate derived from the iHeart/Warner Agreement. *See* 5/21/15 Tr. 5383 (Fischel). They opined that the Indies might receive a lower rate because the Indies artists may be "less well-known," and because Indies may have repertoires that are not "already familiar to listeners." Fischel/Lichtman AWDT ¶ 69. This testimony is generally consistent with the Judges' finding, *supra*, with regard to the Pandora/Merlin Agreement, that Indies in fact receive lower royalty rates than the Majors.

[163] SoundExchange also notes that Sony and Universal turned down a similar offer from iHeart because "[redacted]" SX Ex.1139; SX Ex. 25 at 12, ¶ 35 (Harrison WRT); 4/28/15 Tr. 509-510 (A. Harrison) (describing iHeart's proposal as "[redacted]")

were essentially ignored by iHeart. iHeart agreed to provide to Warner the greater of [redacted]% of all AIP inventory that iHeart offers in the marketplace and AIP having a "fair market value" – as stated in the iHeart/Warner Agreement – of at least $[redacted] per agreement year. SX Ex.33 at 19-20, § 5(a).

- In addition to this "[redacted] AIP," iHeart agreed to provide Warner with another advertising opportunity, to participate in two "[redacted]" campaigns each year. This "[redacted]" guarantees at least [redacted] insertions of ads in duration up to [redacted] seconds each on iHeart's terrestrial stations for artists selected at Warner's discretion. Each advertisement also must include a [redacted]. SX Ex. 33 at 19-20, § 5(a); 81, Exhibit F. Warner calculated the value of a single [redacted] campaign at $[redacted], yielding a combined value for [redacted] such campaigns of close to $[redacted] over the initial term of the agreement. SX Ex. 32 at 14 n.9 (Wilcox WRT); 6/3/15 Tr. 7403 (Wilcox).
- iHeart also agreed to pay royalties to Warner for [redacted]. SX Ex. 33 at 10, § 1(pp); SX Ex. 32 at 14 (Wilcox WRT).
- iHeart agreed to pay Warner a $[redacted] fee for a [redacted] provision, the [redacted] agreement, which iHeart requested be in a separate agreement but ultimately was included in the iHeart/Warner Agreement. 6/3/15 Tr. 7387 (Wilcox).[164]

Through testimony at the hearing, SoundExchange and Warner asserted that Warner perceived the additional items it received, combined with the rate and steering terms, as greater than what it would have received under the statutory license. 5/7/15 Tr. 2370 (Wilcox) (Warner received "a package of consideration that is material and greater and different in positive ways than what we would be obtaining just through a compulsory statutory deal".). Further, Mr. Wilcox testified that he did not think this "deal" would "go forward on the existing terms if one of these were missing." 6/3/15 Tr. 7416 (Wilcox). However, SoundExchange did not proffer evidence or testimony that was contemporaneous with the negotiation of the iHeart/Warner Agreement that was probative as to whether Warner required the other contract terms in order to avail itself of the rate and steering terms. SoundExchange notes though that (regarding the additional contract items of potential value to Warner) iHeart did not produce a fact witness who testified regarding the actual value of these terms to iHeart.

SoundExchange also notes, as did iHeart, that the latter also received additional contractual consideration – beyond the right to perform Warner's sound recordings under the agreement. *See* Fischel/Lichtman AWDT at 20 (regarding the "insurance policy" allowing

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[164] In pertinent part, the [redacted] Agreement provided that, in exchange for a $[redacted] to Warner by iHeart, Warner granted to iHeart [redacted] SX EX. 1339.

iHeart to avoid [redacted] if [redacted] and the [redacted] protection if [redacted] granted better terms to [redacted] for its [redacted] service); SX Ex. 33 at 31.

However, despite the absence of any actual values being placed by the parties on these additional items, Mr. Wilcox concluded that the *net* value of all the other consideration provisions is "heavily weighted to the Warner Music Group." 6/3/15 Tr. 7385 (Wilcox).

SoundExchange also notes in this context, as it did in its opposition to Pandora's rate proposal, that the steering elements of the iHeart/Warner Agreement provide only "first mover" advantages" that would be "mathematically impossible" to replicate across the industry. 5/7/15 Tr. 2374 (Wilcox); Rubinfeld Corr. WDT at 46 ¶ 183; 6/2/15 Tr. 7239 (Cutler). Moreover, SoundExchange noted that iHeart found that its ability to steer toward any particular record company was limited. As noted in the Judges' discussion of the Pandora rate proposal, SoundExchange asserts that, when iHeart tried to [redacted] it created "challenging listening experiences." For example, a listener's seeded "[redacted] Radio Station" [redacted] turned into a *de facto* "[redacted] Radio Station," [redacted] and a listener's seeded "[redacted] Radio Station" [redacted] turned into a *de facto* "[redacted] Radio Station [redacted]. Thus, iHeart concluded that too much steering (to [redacted]%) was "[redacted] all to the detriment of our custom product." SX Ex. 1037.

c. SoundExchange's Criticism of the "Incremental Rate" Approach of Drs. Fischel and Lichtman

SoundExchange begins its critique with these undisputed assertions:

- None of these agreements—or any other agreement submitted by any other party—has $0.[redacted] as the stated per-performance rate or within any range of stated rates.
- There is not a single document in evidence showing that any parties—not just Warner and iHeart—ever had a "meeting of the minds" as to a rate of $0.[redacted] per-performance.
- There is not a single communication between iHeart and Warner citing a rate of $0.[redacted] under the iHeart-Warner agreement.
- No internal iHeart document shows such a rate for the iHeart-Warner agreement.
- There is no evidence in the record showing that a willing copyright owner would agree to license the performance of its sound recordings at a rate of $0.[redacted].
- None of the other economic experts who testified used such an approach in his written testimony.

SXPFF ¶¶ 768-69 (citing 5/22/15 Tr. 5489-90 (Fischel); Rubinfeld CWRT ¶ 23); [what are these ¶¶ in?]¶¶784-88 (and additional citations to the record therein).

Next, SoundExchange takes substantive aim at the "two bundles" of rights approach. SoundExchange (accurately) summarizes this opinion as stating that, according to Drs. Fischel and Lichtman, the *only* relevant information regarding the rate to which willing buyers and willing sellers would agree, absent a statutory license, can be found in the number of performances and revenue in the second bundle.[165] As SoundExchange continues to correctly note, they then claim that dividing the so-called "incremental" revenue by the "incremental" number of performances yields the precise per- play royalty rate to which the parties would have agreed for 100% of the performances expected under their agreement in a world without the statutory license. *See* SX PFF ¶ 771 (and record citations therein).

The fundamental problem with this "incremental" approach, according to SoundExchange, is that it artificially and erroneously divides the royalty payments by breaking the single actual bundle of performances under the agreement into two hypothetical bundles. According to SoundExchange, that approach artificially and erroneously divides consideration into separate bundles that the parties did not negotiate. To make the point, Dr. Rubinfeld, on behalf of SoundExchange, applied an analogy: In a "buy one, get one free" transaction, the price of the second product is not zero; the second product could not be obtained without paying the full price for the first. Accordingly, the appropriate price for each of the two products is not the "incremental price" of the second item, but rather the average price of the two items. Rubinfeld CWRT at 6 ¶ 24.

SoundExchange also notes that Drs. Fischel and Lichtman analyzed the Pandora/Merlin Agreement through the lens of their so-called incremental approach and concluded that the proper rate derived from that agreement – for use as the statutory benchmark – is between $0.0002 and *negative* $0.0002 (*i.e.*, a rate at which the record companies would pay the noninteractive services rather than receive royalties from these services). *See* Fischel/Lichtman AWDT at 40-41. In attempting to highlight the purported absurdity of this result, SoundExchange notes that, despite the clear economic appeal of such a range of rates to Pandora, its own expert, Dr. Shapiro, did not adopt such an incremental rate, but rather recommended a rate that was multiple times greater. Rubinfeld CWRT at 22, ¶ 79.

For these reasons, SoundExchange asserts that the so-called *incremental* per-play approach of Drs. Fischel and Lichtman must be rejected, in favor of an approach that determines per-play rates on an *average* royalty basis.

d. The Alleged Importance of the Value of Non-Rate/Steering Items in the iHeart/Warner Agreement

SoundExchange criticizes Drs. Fischel and Lichtman for failing to make a sufficient attempt to attach monetary values to provisions in the iHeart/Warner Agreement. *See* Fischel/Lichtman AWDT ¶ 39. More particularly, SoundExchange rejects their assumption that

[165] SoundExchange also accurately summarizes the contents of the two bundles: "The first is a 'bundle' for the purported right to perform sound recordings up to the number of performances [Drs.] Fischel [and]Lichtman say the parties expected to occur under the statutory license in the absence of a direct license," and "[t]he second is a 'bundle' for the purported right to make all the additional performances over and above those in the first bundle that [Drs.] Fischel [and]Lichtman say the parties expected to occur because of the direct license." SX PFF ¶ 770.

the non-royalty rate term provisions benefiting Warner, and those benefiting Heart, have a net value of zero. *See* 5/21/15 Tr. 5/21/15 Tr. 5340 (Fischel); (Fischel/Lichtman AWDT at 20-21). [

Rather, SoundExchange asserts the record reflects that this "net zero value" conclusion is inaccurate. The "record" to which SoundExchange cites to support this position is a conclusory statement made by Warner's testifying executive, Mr. Wilcox, who stated that the net value of the non-royalty rate provisions is "heavily weighted to the Warner Music Group." 6/3/15 Tr. 7385 (Wilcox).[166] SoundExchange further seeks to buttress its argument that the iHeart benchmark fails to adjust for the value of items that favored Warner by reciting the list of such items and noting that Mr. Wilcox, in his oral and written testimony, characterized such items as "incredibly important" ([redacted]); "so important" (with regard to [redacted]); a "floor valuation" (with regard to [redacted]); an "immediate uptick" in value with regard to [redacted]). SX PFF ¶¶ 810-814, 827 (and citations to the record therein).

SoundExchange also takes issue with iHeart's claim, as asserted by Dr. Fischel, that the absence of any projections or spreadsheets detailing the value of these additional items is evidence that the parties did not assign values to them. However, SoundExchange acknowledges that "when the Judges asked Mr. Wilcox whether Warner had assigned a number value to … many of these provisions," his "consistent" response was that he "could not be certain" of the number value. SX PFF ¶ 827.

i. AIP and [redacted]

Among the non-royalty and non-steering elements within the iHeart/Warner Agreement, SoundExchange emphasizes iHeart's failure to adjust its benchmark to reflect the value of two items referred to *supra* – AIP and [redacted]

(A) AIP

SoundExchange notes that the iHeart/Warner Agreement *itself* states that AIP has a "fair market value" of at least $[redacted] over [redacted] years. SX PFF ¶¶ 807-808 (and citations to the record therein). Thus, according to SoundExchange, it is irrelevant whether the parties had internal projections or spreadsheets establishing the value of AIP. *See* SX Ex 33 at 19, ¶ 5(a)(ii) (declaring that AIP has a "fair market value of at least [redacted] Dollars USD $[redacted] per Agreement Year").

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[166] Actually, Mr. Wilcox made this statement with regard to a list of contractual items that would provide value only to Warner, not the entirety of other non-royalty/steering items that Drs. Fischel and Lichtman asserted had value to both parties and should be weighed and deemed for rate purposes to have a *net* value of zero. *See id.* at 7384-85 (Mr. Wilcox responding to a question regarding a demonstrative list of contractual items and testifying that "they're heavily weighted to the Warner Music Group. These were, every one of them, things that were important wins for us, if you will, in the negotiation and were key to getting to yes."). Drs. Fischel and Lichtman did not dispute that some contractual items had value to Warner, but rather concluded that the absence of valuations by the parties required an expert to net the offsetting values at zero. Thus, the cited testimony does not support SoundExchange's assertion in the text, *supra*, that "the record" reflects a net value for these other items tilted toward Warner.

Additionally, SoundExchange points to internal iHeart documents in which Bob Pittman, iHeart's C.E.O., asked of his employees, with regard to AIP, "[redacted]" SX Ex. 207. SoundExchange further notes that, in an attempt to bridge differences in the ongoing negotiations, Mr. Pittman suggested that iHeart asked Warner if AIP has value to Warner, because it has value to iHeart. SX Ex. 1372. Additionally, SoundExchange points to Mr. Wilcox's written and oral testimony, in which he claims to recall that [redacted] indicated that iHeart intended to [redacted], but he cannot identify a document confirming that alleged representation by [redacted]. Wilcox WRT at ¶ 23, 6/3/15 Tr. 7460-61 (Wilcox)

SoundExchange also points to numerous documents in which iHeart confirms the substantial value to record companies of AIP participation. *See, e.g.*, IHM Exs. 3114 at 5, 10; 3121 at 4; 3225 at 2. Further, during negotiations, iHeart emphasized to Warner that AIP had substantial stand-alone value. *See* SX Ex. 93 at 1. Additionally, at the hearing, witnesses for *both* iHeart and Warner acknowledged the significant value of AIP to a record company. 5/21/15 Tr. 5194-95 (Poleman) (iHeart executive describing AIP as "invaluable"); 6/3/15 Tr. 7392 (Wilcox); Wilcox WDT at 12-13; (Warner executive describing AIP as "[redacted]").

Based on such reasoning, iHeart estimated the quantity of AIP to be given to Warner not only [redacted], but also by [redacted], as set forth on iHeart's rate card." *See* 5/20/15 Tr. 4885-86 (Pittman). As SoundExchange further points out, Mr. Poleman also noted that access to AIP slots could in the future be [redacted] and, if so, Warner would [redacted]. 5/21/15 Tr. 5189-90 (Poleman). *See also* SX Ex. 1139 ([redacted].

For these reasons, SoundExchange avers that iHeart erred in declining to attribute value to AIP in its iHeart/Warner benchmark.[167]

(B) [redacted]

According to SoundExchange, the value of [redacted] is different from [redacted] AIP in a way that enhances record company promotional programs on iHeart. First, unlike AIP, Warner was not [redacted], and iHeart did not [redacted]. 6/3/15 Tr. 7405 (Wilcox).

[167] SoundExchange, noting one of iHeart's rebuttals on this issue, acknowledges that in the past, iHeart provided AIP [redacted]. Therefore, SoundExchange recognized that AIP provisions could be construed as a form of "insurance" against [redacted]. SoundExchange asserts that the threat that iHeart would [redacted] AIP was real, so any "insurance" value would be quite high, albeit indeterminate. *See* SoundExchange PFF at ¶ 823 (and citations to the record therein).

The iHeart/Warner Agreement's [redacted] provision guarantees Warner at least [redacted] of up to [redacted] for [redacted] on all of iHeart's [redacted] of [redacted] chosen by Warner. SX Ex. 33 at 19-20, § 5(a); *id.* at 81, Exhibit F, §§ 1-2. According to Warner, both the [redacted] and the fact that [redacted] are unique to this program, [redacted]. 6/3/15 Tr. 7401 (Wilcox). Further, the [redacted] provisions require iHeart to include a [redacted] and gives Warner the right to [redacted], and to [redacted]. SX Ex. 33 at 82, Exhibit F, § 7.

Warner did not attempt to value [redacted] contemporaneous with the negotiations, and did not include a stated value for [redacted] in the iHeart/Warner Agreement. SoundExchange did not utilize an expert to value [redacted] in the hearing. However, for this proceeding, a non-expert. Mr. Wilcox, the Warner executive, calculated his understanding of the value of a [redacted] campaign at $[redacted] per year, or approximately $[redacted] for the [redacted] campaigns to which Warner was entitled over the initial term of the agreement. Wilcox WRT at 14 n.9; 6/3/15 Tr. 7403 (Wilcox). SoundExchange notes that no iHeart fact witness disputed this attempted valuation.

For these reasons, SoundExchange disputes the decision by Drs. Fischel and Lichtman to assign no independent value to the [redacted] benefits contained in the iHeart/Warner Agreement.

ii. [redacted] Agreement

Another non-royalty/steering provision identified in the iHeart/Warner Agreement is a reference to a separate agreement – the "[redacted] Agreement" between the parties. SoundExchange avers that Drs. Fischel and Lichtman wrongly omitted the value of this $[redacted] payment from their calculation. According to SoundExchange, this omission was improper because Mr. Wilcox testified that "it was "worth … $[redacted]" 6/3/15 Tr. 7385 (Wilcox). Mr. Wilcox further testified that iHeart had requested that this "[redacted] transaction be set forth in a separate agreement, but Warner preferred that it be included – as it ultimately was – in the iHeart/Warner Agreement. 6/3/15 Tr. 7387 (Wilcox). SoundExchange also notes that iHeart does not dispute that the $[redacted] was executed on the same day. 6/2/15 Tr. 7304 (Cutler); 5/22/15 Tr. 5505 (Fischel). Further, SoundExchange points out that none of iHeart's fact witnesses testified that the $[redacted] was *not* consideration tied closely to the webcasting agreement.

SoundExchange acknowledges that the "[redacted] Agreement" contains an [redacted]. *See* SX Ex. 1339 at 1-2. However, SoundExchange argues that iHeart is inconsistent by claiming that the Judges should apply that express clause, yet they should ignore the express valuation of AIP at $[redacted] in the iHeart/Warner Agreement. *See* SX PFF ¶ 830. Additionally, SoundExchange avers that Warner would not have executed the webcasting agreement (all else equal) absent the $[redacted] payment. 6/3/15 Tr. 7388 (Wilcox) ("It was a material amount of money and important to us as part of the total list of consideration we were getting …").

In sum, when Dr. Rubinfeld and SoundExchange account for all of the value they claim was missing from the valuation undertaken by Drs. Fischel and Lichtman, they conclude that under iHeart's "Today's Growth" model, the benchmark per-play rate would equal or exceed $0.[redacted]. *See* SXPFF ¶¶ 846-853 (and record citations therein).

e. Performance Under the iHeart/Warner Agreement Has Not Matched the Projections in iHeart's "Today's Growth" Model

In this proceeding, SoundExchange did not rely in its direct case upon any of Warner's projections reflecting its expectations at the time the iHeart/Warner Agreement was negotiated and executed. Rather, SoundExchange relies upon an analysis by Dr. Rubinfeld of available data regarding performances and royalties paid during the first eight months of the iHeart-Warner agreement – from October 2013 to May 2014. Dr. Rubinfeld relied upon this slice of performance data, rather than the expectations of the contracting parties, because he found that "performance data reflect actual experiences in the marketplace [and] [t]he most recent performance data is likely to be the best predictor of what will happen in the immediate future." Rubinfeld CWRT ¶ 27. However, Dr. Rubinfeld also cautioned that "review of a longer period of performance data may offer additional value if the review reveals important trends in the industry." *Id.* SoundExchange also point out that Dr. Katz (NAB's economic expert), Mr. Cutler (an iHeart executive) and Aaron Harrison (a Universal executive) all recognized the importance of using current performance data to update prior projections or expectations. *See* SX PFF ¶¶ 800, 803-04 (and citations to the record contained therein).

From the 8-month slice of data that he reviewed and about which he opined, Dr. Rubinfeld calculated an alternative average per-play royalty rate. Rubinfeld CWDT at 57-59 ¶¶ 229-236); SX Ex. 64 (Rubinfeld App. 1b, backup calculations).[168] For custom noninteractive performances, Dr. Rubinfeld calculated a per-play rate of $0.[redacted] ($0.[redacted] rounded). When he attributed the value of AIP to the per-play rate, his eight-month performance-based rate rose to $0.[redacted] per play ($0.[redacted] rounded). SX Ex. 66. Dr. Rubinfeld then attempted to equalize the iHeart/Warner and derived potential statutory rate to equalize royalty-bearing performances by adjusting for skips and for the playing of [redacted]. To that end, he used the same adjustment factor, 1.1, as he had used when performing his own interactive benchmarking analysis. Rubinfeld CWDT at 58 ¶ 234; SX Ex. 66.

SoundExchange avers that Dr. Rubinfeld's calculations as they relate to custom webcasting are conservative for the following reasons:

- He makes no adjustment upward for the certainty of value that Warner receives as a result of getting [redacted]. Rubinfeld CWDT at 57, ¶ 229.

[168] Dr. Rubinfeld also updated his calculations to include June to September 2014). SX Ex. 133.

- He does not account for any additional value from [redacted].[169]

f. iHeart Relies on Projections from Only One Model – the "Today's Growth Model

SoundExchange avers that Drs. Fischel and Lichtman relied exclusively on one specific projection that applied certain "assumptions" regarding future performance under the iHeart/Warner Agreement. These expectations were contained in a model – the "Today's Growth" model – presented to iHeart's Board of Directors in mid-2013. Fischel/Lichtman AWDT at 21 ¶ 40.

Although Drs. Fischel and Lichtman state that they chose the "Today' Growth" model because the iHeart Board purportedly "relied on [it] as the most realistic [case]" when approving the iHeart-Warner Agreement, 5/21/15 Tr. 5322(Fischel), SoundExchange notes that iHeart actually [redacted]. IHM Ex. 3338 (Cutler WDT); *see also* 6/2/15 Tr.7263-64 (Cutler).

Although there is no evidence that the iHeart Board relied on the "[redacted]" or "[redacted]" models, SoundExchange avers (albeit without supporting evidence) that because iHeart executives [redacted], "it was wrong for Drs. Fischel and Lichtman to ignore them completely." SX PFF ¶ 779. SoundExchange further notes that, although Mr. Cutler testified that he viewed the Today's Growth model as the best estimate, neither he nor any other iHeart witness testified that [redacted]. *Id.* Consequently, SoundExchange asserts that the Fischel/Lichtman analysis is compromised because they failed to test [redacted]. *See* 5/22/15 Tr. 5496-5497 (Fischel).

SoundExchange noted when it looked at actual performance under the iHeart/Warner Agreement, one of the models that was [redacted] – the "[redacted]" Model –proved to be a more accurate estimate of [redacted]. *See* 5/22/15 Tr. 5494 (Fischel); 6/2/15 Tr. 7264-65 (Cutler). This consistency between the "[redacted]" model and initial actual performance existed, according to SoundExchange, because iHeart had [redacted] 5/22/15 Tr. 5522 (Fischel); 5/20/15 Tr. 4839-40 (Pittman) ([redacted]).

SoundExchange surmises that such [redacted] policies were put into effect, and thus contributed to the actual initial performance under the iHeart/Warner Agreement that resembled

[169] Dr. Rubinfeld claims his estimate is also conservative because he applies the conservative pre-deal market share of [redacted]% despite a claim by Warner that its actual market share on iHeartRadio was approximately [redacted]%. Rubinfeld CWDT at 59 n.135.

[170] [redacted]. Cutler WDT, Ex. DD.

the “[redacted]” model rather than the “Today’s Growth” model. Whatever the reason, as Mr. Cutler of iHeart acknowledged, iHeart’s growth in Warner plays over the initial contract period has been [redacted]. 6/2/15 Tr. 7264-65 (Cutler).

SoundExchange notes as well that Dr. Fischel admitted on cross-examination that he had performed an analysis of the effective incremental rates under the “[redacted]” model (but did not submit evidence of that calculation or testify as to that calculation). On cross-examination, Dr. Fischel further acknowledged that the incremental rate he had calculated equaled $0.[redacted] per play under the “[redacted]” model. 5/22/15 Tr. 5523 (Fischel).[171]

SoundExchange additionally points to an effective per-play rate that iHeart supposedly wrongly ignored – the rate derived from a model [redacted]. *See* SX Ex. 367 at 005; 6/3/15 Tr. 7552-53 (Wilcox); *see also* SX Ex. 92 at 15 (setting forth alternative model comparisons). Applying this model, according to SoundExchange, yielded an average performance rate above $0.[redacted], and an incremental rate of approximately $0.[redacted]. Once again, these rates were mathematically derived by SoundExchange, not its witnesses, based on “the simple math that Prof. Fischel described” as applicable to calculating these rates. *See* SX PFF ¶ 794 at 264.[172]

g. The Alleged Deficiencies in the 27 iHeart/Indies Agreements and in The Analysis of their Terms by iHeart’s Experts

SoundExchange raises several challenges to iHeart’s attempt to use the 27 iHeart/Indies Agreements as benchmarks in this proceeding. First, SoundExchange avers that the status of these licensees as Indies renders them unrepresentative of the rates and terms that a noninteractive webcaster would negotiate with a major recorded music company. SoundExchange notes that even Dr. Fischel acknowledged that “Warner got a [[redacted]%] better deal than the Indies” from iHeart. 5/22/15 Tr. 5542 (May 22, 2015) (Fischel).

Second, SoundExchange notes that the greater-of rate structure in the iHeart/Indies agreements for custom noninteractive webcasting are [redacted], and thus are unduly influenced by that statutory rate. *See, e.g.*, IHM 3340, Tab 7/Ex. F (agreement between Indie DashGo and iHeart at 4, 8) Third, SoundExchange avers that these

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[171] Although Dr. Fischel did not identify the average rate derived from the “[redacted]” model, the basic math derived from iHeart’s “[redacted]” model projections reveal an average royalty rate of $0.[redacted]. for the entirety of performances under the iHeart/Warner Agreement if the “[redacted]” model had been applied. SX Ex 207; *See* SX PFF ¶ 793.

[172] Although Mr. Wilcox testified that this model indicating higher rates was [redacted], he did not clearly identify a model upon which [redacted]. Indeed, Mr. Wilcox testified that that the model that he identified as having been [redacted] “was just one of many sets of assumptions we used throughout the course of negotiating this deal to stress-test the, you know, edge cases, you know, trying to figure out that this deal would perform positively for us in as many situations as we can throw at it. That's, sort of, the point.” 6/3/15 Tr. 7421 (Wilcox). Thus, it is unclear as to exactly what model or models were [redacted]. Moreover, Mr. Wilcox did not identify in his written testimony which model or models were [redacted]. The Judges find Mr. Wilcox’s oral testimony on this subject to be neither credible nor informative.

Indies comprise in total no more than [redacted]% of plays on the service in July 2014, and most account for less than [redacted]% of plays *See* SX PFF 863.[173]

SoundExchange notes that Drs. Fischel and Lichtman determined both average and incremental rates related to these 27 iHeart/Indies Agreements. iHeart calculated an *average* royalty rate of $0.[redacted] from these 27 agreements, and an *incremental* rate of $0.[redacted] from these 27 agreements. Fischel/Lichtman AWDT, Ex. D.

However, with regard to the incremental rate, SoundExchange notes that Drs. Fischel and Lichtman did not possess the same contemporaneous projections from iHeart (or the Indies) as he had relied upon to determine the incremental rate under the iHeart/Warner Agreement. 5/22/15 Tr. 5543 (Fischel). Accordingly, the presumption by Drs. Fischel and Lichtman that iHeart would increase performances by [redacted]% is not based on any iHeart projection, nor is it supported by any provision of the 27 contracts. 5/22/15 Tr. 5544 (Fischel). Moreover, the starting-point pre-agreement performance numbers were based upon iHeart's *actual performances* of Indie recordings. *Id.* at 5545.[174] From this number, Drs. Fischel and Lichtman then extrapolated an "expectations" based [redacted]% increase in the number of post-execution performances. *Id.*

Finally, SoundExchange notes the testimony of one Indie representative, Mr. Barros of Concord, who stated that Concord would not have entered into this agreement with iHeart to reduce custom noninteractive webcasting rates to [redacted] if the agreement did not also include the [redacted]enues and compensation for performances of [redacted]. 5/28/15 Tr. 6506, 6509 (Barros).[175] According to SoundExchange, Drs. Fischel and Lichtman erred by failing to adjust their proposed rates to account for this additional consideration.

4. The Judges' Analyses and Findings Regarding iHeart's Rate Proposal

a. The Judges Reject iHeart's "Incremental" Rate Analysis

The Judges agree with SoundExchange's critique that the "incremental approach" advanced by iHeart is an inappropriate method for determining rates under section 114. There are a number of reasons why the "incremental approach" is improper.

First, the basic premise of the approach is erroneous. In an effort to avoid the so-called "shadow" of the statutory rate, Drs. Fischel and Lichtman essentially substitute a rate of zero for

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[173] SoundExchange does not provide a citation to the record for these statistics, referring only to "iHeart's data." SX PFF ¶ 863. By contrast, Drs. Fischel and Lichtman stated in their written testimony that "[a]s of July 2014, these 27 labels accounted for approximately [redacted]% of webcast performances on iHeart," but it was unclear from their testimony whether that percentage combined custom and simulcast performances. *See* Fischel/Lichtman AWDT ¶ 57 & n.51. Thus, the record is unclear what percentage of plays on iHeart's custom noninteractive service is comprised of these 27 Indies' recordings.

[174] SoundExchange also points out that Drs. Fischel and Lichtman only had performance data for [redacted] of the 27 Indies, so they extrapolated the data that they had. *Id.* at 5548; *see also* SX Ex. 2347.

[175] As noted in the Judges' analysis of the Pandora/Merlin Agreement, Mr. Barros did not indicate that Concord, or anyone on its behalf, established a monetary value for these other contractual items.

the number of sound recordings played under the existing statutory rate. Then, they conceptually divide the expected total of performances under the direct license (the iHeart/Warner Agreement) into two value-bundles. The first conceptual value-bundle (Scenario 1) consists of the lower number of performances (without steering) that iHeart expected to be played under the higher existing statutory rate. The second conceptual value-bundle (Scenario 2) consists of the number of performances (with steering, from [redacted]% to [redacted]% market share) that iHeart expected to be played under the lower direct deal rate. Drs. Fischel and Lichtman then consider the expected difference between the higher revenues arising from the direct deal. Finally, they divide the incremental revenue by the number of incremental plays to determine their "incremental rate."

This methodology intentionally attributes no market value to the rate and revenue paid for the *pre-incremental* performances. Although, as noted above, Drs. Fischel and Lichtman engage in this process in order to remove the alleged impact of the "shadow" of the statutory rate, they merely replace one supposed problem with a very real and more serious problem. That is, they replace the statutory rate with an effective rate of zero for the pre-incremental performances. There was no evidence presented in this proceeding – and indeed no logical evidence could be presented – to support an assertion that the bulk of the pre-incremental performances under iHeart's "two bundle" concept would be priced at zero in an actual market. To state the obvious, the creation of sound recordings is not costless, and prices are positive because costs must be recovered.[176]

Relatedly, although iHeart would like the Judges to focus only on the incremental number of performances and the incremental revenue, those incremental values cannot exist without iHeart first paying for the pre-incremental performances at pre-incremental rates. To put the point colloquially, "you cannot get there from here." That tautological point is not avoided by arbitrarily attributing a zero value to the pre-incremental performances.

SoundExchange makes this point well by analogizing to a "buy one, get one free" offer. If a vendor offered an ice cream cone (to adopt SoundExchange's demonstrative example at the hearing) for $1.00, but offered two ice cream cones for $1.06, it would be absurd to conclude that the true market price of an ice cream cone is the incremental six cents. Rather, this offer indicates a market price of $0.53 – the average price for the two ice cream cones. Or, to take a common example, tire sellers will often advertise a special where the buyer can pay for three tires and get the fourth tire free. This is economically (and mathematically) equivalent to a 25% reduction in the price of four tires. No one could go to the automotive store and receive only the "free" fourth tire!

iHeart attempts to distinguish the ice cream cone example by noting that, in the present case, Drs. Fischel and Lichtman are not eliminating a market-based price for the pre-incremental bundle, but rather are eliminating a government-set rate that casts a "shadow" on the market. There are several errors in this reasoning. First, the statutory rates were set after market

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[176] It is also unsupported by the evidence that record companies would forego all royalties in the hypothetical market merely to obtain a promotional value from the playing of their recordings on a noninteractive service.

participants provided the Judges in the prior proceeding with market evidence. There is no *a priori* reason to conclude that the rates set in that earlier proceeding failed to reflect or approximate market forces, and iHeart does not provide evidence as to why the Judges should re-litigate its prior rates and reach such a conclusion.[177] Second, to use a zero rate in order to remove the alleged shadow of the Judges' statutory rate or a settlement rate would be, to put the matter colloquially, throwing out the baby with the bathwater." A functionally zero rate for the pre-incremental performances is no mere potential "shadow;" it is an ink blot that obliterates any economic value inherent in the majority of the performances for which the rates must be established.[178]

Accordingly, the Judges reject iHeart's incremental approach and they reject the $0.0005 rate its experts derived by using the incremental approach. To be clear, that incremental $0.0005 proposed rate does not constitute a benchmark or a guidepost which the Judges have relied for any purpose, and that incremental rate and the analysis from which it was derived has not influenced the Judges in their determination of the statutory rate in this proceeding.[179]

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[177] Similarly, iHeart has not proffered evidence sufficient to show why the rates set in settlements between parties, that both parties agree may be evidence of a market rate, fail to reflect, or at least approximate, market rates as of the time they were set.

[178] On a less colloquial and more economic basis, iHeart has confused an elasticity-type concept with price. iHeart calculates the change in total revenue divided by the change in quantity. Such a proportionate change is not equivalent to a unit price.

[179] iHeart attempts to support its "incremental" analysis with three arguments that it claims are confirmatory of the $0.0005 rate. *See* iHeart PFF ¶¶ 236-260 (and citations to the record therein). The Judges note that their rejection of this "incremental" analysis moots the relevance of any attempt to confirm its purported contextual reasonableness. Further, the fact that iHeart did not propose these approaches as benchmarks or as other *independent* bases to set the rates makes them unhelpful and inappropriate as evidence to support iHeart's rate proposal. However, in the interest of completeness, the Judges note the following with regard to those arguments. First, Drs. Fischel and Lichtman undertook what they called a "thought experiment," whereby they attempted to estimate a rate necessary for sound recording copyright holders to maintain revenue at current levels if 100% of all listening to recorded music migrated to noninteractive webcasting. (They concluded that the rate would be $0.[redacted] per play.) They also did the same analysis on the assumption that only 25% migrated to noninteractive service. (They concluded that the rate would be $0.[redacted] per play.) However, Drs. Fischel and Lichtman acknowledge that this "thought experiment" is *"not evidence of what a willing buyer and willing seller would negotiate."* Fischel/Lichtman AWDT ¶ 128 (emphasis added). Therefore, such speculation is irrelevant to the Judges. Second, Drs. Fischel and Lichtman performed an "Economic Value Added ("EVA") analysis of the costs, revenues and necessary ROI of a "hypothetical simulcaster" to determine the rate necessary for it to remain in business in the long-run, which they determined to be between $0.[redacted] and $0.[redacted] per play. However, as the Judges have repeatedly held, rate proceedings under section 114 are not public utility style proceedings whereby parties are guaranteed a rate of return. *See, e.g., Web III Remand*, 79 Fed. Reg. at 23107. Further, their EVA model was based on a sample of terrestrial radio firms that is not necessarily representative of simulcasters. Additionally, their EVA analysis fails to consider the rates necessary for *record companies* to obtain a sufficient rate of return, so they have simply focused on the demand side of the market and ignored the "willing sellers" on the supply side. Third, Drs. Fischel and Lichtman compare the statutory rate for satellite digital audio radio services (SDARS) and find that it suggests a per-play rate of $0.[redacted] to $0.[redacted]. However, rates set by the Judges in other types of proceedings are not probative of rates that should be set in this proceeding, especially when the standards in the two proceedings are different. The rate standard in SDARS proceedings is different from the standard in section 114(f)(2)(B) for noninteractive services. *See* 17 U.S.C § 801(b)(1)(A)-(D) (setting forth particular objectives that the rates must achieve).

b. The Judges Find the Average per-Play Rate Indicated by the iHeart/Warner Agreement to be a Useful Benchmark

Unlike the incremental rate derived by iHeart's experts, the "average rate," *i.e.*, the stated per-play rate contained in the iHeart/Warner Agreement, is a useful benchmark that, after adjustment, is probative of the rate that would be paid by a Major, as a willing seller/licensor, to a noninteractive service, as a willing buyer/licensee.[180]

i. The Benchmark Passes the "Four-Part Test" derived from the Judges' Prior Decisions

First, the iHeart/Warner Agreement satisfies the sub-tests implicit in the Judges' prior determinations, as outlined by Dr. Rubinfeld:

Willing buyer and seller test: the rates are intended to be those that would have been negotiated in a hypothetical marketplace between a willing buyer and a willing seller.

There is no dispute that Warner was a willing seller in connection with the iHeart/Warner Agreement. As one of the three Majors, Warner is a sophisticated entity capable of negotiating direct agreements in a manner that it understands will advance its economic interests. Likewise, iHeart is a leading noninteractive webcaster – not to mention one of the largest transmitters of music across various platforms. iHeart thus without dispute is also clearly capable of representing its economic interests in negotiating direct agreements.

In the present case, the record is replete with voluminous submissions and substantial testimony indicating the diligence of both iHeart and Warner in negotiating this direct agreement. Clearly, each party was a willing participant in the legal sense; that is, each party was under no compulsion to enter into the iHeart/Warner Agreement, and each party had the opportunity to avail itself fully of all facts that it deemed pertinent before executing that agreement. *See, e.g., Amerada Hess Corp. v. Comm'r*, 517 F.2d 75, 83 (3d Cir. 1975) (defining a "willing buyer" and a "willing seller" as parties not "being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.'").

Same parties test: the buyers in this hypothetical marketplace are the statutory webcasting services and the sellers are record companies.

In the iHeart/Warner Agreement, the buyer/licensee, iHeart, is a statutory webcasting service. The seller/licensor, Warner, is a record company. Clearly, this aspect of the statutory test is satisfied.

Statutory license test: the hypothetical marketplace is one in which there is no statutory license.

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[180] In discussing the reasons why this average rate is a useful benchmark, the Judges find it helpful to organize their finding by adopting Dr. Rubinfeld's characterization of the elements of the statutory test implicitly set forth in section 114. *See* Rubinfeld CWDT ¶ 122(a)-(d).

The iHeart/Warner Agreement is a direct agreement between the parties. The rates established in this agreement are not statutory rates. More particularly, at the time the iHeart/Warner Agreement was executed, iHeart was obligated to pay royalties to Warner according to the schedule of rates set forth in the SoundExchange/NAB settlement.[181]

SoundExchange asserts that, nonetheless, the rates in the iHeart/Warner Agreement are too heavily influenced by the "shadow" of the statutory rates to satisfy this "statutory license test." The Judges disagree. As with regard to the Pandora/Merlin Agreement, it is crucial to appreciate that the adjusted effective rate[182] in the direct license is *less* than the default rate that would otherwise control (the SoundExchange/NAB settlement rates for iHeart, and the Pureplay rates for Pandora). Accordingly, Warner was under no compulsion to accept the lower rate (compared to the SoundExchange/NAB settlement rate) set forth in the iHeart/Warner Agreement; *it could have rejected that rate and defaulted to the higher SoundExchange/NAB settlement rate*. Instead, Warner agreed to the lower rate, in exchange for the anticipated steering by iHeart of additional webcast performances of Warner sound recordings (from approximately [redacted]% to [redacted]% of total sound recordings). Accordingly, the Judges find that the "statutory license test" has also been satisfied by the iHeart/Warner Agreement.

Further, and as discussed in connection with the Pandora/Merlin Agreement, the steering aspects of the iHeart/Warner Agreement also satisfy a statutory "test" omitted from Dr. Rubinfeld's four-part approach: the "effective competition" test. The steering aspect of the iHeart/Warner Agreement reflects price competition – an increase in quantity (more performances) in exchange for a lower price (a lower rate). All of the reasons set forth in this determination in the analysis of the Pandora/Merlin Agreement regarding the pro-competitive aspects of such steering, including the dynamic effect of a threat of steering, apply with equal force to the iHeart/Warner Agreement.[183]

Same rights test: the products sold consist of a blanket license for digital transmission of the record companies' complete repertoire of sound recordings, in compliance with the DMCA requirements.

It is not disputed that the iHeart/Warner Agreement provides in pertinent part for a license from Warner to iHeart to play Warner sound recordings on iHeart's noninteractive webcasting service. *See* SX Ex. 33 at 8 ¶ 1(y) (defining "[redacted]"); 11, ¶ 2(a)(1) (granting right to play "[redacted]" on "[redacted]"). Pursuant to the

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[181] *See* footnote 28, *supra*.

[182] The Judges' determination of the adjusted effective rate under the iHeart/Warner Agreement is discussed *infra*.

[183] iHeart notes that the threat of steering could cause steering to occur in a number of differentiated ways, *e.g.*, with one service making steering deals with several licensors, several licensees making similar deals with the same licensor(s), or a licensee making different deals with different licensors over time. *See* iHeart RPFF at 6, n. 15. However, the Judges need not rely on such specific predictions. In whatever ways in which the reality of steering and the concomitant threat of steering-induced price competition develop, it is clear to the Judges that, as Dr. Shapiro explained, steering is the mechanism by which the complementary oligopoly power of the Majors is offset, allowing the Majors to realize only their considerable (non-complementary) oligopolistic power generated by their repertoires and their organizational acumen.

iHeart/Warner Agreement, a "[redacted]" must [redacted]. *Id*. at p. 8, ¶ 1(y). In turn, Exhibit A to the iHeart/Warner Agreement permits [redacted]; requires iHeart to [redacted]; and allows a listener to [redacted]. *Id*., Ex. A.

Accordingly, the Judges find that iHeart/Warner Agreement satisfies the core of the "same rights test."

ii. The Average Rate in the iHeart/Warner Agreement

The Judges agree with SoundExchange that any use of the iHeart/Warner Agreement as a benchmark must apply the effective *average* rate contained in that agreement.[184] *See* SX RPFF ¶ 844 ("The *average effective rate* approach … is the proper analytical method ….") (emphasis in original). The iHeart/Warner Agreement sets forth different per-play rates for [redacted]. The record does not reflect the reason(s) why iHeart and Warner negotiated an increase in the rates from a low of $0.[redacted] in [redacted] to a high of $0.[redacted] in [redacted] (and for any renewal term thereafter). In any event, the parties' inclusion of specific per-play rates paid to Warner in exchange for the right granted to iHeart to play Warner's sound recordings reflects the parties' WTA and WTP for the particular years. In the absence of relevant evidence necessitating adjustments or legal conditions extrinsic to the parties' agreement, the Judges cannot second-guess the rates to which the parties have agreed in a benchmark contract that otherwise satisfies the statutory test for a usable benchmark.

By applying the average rate explicitly set forth in the iHeart/Warner Agreement (subject to potential adjustments), the Judges have obviated the protracted dispute between the parties regarding the probative value of different models and projections of future growth of performances and royalties. That is, in the absence of a "two-bundle" theory, the parties' expectations and projections are baked into the single explicit annual rate contained in the iHeart/Warner Agreement. Regardless of whether actual performance eventually resembles the "Today's Growth Model" relied upon by the iHeart Board, or some more pessimistic or optimistic model of projections considered by iHeart or Warner, iHeart was contractually bound to pay a fixed royalty per year, and Warner had the duty to provide iHeart with access to Warner's sound recordings if those fixed per-play payments were made. Accordingly, the Judges look to the average rate agreed to by the parties in the iHeart/Warner Agreement for 2016, which coincides with the first year of the statutory 2016-2020 period. That agreed-upon rate is $0.[redacted] per play.

[184] The stated per-play rate is the equivalent of the "average" rate because it is the same rate paid for each performance. That is, to use iHeart's parlance, there is only one "bundle" of rights, with each performance priced at the same rate. The issue of how to adjust, if at all, that "average" rate into the average "effective" rate is discussed *infra*.

However, that average, stated per-play rate is not necessarily applicable, standing alone, as a benchmark, if it is subject to necessary adjustments – upward or downward – to account for other forms of consideration or to more accurately account for probative evidence related to the rights available under the statutory license. The Judges turn to these issues in the next section of this determination.

iii. Potential Adjustments to the Rate Derived from the iHeart/Warner Agreement

(A) General Considerations

A potential benchmark can include terms that provide a *licensor* with additional compensation, whether in cash or in kind, beyond the simple receipt of money in exchange for the right to play sound recordings. In similar fashion, a potential benchmark can also provide a *licensee* with additional compensation, beyond the basic right to play sound recordings in exchange for the payment of money. When the parties' proposed benchmark agreement has bundled such other items with the simple payment-for-plays obligation that mirrors the rate provisions of section 114, the issue arises as to whether and how, if at all, to value these non-statutory items.

As an initial matter, the Judges note that the parties have a strong self-interest to establish values for non-statutory items that would support their positions. Thus, the Judges would anticipate that the record companies and SoundExchange would present specific evidence of the monetary value for the non-statutory consideration they received under the contract that must be added to the stated ("headline") rate on a per-play basis. More particularly, the Judges would expect that the record companies' *internal valuations and spreadsheets* would set forth their understanding of these *monetary* values (not merely the existence of some unquantified value). Similarly, the Judges would anticipate receiving *expert testimony* from SoundExchange's economic witnesses, ascribing a *monetary* value to such additional contractual consideration allegedly benefiting the record companies, especially if there were no contemporaneous internal valuations made by the record companies themselves.

Reciprocally, the Judges would also expect to receive evidence from the webcasters/ licensees with regard to *their contemporaneous calculation* of the *monetary* value of contractual consideration they allege to have received in addition to the basic right to play sound recordings. Also, and especially if such evidence did not exist, the Judges would expect to receive evidence from the economic experts testifying on behalf of the webcasters/licensees regarding the *monetary* value of such additional forms of consideration supposedly benefiting the webcasters/licensees.

The Judges' expectation that such evidence would be proffered is heightened by the accurate accusations hurled by each side that the other side was manipulating the terms of the potential benchmark in order to influence the Judges in this proceeding. *See, e.g.*, 4/30/15 Tr. 1141- 1142 (A. Harrison) ([redacted]); 4/28/15 Tr. 508-09 (Kooker) [redacted]; 6/1/15 Tr. 6962 (Lexton) (acknowledging that any deal Merlin concludes will be available as evidence in CRB hearings); SX Ex.102 at 3 (5/14/14 e-mail among Merlin executives); PAN Ex. 5117 (same); 5/19/15 Tr. 4760 (Shapiro) ("My working assumption is that *everybody* is aware of this proceeding and how … deals they cut might affect it.") (emphasis added); IHM Ex. 3517 [redacted].). It would be surprising, to say the least, if parties who anticipated that a direct deal would be used by an adversary improperly in this proceeding did not develop evidence sufficient to rebut that attack, unless no such evidence—factual or expert—could reasonably be presented. Thus, when a party fails to provide such important, competent and probative factual or expert evidence, the Judges are left with no evidentiary basis to support the assertion that the alleged additional value of other contractual items is sufficient to alter the rates and terms of the benchmark agreements in which they are contained.

With those general considerations in mind, the Judges now analyze particular issues disputed by the parties regarding the valuation of certain items in the iHeart/Warner Agreement.

(B) AIP

AIP – iHeart's Artist Integration Program – allows Warner's artists to benefit from particular advertising on iHeart's music-formatted radio stations and iHeart's websites, in the form of [redacted] SX Ex 33 at 19 § 5(a)(i). Clearly, such advertising inures to Warner's benefit.

Additionally, the iHeart/Warner Agreement contains an express provision stating that this "[redacted] AIP Commitment" has an annual "*fair market value* of [redacted] *Dollars (USD $*[redacted]*).*" *Id.* at § 5(a)(ii) (emphasis added). SoundExchange argues that there is no reason to require evidence of an internal valuation when the parties have agreed to a "fair market value" on the face of their contract.

iHeart makes several arguments in an attempt to disavow this agreed-upon valuation:

- AIP provides value to iHeart and to Warner because AIP content is valuable to listeners and therefore also "helps build [iHeart's] brand … as [a] trusted curator[] …." 5/21/15 Tr. 5189-92 (Poleman).
- Warner received [redacted] AIP [redacted] and the $[redacted] reference was intended to reflect [redacted]. 6/2/15 Tr. 7312 (Cutler).
- iHeart's commitment to [redacted] AIP therefore was in the nature of "insurance," rather than a granting of an additional right. *See* IHM RPFF at ¶ 815 (and citations to the record therein).
- Neither iHeart, Warner, nor Universal treated AIP as a "[redacted]," and iHeart [redacted]. *Id.* at ¶ 817 (and citations to the record therein).
- The $[redacted] figure was derived from iHeart's advertising "rate card" as a means to measure that Warner got [redacted]. 5/21/15 Tr. 5190 (Poleman).
- In its own projections, Warner declined to value AIP because AIP [redacted] 6/3/15 Tr. 7500 (Wilcox).

The Judges find that the AIP provision in the iHeart/Warner Agreement does not support an increase in the effective average per-play rate derived from that benchmark. As an initial matter, the AIP language in the iHeart/Warner Agreement does not state that the parties agreed that, *inter se*, the value of the AIP terms is $[redacted]. Rather, the iHeart/Warner Agreement sets forth a representation of a purported general economic fact regarding a "market" – a statement that that there [redacted]. However, that assertion of supposed "fact" is belied by the record. It is undisputed that iHeart provided AIP [redacted] to Warner (and to Sony and Universal) *prior* to the formation of the iHeart/Warner Agreement, and that iHeart continued to provide AIP [redacted] to Sony and Universal *after* the execution of the iHeart/Warner Agreement. 5/21/15 Tr. 5343-44, 5348 (Fischel); 6/2/15 Tr. 7312, 7335 (Cutler). It is also undisputed – and clear from the iHeart/Warner Agreement – [redacted], further negating the existence of any market value. SX Ex. 33 at 34, ¶ 18(g).

As Mr. Poleman, an iHeart witness, testified: "these monetary figures serve no other purpose than [redacted]. These monetary figures do not reflect [redacted] Poleman WRT at ¶ 22.

The Judges find these undisputed facts to demonstrate that there was no actual "market" in which Warner procured AIP from iHeart. If such a market existed – with a fair market value of $[redacted] for the AIP provided to Warner – it would have been irrational for iHeart simply to give away such substantial value (*e.g.*, the equivalent of [redacted]% of Dr. Rubinfeld's proposed rate for 2016 and of the NAB/SoundExchange settlement rate for 2015). *See* 5/28/15 Tr. 6284 (Rubinfeld) (AIP at a value of $[redacted] per year would raise the effective rate by $0.[redacted] per play).

Rather, the Judges find guidance for the meaning and of this "$[redacted]" figure – as it relates to the setting of rates in this proceeding – in the context of the contractual clause in which it is contained, which states: "[iHeart] shall provide Warner AIP insertions in each Agreement year … that (i) have a fair market value of at least … $[redacted] per Agreement Year; and represent at least … [redacted]% of all AIP inventory in each daypart and market." SX Ex. 33, at 19 ¶ 5(a)(ii). This provision is consonant with iHeart's explanation that the $[redacted] figure was used to establish [redacted], and therefore is not a monetary value that the Judges may simply pro-rate (and thereby grossly inflate) the benchmark rate.[185]

[185] The Judges find that the contractual remedial provisions relating to AIP support their findings in this regard.. Performance of the AIP terms required iHeart and Warner to [redacted]. *Id.* at ¶ 5(a)(i). In turn, the iHeart/Warner Agreement provides that, if Warner and iHeart disagree regarding [redacted], then([redacted]) Warner ma [redacted] *Id.* Thus, as a remedy for breach, [redacted] This remedial provision further indicates that Warner had obtained in the iHeart/Warner Agreement [redacted]

The Judges also find that iHeart's willingness to provide AIP [redacted] to record companies was rational. As Mr. Poleman testified, *see supra*, AIP campaigns provided information about sound recording artists that served to build iHeart's brand as a trusted "curator" of music for its listeners. Thus, AIP had value to both the record companies and iHeart, which would explain why a sophisticated entity such as iHeart would [redacted] AIP time [redacted] to record companies. Relatedly, the Judges note internal iHeart communications indicating that iHeart [redacted].

The Judges further find that the testimony by Warner's executive, Mr. Wilcox, confirms that the "$[redacted]" figure was used as [redacted] rather than a statement of value that the Judges could simply add to the effective rate under the iHeart/Warner Agreement. The following testimony on direct examination is telling:

> Q: Did iHeart represent to you [AIP] had value, monetary value?
>
> A: Yes.
>
> Q: What was that amount?
>
> A: Well, ultimately it was agreed on that we would *say* that it was [redacted]. They were contending it was worth more and that was a conservative estimate. *Ultimately, they gave us the $*[redacted] *CPM number as a way to value the different impressions that were available to us through AIP. So that was ultimately where we agreed to settle in terms of valuing it*.[186]

6/3/15 Tr. 7388-89 (Wilcox). This testimony reveals two points: First, the valuation was negotiated to establish a quantity term for AIP. Second, this testimony does not indicate any reference in the negotiations to a "fair market value" for AIP that the parties later simply plugged into the iHeart/Warner Agreement. *See also* 6/2/15 Tr. 7318 (Cutler) ("This is a sort of a quick-and-dirty formula where we took a hugely averaged rate and applied it to what we – you know, ultimately these promotional spots in these AIP programs.").

The Judges also find credible and important the undisputed fact that no party, and no record company, considered that AIP could be valued as a cash equivalent. That is consistent with the finding that the AIP term in the iHeart/Warner Agreement was intended as an [redacted], rather than a valuing mechanism for dramatically inflating the effective per-play rate in that agreement.

The Judges decision on this issue is also informed by the negotiating position taken by Warner. In particular, under cross-examination, Mr. Wilcox, the testifying Warner executive,

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which, upon an iHeart breach, [redacted]. Additionally, [redacted]. *See id.* ("[redacted]").

[186] "CPM" is cost per thousand advertising impressions. 4/28/15 Tr. 419 (Kooker). Thus, the $[redacted] per 1,000 impressions factor can be used to determine the quantity of impressions if $[redacted] is substituted for the $[redacted] figure. Impressions are viewed or heard ads. 6/3/15 Tr. 7403-04 (Wilcox).

when asked if "you told the iHeart representatives during negotiations that you thought AIP *was worth zero*," testified: "I don't have a specific recollection right now, but … *that would have been consistent with the negotiating posture that I might have taken*." 6/3/15 Tr. 7466 (Wilcox) (emphasis added). This testimony undermines Warner's assertion that the Judges should simply add $0.[redacted] to the per-play rate derived from this benchmark, when Warner's own witness had claimed in negotiations that AIP had no value. Moreover, even if Mr. Wilcox's assertion represented only his "negotiating posture," then the Judges find that iHeart's representation of a positive value, including the $[redacted] figure plugged into the agreement, was also the consequence of negotiation rather a declaration of fact as to the existence of a "fair market value" of $[redacted].[187] Finally, the Judges do not find credible Mr. Wilcox's testimony that he was informed by iHeart that it would [redacted] AIP, in light of the absence of any document sufficient to corroborate that assertion, and in light of the fact that iHeart has not [redacted] AIP. Moreover, even if iHeart had taken such a negotiating position, the Judges do not find, after listening to Mr. Wilcox's testimony, that he genuinely believed such a change in AIP policy was forthcoming.

The Judges do recognize that, by converting AIP from a discretionary, voluntary program to a contractually binding commitment, iHeart provided Warner with what Drs. Fischel and Rubinfeld both considered to be "insurance" value. However, neither party through a fact or expert witness presented any basis to create a monetary value for this "insurance." Therefore, the Judges are presented in this context with the conundrum of an item of ostensible (insurance) value that has not been valued by the parties, but is tendered to the Judges without evidentiary guidance. The Judges return to the point made in the General Considerations section. SoundExchange, through Dr. Rubinfeld, acknowledges that there is some insurance value in the conversion of AIP into a contractual commitment, yet SoundExchange did not present a method for valuation. iHeart, through Dr. Fischel, avers that this "insurance" value would be quite small, and he too did not provide a monetary value. If a party had the understanding that an element within a benchmark could be valued in a manner that would further support its position, the Judges would expect that party to present evidence in that regard. Here, SoundExchange declined to do with regard to the "insurance" value of the conversion of AIP into a contractual commitment. The Judges therefore find that such unquantified "insurance" value cannot be added to the effective per-play rate under the iHeart/Warner Agreement.[188]

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[187] The irony surrounding this issue is not lost on the Judges. In this proceeding, Warner claims AIP has significant value, in order to inflate the benchmark, but claimed during negotiations that AIP had no value, in order to [redacted]. 6/3/15 Tr. 7466 (Wilcox). Likewise, during negotiations, iHeart touted the benefits of AIP, but minimizes its significance during this proceeding, in an attempt to avoid an increase in the effective benchmark rate. Such switching of positions, combined with the other issues discussed in this section regarding AIP, underscore the indeterminacy of AIP's impact, if any, on this benchmark.

[188] Also, the unquantified value of any "insurance" aspect of the contractual AIP commitment would have had to be offset against the value of other non-pecuniary items in the iHeart/Warner Agreement that favor iHeart, as discussed *infra*.

(C) [redacted]

[redacted], the [redacted], is a program by which Warner may [redacted]. *See* SX Ex. 33, Ex. F thereto. SoundExchange asserts that it has a quantifiable value to Warner that must be pro-rated across the number of performances and added to the per-play rate. However, the record indicates that Warner did not engage in any valuation of [redacted] contemporaneous with the negotiation of the iHeart/Warner Agreement and that Dr. Rubinfeld did not perform any such expert economic valuation. 5/28/15 Tr. 6437 (Rubinfeld).

Rather, SoundExchange's entire argument in support of a valuation, in excess of $[redacted], for [redacted] is based upon the hearing testimony of Mr. Wilcox. He derived this value from a single [redacted] campaign undertaken by Warner after the iHeart/Warner Agreement had been executed. Wilcox WRT at 14, n.9. However, as iHeart points out, Warner's post-execution performance – or, more accurately non-performance – contradicts this attempt at a performance-based valuation. That is, Mr. Wilcox did not dispute that Warner had [redacted]. 6/3/15 Tr. 7452 (Wilcox). Thus, the Judges find that, even to the extent that post-contract performance might be helpful in determining value, Mr. Wilcox's testimony as to a value in excess of $[redacted] for [redacted] is simply not credible.

In this context as well, neither parties' negotiators nor its economic experts set forth a monetary value. The rebuttal performance-based testimony that SoundExchange relies upon from Mr. Wilcox to demonstrate that [redacted] had value is simply insufficient when considered against Warner's failure to [redacted], and in light of the fact that the Judges did not find Mr. Wilcox to be a particularly credible witness. Accordingly, the Judges do not find that the inclusion of [redacted] rights in the iHeart/Warner Agreement supports an increase in the effective average per-play rate derived from that agreement.

(D) The [redacted] Agreement

The Judges decline to include in the average effective rate any value derived from the $[redacted] payment by iHeart to Warner for rights under the [redacted] Agreement. As an initial matter, this agreement is not even part of the iHeart/Warner Agreement. Second, the [redacted] Agreement contains an integration clause which, as iHeart correctly notes, by its plain language declares that it is the entire agreement between the parties and thus excludes reference to any other agreement, such as the iHeart/Warner Agreement. SX Ex. 1339. The Judges further note that the iHeart/Warner Agreement [redacted] SX Ex. 33 ¶ 18(c). Third, the [redacted] Agreement provides for a payment of $[redacted] in exchange for a specific set of rights unrelated to iHeart's right to play Warner sound recordings on iHeart's noninteractive service. Fourth, it is irrelevant that Warner was aware of, and made reference to, the [redacted] Agreement value when it considered the value of its forthcoming relationship with iHeart. Indeed, as iHeart points out, Warner's internal models and other documents identified the [redacted] Agreement's $[redacted] payment obligation as a distinct payment for [redacted]. *See* iHeart RPFF ¶ 828 (and citations to the record therein).

The Judges also agree with iHeart's argument that the $[redacted] payment obligation in the [redacted] Agreement presents the Judges with an issue of *allocation* rather than valuation. *See* iHeart RPFF ¶ 830. The fact that the [redacted] Agreement contains an unambiguous integration clause underscores the fact that the rights and payments under that contract must be allocated only to that contract. The Judges therefore find that the $[redacted] payment to Warner by iHeart under the [redacted] Agreement is properly *allocated* to that agreement for the provision of [redacted], and cannot be attributed to the *valuation* of the parties' rights – and rates – under the iHeart/Warner Agreement.

(E) Other Unvalued Contract Items

As noted *supra*, SoundExchange asserts that the effective average rate under the iHeart/Warner Agreement must be increased to reflect the value of additional contract items, including:

- The guarantee that iHeart would [redacted] even if such steering fell short of that level.[189]
- The alternative percentage-of-revenue rate in the greater-of formulation
- The additional $[redacted] payment guarantee by iHeart even if it never played any Warner sound recordings
- The guarantee that Warner would receive at least the same [redacted] as it did prior to the iHeart/Warner Agreement.
- Warner's [redacted], which iHeart could [redacted].
- Royalties paid for [redacted].

See SX RPFF ¶ 889 (and citations to the record therein).

With regard to all of these items, notwithstanding any potential monetary value that might be associated with them, neither Warner nor SoundExchange established values for these items. Indeed, SoundExchange acknowledges that, when the Judges asked Mr. Wilcox whether Warner had assigned a number value to "these provisions," he admitted that Warner "could not be certain." 6/3/15 Tr. 7409 (Wilcox). As the Judges noted in the General Considerations section of this analysis of the iHeart proposal, if the party that seeks to increase (or decrease) an otherwise effective benchmark rate to account for other items of potential value cannot or has not

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[189] The parties disputed whether the pre-agreement pro rata level was [redacted]% or [redacted]%. That dispute related to a measurement of the "two bundles" hypothesized by Drs. Fischel and Lichtman, but rejected by the Judges in this determination. Under an average rate approach with a steering-based [redacted]% pro rate share, it is irrelevant whether the pre-contract *pro rata* Warner share on iHeart was [redacted]% or [redacted]%.

provided evidence of such value, when it was in its self-interest to do so, the Judges cannot arbitrarily adjust or ignore that otherwise proper and reasonable benchmark.

(F) Offsetting Value to iHeart in the iHeart/Warner Agreement

iHeart points out that the iHeart/Warner Agreement also provides value to iHeart in the form of: (1) a [redacted] royalty ceiling that serves as *de facto* insurance against a [redacted] and (2) most-favored-nation status at least equalizing iHeart's terms with Warner's terms in any agreement with [redacted] Fischel/Lichtman AWDT ¶ 38. However, the chronic problem the Judges have referenced *supra* applies here as well – iHeart did not attempt to place a value on such items. *Id.* at ¶ 39 ("It is difficult to precisely quantify the value of these various non-pecuniary terms [and] iHeart "made no explicit attempt to value these terms.").

However, Drs. Fischel and Lichtman point out that because both parties failed to value such terms, it is acceptable to "assume[] a net value of zero for these terms." *Id.; see* 5/28/15 Tr. 6435-37 (Rubinfeld) (acknowledging that he failed to attribute numerical dollar values to items in the iHeart/Warner Agreement that benefited each party respectively).

The Judges disregard these unvalued items; not because, as Drs. Fischel and Lichtman assert, they should be presumed to have a net value of zero. Rather, as stated in the General Considerations section, the Judges tie the indeterminacy of the net value of these offsetting items to a (perhaps tactical) failure of proof of value by sophisticated parties. As Dr. Rubinfeld acknowledged in a colloquy with the Judges:

> [JUDGES]
>
> [I]f iHeart is paying a … rate based on dollar denominated items and gets some other non-dollar denominated value – net value to iHeart as if it was paying some lower rate because it got new items of value – … we just can't value them because *nobody* did and we don't have the evidence to do so.
>
> [DR. RUBINFELD]
>
> Yeah, that's possible.

5/28/15 Tr. 6439. Continuing further, the Judges reiterated that for these other items of value, "the sign is moving plus and minus" but "without dollar values attached by the experts or the parties in their contracts or their negotiations," and lamented that they "have no way of valuing them …." Dr. Rubinfeld responded by commiserating, acknowledging that he too did not, and instead he simply fell back to a non-sequitur – noting unhelpfully that his proposed rate was closer to the "actual NAB rates … than [Dr.] Fischel's proposed incremental rate." *Id.* at 6439.

(G) Adjusting the iHeart/Warner Benchmark Rate to Account for [redacted] and Thereby Equalizing the Number of Royalty-Bearing Plays between the Benchmark and the Statute.

Drs. Fischel and Lichtman note that an iHeart listener is entitled to [redacted][190] per hour per station or channel, for which iHeart is not required to pay royalties.. Fischel/Lichtman AWDT ¶ 35; SX Ex 33 at 15 ¶ 3(b)(i); *id.* at 38 Ex A therein. They note, after setting forth the number of [redacted] and performances that, "[i]in July 2014, [redacted] … constituted approximately [redacted] percent of all iHeart custom performances, so that the functional per-performance rate paid on these contracts is approximately [redacted]% lower than the statutory per-performance pureplay rate." Fischel/Lichtman AWDT ¶ 61 & n.9. This [redacted] adjustment is very close to Dr. Rubinfeld's skips adjustment factor of [redacted], which also included an offset for increased plays by virtue of the royalty value of [redacted] under his interactive benchmark agreements).

If Drs. Fischel and Lichtman had applied that [redacted]% reduction to the otherwise stated average rate of $0.[redacted] for 2013 in the iHeart/Warner Agreement, they would have equalized that rate to a statutory rate of $.0[redacted]. However, Drs. Fischel and Lichtman adjust their 2013 stated average rate from $0.[redacted] to $0.[redacted]. SoundExchange avers that it appears from iHeart's own documents however that this $0.[redacted] rate reflects an incorporation of the Pureplay rate rather than a calculation to adjust for [redacted] *See* SX Ex. 221 at 1, 4 & n.21.

In response to this criticism, iHeart does not refer the Judges to any evidence of calculations it did to support a s[redacted] reduction from $0.[redacted] to $0.[redacted]. Rather, iHeart simply declares SoundExchange's reliance on SX Ex. 221, iHeart's own document, is insufficient to call into question the [redacted] adjustment proposed by iHeart. *See* iHeart RPFF at 119-20.

The Judges find that SoundExchange's criticism is appropriate. In order to reflect not only the [redacted] adjustment, but also to make an adjustment to reflect plays of [redacted], the Judges adopt Dr. Rubinfeld's [redacted] adjustment to equalize the number of plays as between this benchmark and the statutory rate. Thus, the 2013 rate of $0.[redacted], as noted above, would equalize to $0.[redacted].

More importantly, for the first year of the statutory period at issue, 2016, the stated average rate is $0.[redacted]. Applying a [redacted] adjustment of [redacted] results in an equalized rate of $0.[redacted]. (Even applying iHeart's proffered [redacted]% rate reduction for this factor would result in an adjusted rate of $0.[redacted], before any consideration of additional [redacted].) [191]

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[190] [redacted] custom performances are defined in the iHeart/Warner Agreement as performances "that are [redacted]." SX Ex. 33 at p. 15, ¶ 3(b)(i).

[191] SoundExchange also takes issue with iHeart's alleged application of a [redacted] adjustment to [redacted] webcasts [redacted] which SoundExchange avers cannot be adjusted for [redacted] because these stations—[redacted]—do not [redacted]. *See* SX PFF ¶¶ 849-850 (and citations to the record therein). iHeart disputes that assertion. *See* IHM RPFF at p.120 (and citations to the record therein). SoundExchange also combined its [redacted] criticism in this regard with a separate criticism regarding the treatment of "digital only" transmissions by iHeart, leading Dr. Rubinfeld to make a $0.[redacted] upward adjustment to account for

c. The Percentage of Revenue provision in the iHeart/Warner and iHeart/Indies Agreements

The iHeart/Warner Agreement contains a greater-of rate formula that includes a [redacted]% - [redacted]% rate, depending upon the year of the agreement. SX Ex. 33 pp. 15-16, ¶ 3(b)(ii).[192]

For the reasons set forth in the Judges' comprehensive rejection of a greater-of structure with a percentage-of-revenue prong, the Judges do not include these iHeart greater-of provisions in the benchmarks they derive from the iHeart/Warner Agreement and the iHeart/Indies Agreements.

d. The Judges Consideration of the 27 iHeart/Indies Agreements

iHeart has calculated an *average* royalty per play for Indies of $0.[redacted]. Fischel/Lichtman AWDT Ex. D therein.[193] However, the iHeart/Indies Agreements apply the per-play rates that have a set (*i.e.*, average) per-play rate that controls for each year.[194] Those per-play rates are all equal to the [redacted] rates and therefore are less than $0.[redacted]. *See, e.g.*, IHM Ex. 3353 ¶ 1(w) (the iHeart/Next Plateau Entertainment Agreement). Thus, iHeart apparently has derived that $0.[redacted] rate by adding to the stated custom rates its per-play calculation of additions to the rate arising from the [redacted] revenue to which Indies are entitled under the iHeart/Warner Indies Agreements.

As the Judges noted with regard to the [redacted] revenues in their analysis of the proposed rates for simulcasting, these revenues are simply too indeterminate to support a rate analysis by the Judges. The Judges incorporate those findings here, and find that the 27 iHeart/Indies Agreements are not usable as benchmarks, guideposts or other evidence to support the rates set in this proceeding.[195]

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both of these issues. *See* SXPFF ¶ 851 (and citations to the record therein). SoundExchange did not clearly and sufficiently explain its position on these combined issues, and the Judges therefore decline to make the $0.0001 upward adjustment advocated by Dr. Rubinfeld.

[192] The iHeart/Indies Agreements contain a greater-of structure that, as noted above, fixes the percentage-of-revenue prong at [redacted]%. *See, e.g.*, IHM Ex. 3353 at pp. 7-8, ¶ 4(a)(iii)(A). However, as stated in the text, *supra*, the Judges find these agreements not to be probative.

[193] Drs. Fischel and Lichtman also calculated an "*incremental*" per-play rate for Indies of $0.[redacted]. *Id.* The Judges reject that rate for the same reason they rejected the $0.0005 "*incremental*" rate they proffered under the iHeart/Warner Agreement.

[194] The greater-of percentage of revenue alternative was never triggered. Fischel/Lichtman AWDT ¶ 61.

[195] To be clear, the Pandora/Merlin *effective* rate is $0.[redacted] – below the Pureplay rate because of the steering provisions in that agreement. *See supra*. Pandora had been subject to the Pureplay rates and utilized steering to induce the Merlin members to agree to a lower rate in exchange for more plays. The same concept (albeit with different rates) underlies the 27 iHeart/Indies Agreements. These 27 Indies agreed to reduce the rate to $0.[redacted] in [redacted] from the $0.[redacted] settlement rate on which they could have insisted, in exchange for a lower rate that incentivizes iHeart to steer more plays to them plus some indeterminate amount of [redacted] revenues.

F. Sirius XM Rate Proposal

1. Proposed Royalties

Sirius XM proposes a per-performance royalty rate of $0.0016 for each year of the rate term for all commercial webcasts. *Id*. at 1.

Sirius XM proposes that the section 114 digital sound recording public performance license applicable to commercial webcasters for the 2016 – 2020 rate period be $0.0016 per-performance. In support of this rate, Sirius XM avers that a zone of reasonableness can be established for the statutory rate. The high end of the zone, according to Sirius XM, is the $0.0016 per-performance rate, which represents the lowest rate contained in the 2009 WSA settlement agreement between SoundExchange and Sirius XM. The low end of the zone, according to Sirius XM, is represented by several "guideposts," *i.e.*, the low end of the estimated range of proposed rates proffered by the economic experts who testified on behalf of the other Services who participated in this proceeding. That lower bound, according to Sirius XM, is $0.0011. *See* Sirius XM PFF ¶¶ 65-68.[196]

Sirius XM did not produce an expert witness to testify in support of its rate proposal. Rather, as noted above, Sirius XM relies upon the lowest rate within its WSA with SoundExchange and the work of the other Services' economic witnesses to support its range, endpoints and proposed rate. Thus, the probative value of the Sirius XM rate is dependent in large measure upon the Judges' analysis and conclusions regarding the models proffered by these other experts. Indeed, Sirius XM does not attempt to independently support the work of those other experts. Instead, Sirius XM devotes the bulk of its *independent* argument to an analysis of its WSA settlement agreement.[197]

2. Sirius XM's Arguments in Favor of its Rate Proposal

Sirius XM's primary business is broadcasting on a subscription fee basis over its two proprietary satellite systems. However, it also provides a simulcast of its satellite broadcast over the Internet. SXM Ex. 6000 ¶ 20 (Frear WDT). Thus, Sirius XM's Internet radio service is primarily a *simulcast* of Sirius XM's satellite service. *Id.* ¶ 27 (emphasis added).

Sirius XM also offers as an Internet service a noninteractive feature, "My Sirius XM," at no extra charge to its Internet radio subscribers. *Id.* at ¶ 28. (Sirius XM also offers an on-demand service, "Sirius XM On Demand," that is not subject to the section 114(f)(2)(B) rates). The noninteractive, non-simulcast service, My Sirius XM, allows subscribers to slightly personalize a select group of music and comedy channels from the satellite service, to adjust for characteristics like library depth, familiarity, and music style. *Id.* at ¶ 28.

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[196] Although Sirius XM asks the Judges to rely on the low end of these "guideposts," it notes that the high end of these "guidepost" ranges from the other Service economic experts is *$0.0017*, higher than the top of its proposed range and its proffered benchmark of $0.0016.

[197] For this reason, the Judges need not discuss the merits Sirius XM's proposed range or, in particular, the low end of that range. The relative merits of the benchmarks on which Sirius XM relies are discussed in the sections of this determination dealing directly with those other benchmarks.

Although introduced as a response to truly customized Internet radio like Pandora, My Sirius XM does not provide the same amount of customization. My Sirius XM begins from the same playlist created by human curators for a satellite radio channel, and narrows that playlist slightly by manipulating a few sliders, which emphasize or deemphasize broad characteristics common to the relevant genre. 5/22/15 Tr. 5419-21 (Frear). For example, listening to the '60s channel through My Sirius XM might allow the subscriber to emphasize more late '60s music, more early '60s music, more electric music, or more acoustic music. *Id*. at 5419:19-25. My Sirius XM allows users to shrink the playlist by adjusting for these characteristics—but does not permit users to expand the playlist from that of the satellite radio channel. *Id.*

The Sirius XM Internet radio service is a minor part of Sirius XM's overall business, with its self-pay subscription revenue (*i.e.*, excluding trial subscriptions) accounting for only [redacted]% of Sirius XM's total revenue. Frear WDT at ¶ 29. Usage of the non-simulcast My Sirius XM is low even in comparison to the usage of Internet radio simulcast channels. *Id.* at ¶ 28.

Sirius XM points out the relatively low importance of noninteractive services to its overall business model in order to explain why it entered into the WSA with SoundExchange in 2009 – and why that settlement agreement was and remains not probative of market value and lacked the persuasive value attributed to it in the *Web III Remand*. In this regard, Sirius XM avers:

- As a result of the *Webcasting II* rates, Sirius XM made the decision to drop all free streaming on both the Sirius and XM platforms, a decision that resulted in a [redacted]-[redacted]% drop in the Internet radio service's reported listening hours and a resulting decrease in royalty payments to SoundExchange. *Id.* at ¶35; 5/22/15 Tr. 5416-17 (Frear).
- By late 2008, Sirius XM had insufficient cash to repay hundreds of millions of dollars of debt scheduled to come due in February 2009, and was unable to access the capital markets to refinance this, and other, debt. Frear WDT at ¶40.
- The pre-merger predecessors to Sirius XM, Sirius and XM, had recently spent over $150 million on merger costs alone. *Id*. at ¶46.
- Sirius XM narrowly avoided filing for bankruptcy protection when a potential lender agreed to provide a loan that narrowly enabled Sirius XM to avert a default on its debt and bankruptcy. *Id.;* 5/22/15 Tr. 5430 (Frear).
- The Sirius XM stock price reflected its fell from over $4.00 per share in January 2007 to a low of $0.05 per share on February 11, 2009, causing NASDAQ to issue a delisting notice to Sirius XM. *Id.* at ¶ 45. On September 15, 2009, Sirius XM received a delisting notice from NASDAQ. Frear WDT at ¶45.

In the context of the severe financial stress affecting Sirius XM's entire business, and the Internet radio services' extremely low usage and importance to its core business, Sirius XM believed it had no sensible option other than to accept the deal offered by SoundExchange. If it had not taken the deal, Sirius XM would have been required to continuing paying the higher *Webcasting II* rates. At the same time, NAB simulcasters with which Sirius XM's Internet radio service competes would be paying the lower WSA settlement rates, and Pandora would be paying a small fraction of the *Webcasting II* rates, putting Sirius XM at a significant competitive disadvantage.

Although Sirius XM could have refused to sign the WSA with SoundExchange and instead sought lower rates in the then-forthcoming *Web III* proceeding, the low listenership to the Internet radio service meant that the cost of participation in that proceeding could far exceed any possible future savings in royalty payments. Although Sirius XM attempted repeatedly to negotiate a more significant reduction, SoundExchange consistently refused to materially move off its opening offer of essentially matching the NAB rates. 5/22/15 Tr. 5435-36 (Frear). With no other option that would have a less costly net result, Sirius XM entered in to the WSA settlement agreement with SoundExchange. *Id*. at 5434-35.

Then, according to Sirius XM, two days before the deadline on which Sirius XM and SoundExchange were required to close negotiations—and after the parties had already agreed on the rate schedule and finalized their deal—Michael Huppe (the party negotiating on behalf of SoundExchange) added an extra term into the Agreement, requiring that it be precedential under the WSA. 6/3/15 Tr. 7627-29 (Huppe); 5/22/15 Tr. 5443-54 (Frear). Having already failed to advance its other interests in negotiations, Sirius XM agreed to this new term requiring its WSA settlement agreement to be precedential, concluding negotiations and consummating the agreement before the statutory deadline. *Id.* at 5444.

For the foregoing reasons, Sirius XM maintains that the rates in the Sirius XM WSA settlement agreement do not reflect any industry-wide fair market value for the license. Instead, it claims that the rates are a product of: (1) the *Web II* rates, which, in Sirius XM's view, Congress found to be so wildly supracompetitive as to warrant Congressional intervention and which would continue to apply in the absence of a settlement; (2) SoundExchange's monopoly power as the only entity that could provide any effective relief from those rates; and (3) the exacerbation of that imbalance in bargaining power caused by various unrelated circumstances affecting Sirius XM at the time of the negotiations. Sirius XM Ex. 6000 ¶ 52. Sirius XM further avers that, by contrast, neither SoundExchange nor its constituent record companies had similar countervailing pressures that could have mitigated this extreme imbalance. *Id.* at ¶ 57 (and citations to the record therein).

Nonetheless, Sirius XM proposes that the Judges rely on the WSA settlement agreement between Sirius XM and SoundExchange, by adopting its lowest rate, $0.0016, not only as the "the outer boundary of a range of reasonable rates," but also as the rate to be set in the present proceeding. *See* Sirius XM PFF ¶ 64. Additionally, Sirius XM does not propose any rate escalation or reduction over the 2016-2020 period, whether to reflect inflation, deflation, or any other factor. Finally, Sirius XM does not propose a two-prong rate structure embodying any other rate formula than the per-play structure.

3. SoundExchange's Opposition to the Sirius XM Rate Proposal

SoundExchange opposes the Sirius XM rate proposal on several grounds. First, SoundExchange rejects Sirius XM's suggestion that its settlement contained above-market rates, because Sirius XM voluntarily agreed to those rates, even though it was under no compulsion to negotiate with SoundExchange. *See* SXRPFF ¶ 1022. Second, SoundExchange states that Sirius XM is flatly wrong to suggest that its negotiation with SoundExchange did not "mov[e] the needle with respect to royalty rates." In fact, Sirius XM was not only able to negotiate rate lower than the then-prevailing statutory rates for 2009, 2010, and 2011, but it was also able to negotiate lower rates for 2013, 2014, and 2015 than were contained in the NAB settlement. SX PFF ¶ 1079; SX RPFF ¶ 1027.

Third, when SoundExchange, through Mr. Huppe, informed Sirius XM that SoundExchange wanted the settlement agreement to be precedential under the WSA, Sirius XM voiced no objection whatsoever in its email response less than an hour later. NAB Ex. 4235.

Fourth, SoundExchange argues that basic economics suggests that any financial distress Sirius XM was experiencing at the time should have reduced, not increased, its willingness to pay royalties for webcasting. SX Ex. 29 ¶ 228 (Rubinfeld Corr. WRT).

Fifth, Sirius XM had a number of alternative options in addition to agreeing to the settlement with SoundExchange. Specifically, SoundExchange notes that Sirius XM instead had the option to:

- litigate in the *Web III* proceeding and seek lower rates from the Judges;
- avoid the cost of litigating *Web III* and simply awaited the Judges' rate determination (a "costless option" according to SoundExchange); or
- avoid the statutory license completely and enter into direct licenses with the various record companies.

SX PFF ¶ 1077 (and citations to the record therein).

Sixth, SoundExchange notes that Sirius XM – despite its asserted financial difficulties – continued and expanded its noninteractive services, even though it asserted that such services were an insignificant portion of Sirius XM's total subscribership revenue. Moreover, SoundExchange notes, Sirius XM's internet revenue grew from $[redacted] in 2010 to $[redacted] in 2014 while Sirius XM was paying rates under its WSA settlement agreement with SoundExchange. SX PFF ¶ 1078 (and citations to the record therein).

Seventh, SoundExchange asserts that Sirius XM's rate proposal has no sound basis. According to SoundExchange, the proposal was simply plucked from the first year of the Sirius XM WSA settlement. *Id.* ¶ 61. Moreover, according to SoundExchange, Sirius XM's reliance on the low-end rate in an agreement that its principal witness, Mr. Frear, now expressly disavows, is arbitrarily selective and internally inconsistent. SX PFF ¶ 1081.

4. The Judges' Analysis of the Sirius XM Rate Proposal

The Judges reject Sirius XM's argument for a number of reasons. First, the Judges decline to re-litigate the probative value of the 2009 WSA settlement agreement between Sirius XM and SoundExchange. That agreement was entered into more than six years ago, and therefore does not represent the present state of the noninteractive market, absent affirmative evidence to the contrary. Whether Sirius XM was compelled by its financial circumstances or not to enter into that settlement might have affected the relevance of that agreement as a benchmark in *Web III*, but it has no significance to the Judges in the present proceeding. Indeed, as SoundExchange notes, it is inconsistent for Sirius XM, on the one hand, to criticize the benchmark value of its 2009 WSA settlement agreement, and then to expressly adopt the lowest rate from that agreement as its proposed rate in the present proceeding.[198]

Second, the Judges are unpersuaded by the fact that Sirius XM apparently can afford the $0.0016 rate it now proposes, in contrast to earlier years when it was financially *in extremis*. As the Judges held in the *Web III Remand*, and have consistently held, section 114(f)(2)(B) does not require the Judges to set a rate that ensures the financial viability of any entity. Thus, the fact that Sirius XM may be able to afford the $0.0016 rate now, but might not be able to afford any higher rate, is simply not pertinent to the Judges' determination. Moreover, the fact that Sirius XM acknowledges that noninteractive streaming is only an "ancillary" part of its business (in contrast to its satellite service) indicates that the impact of the rates on its noninteractive service cannot be a driver of the statutory rate determination. The Judges note that Sirius XM was willing to accept rates in its 2009 WSA settlement at least in part because of the ancillary nature of its noninteractive service. Because that noninteractive service remains ancillary in nature to Sirius XM, the Judges cannot conclude that impact of the rates set in this proceeding have any greater particular importance to Sirius XM now.

G. NAB Rate Proposal

1. Proposed Rates

The NAB proposes a two-tiered rate structure for webcasts by simulcasters. Broadcasters that transmit fewer than 876,000 ATH would pay only the minimum fee. *Id*. at 3. All other broadcasters would pay a per-performance royalty rate of $0.0005 to simulcast for each year of the rate term. *Id*. at 3-4.

NAB's rate proposal is limited to simulcasts (retransmissions by broadcasters of programming transmitted over their AM or FM radio stations), and does not cover other commercial webcasts. NAB Proposed Rates and Terms, at 2 (definition of Eligible Transmission) (October 7, 2014). Having rejected the NAB's proposal to apply a separate rate to simulcasters[199], the Judges consider the NAB's proposed rate as a rate that would apply to all commercial webcasters. For the reasons detailed below, the Judges reject the NAB's rate proposal.

2. Analysis of Economic Evidence

The NAB presented its methodology for arriving at a rate proposal through its economic expert witness, Professor Michael Katz. Professor Katz did not perform a benchmark analysis to arrive at a rate. Rather, he selected guideposts that define the lower and upper bounds of what he described as a range of reasonable rates that a willing buyer and a willing seller would agree to in

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[198] The Judges have also analyzed the impact, if any, of the *other* 2009 WSA settlement agreement – between the NAB and SoundExchange. *See supra*.

[199] *See* discussion *supra*, section I.A.3 [MAKE SURE THIS INTERNAL CITE REMAINS CORRECT]

a workably competitive market. *See* Katz WDT ¶80. The NAB's proposed rate of $0.0005 per-performance presumably falls somewhere within that range.[200]

Professor Katz determined the low end of his "zone of reasonableness" by reference to terrestrial radio. *See* Katz WDT ¶¶ 81-84. Radio broadcasters are not required to pay royalties for terrestrial broadcasts of sound recordings, and typically do not do so. *See* 17 U.S.C. §114(a); Katz WDT ¶ 82. Nevertheless, Professor Katz points out, record companies seek out radio airplay to promote other income streams, such as sales of CDs and permanent downloads. *See* Katz WDT ¶ 82. He argues that economic theory predicts that this promotional effect would drive down royalty rates, possibly even resulting in negative royalty rates if the law permitted record companies to pay broadcasters to play their music (*i.e.*, payola). *Id*. at ¶¶ 81-82.

Professor Katz then argues "available evidence indicates that promotional benefits also arise from web simulcasts of terrestrial broadcasts." *Id*. at ¶ 83. In effect, he equates simulcasting with terrestrial radio and concludes that the lower bound of the range of reasonable rates for simulcasting is "near zero." *Id*. at ¶ 84.

To set an upper bound to his zone of reasonableness, Professor Katz looked to the Judges' decision in *SDARS II*. *Id*. at ¶ 85. According to Professor Katz,

> In SDARS II, the judges found that 13 percent [of gross revenue] constitutes a sensible upper bound on the zone of reasonableness before adjusting to account for Section 801(b) factors. The rate was then reduced by an additional two percent for the third 801(b) factor, which was specific to Sirius XM and the SDARS II proceeding.

Id. (footnotes omitted). He adopted 13 percent of gross revenue as "an initial guidepost" for determining his range of reasonable rates for simulcasters, subject to two adjustments to account for differences between SDARS (satellite radio) and simulcasters. *Id*. at ¶¶ 86-87. The first adjustment (the "music-listening adjustment") accounted for the fact that music accounts for a lower percentage of listening on AM/FM radio than on satellite radio. The second adjustment (the "music-revenue adjustment") accounted for "the fact that non-music-formatted stations generally will not be paying royalties." *Id*. at ¶ 89.

The net effect of the two adjustments essentially offset each other, resulting in an adjustment factor of one. *Id*. at ¶92. Consequently, Professor Katz determined that the upper bound to his zone of reasonableness is 13 percent of gross simulcasting revenues. Nevertheless, he argues "there are strong reasons to conclude that the actual upper bound of the zone of reasonableness is significantly lower than 13 percent."[201] *Id*. at ¶93.

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[200] As discussed below, the upper bound of the NAB's range of reasonable rates is expressed as a percentage of revenue. The NAB's proposed rate is expressed as a per-performance royalty, however, and there is insufficient data in the record to convert the per-performance rate to a percentage of revenue (and vice versa). Since the Judges deem it highly unlikely that the NAB would propose a rate that exceeds the upper bound of its own expert's zone of reasonableness, the Judges presume that the proposed rate falls below that upper bound.

[201] Professor Katz's primary argument that the 13 percent figure is too high is that it was derived in *SDARS I* from analysis of a market that was not effectively competitive. *Id*.

Professor Katz's approach is similar in some respects to the approach that the Judges took (and the Court of Appeals affirmed) in *SDARS II*. In that case, the zone of reasonableness that the Judges determined based on the parties' benchmarks was extremely broad. In order to narrow down the possible rates within that zone, the Judges referred to several "guide posts," including the 13 percent rate that had been the basis for the rate that the Judges set in *SDARS I*.

SDARS II, however, is distinguishable from the present case. In *SDARS II* the Judges had little confidence in the benchmark analyses offered by the parties which, in any event, yielded a range of possible rates that was too broad to provide useful guidance to the Judges. Thus the Judges found it necessary to consider other available evidence as guideposts. In the instant case, the Judges have sufficient confidence in the available benchmark analyses to proceed without reference to other guideposts.

In *SDARS II*, the Judges were not determining a market rate under the willing-buyer, willing-seller standard. The Judges decided *SDARS II* under the section 801(b) reasonable rate standard. As the Court of Appeals emphasized, under that standard "[t]he Copyright Act permits, but does not require, the Judges to use market rates to help determine reasonable rates." *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1010 (D.C. Cir. 2014). That is not the case under section 114(f)(2)(B). The Judges *must* determine market rates, yet the rates used by Professor Katz to determine the upper and lower bounds of his zone of reasonableness are *not* market rates.

There is no market for licensing of sound recordings for transmission by terrestrial radio stations, since there is no general public performance right for sound recordings. That would be sufficient reason to reject Professor Katz's proposed lower bound of "near zero" that he derived from terrestrial radio. Moreover, Professor Katz relies on an assumption that the promotional effect of simulcasting is essentially the same as the promotional effect of terrestrial broadcasting, because they carry the same content. As discussed above, broadcasters' use of technologies to substitute songs in their simulcast streams destroys the underlying premise that the content of a simulcast stream is the same as the terrestrial broadcast. Even if the content is the same, the Judges do not find sufficient persuasive evidence supporting the conclusion that simulcasts have the same promotional effect as terrestrial broadcasts.[202]

As for Professor Katz's use of the *SDARS II* rate to establish an upper bound to his zone of reasonableness, that too is not a market rate. It is a rate established by the government by means of a CRB proceeding. Moreover, it is not even a rate that is intended to replicate market conditions. It is a section 801(b) reasonable rate, albeit one that was informed by marketplace evidence (though from a somewhat different market). In short, neither end of Professor Katz's zone of reasonableness is anchored in the noninteractive streaming market that the Judges are seeking to replicate in this proceeding. The Judges find Professor Katz's zone of reasonableness unhelpful in setting a rate for commercial webcasters, and reject the NAB's proposed rate that it derived from Professor Katz's analysis.

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[202] *See* discussion, *supra* section III.A.3.c.v.

V. Judges' Determination of Noncommercial Webcasting Rates

A. Parties' Proposals

1. SoundExchange

SoundExchange proposes that noncommercial webcasters pay a flat annual fee of $500 per station or channel for all performances up to a cap of 159,140 ATH per month. *Id*. SoundExchange proposes that, in any month that a noncommercial webcaster exceeds 159,140 ATH, the webcaster pay per-performance royalties at the following rates for its transmissions in excess of 159,140 ATH:

SoundExchange Proposed Per-Performance Rates For Performances above 159,140 ATH	
Year	**Per-performance Rate**
2016	$0.0025
2017	$0.0026
2018	$0.0027
2019	$0.0028
2020	$0.0029

Id. These are the same per-performance rates the SoundExchange proposes for commercial webcasters.

2. NRBNMLC

The NRBNMLC proposes what it describes as a "tiered and capped flat fee structure." NRBNMLC PFF ¶80. Under the NRBNMLC proposal, each noncommercial webcaster would pay a $500 annual fee for all performances of sound recordings up to a threshold of 400 average concurrent listeners (3,504,000 ATH) annually, and an additional $200 for each additional 100 average concurrent listeners (876,000 ATH) annually, up to an annual fee cap of $1,500 per station or channel. *See Introductory Memorandum to Written Direct Statement of NRBNMLC*, at 3 (October 7, 2014) (NRBNMLC Introduction); *The NRBNMLC's Proposed Noncommercial Webcaster Rates and Terms*, at 3 (October 7, 2014) (NRBNMLC Proposed Rates and Terms). The NRBNMLC would define ATH to include only transmissions of recorded music. *Id*. at 1.

3. IBS and Harvard Broadcasting/WHRB

Section 351.4 of the Judges' procedural rules sets forth the required contents of a participant's WDS, including the requirement that, in a rate proceeding, "each party must state its requested rate." 37 C.F.R. § 351.4(b)(3) (required contents of WDS). The rule goes on to permit participants to revise their rate proposals at any time up to the filing of proposed findings of fact and conclusions of law. *Id*.

IBS's WDS does not contain a rate proposal, or anything that the Judges could reasonably interpret as a rate proposal. It consists solely of the three-page written testimony of

Frederick Kass. Captain Kass introduces himself and IBS, and briefly discusses the nature of IBS members' webcasting activities:

> [IBS member] stations operate as non-profit entities within the meaning of the statute, as amended. They use digitally recorded music as instructional media for announcers and programmers. The instantaneous listenership to such music on member stations is typically on the order of five listeners, with the exception of course-related music and other on-campus events. In contrast, audiences for live sports broadcast live musical performances, and lectures and other live on-campus originations are typically much larger than the audience for digitally recorded music.
>
> IBS Members provide significant science, technology, engineering, management, media, and communication skill set training. The stations typically act as learning laboratories where students may learn and perfect their skills.

IBS Ex. 9000 at 3 (Kass WDT).

Similarly, WHRB's WDS does not contain a rate proposal, or anything the Judges could reasonably interpret as a rate proposal. WHRB's WDS is comprised of the WDT of Michael Papish, one of the station's board members. In three pages of written testimony, Mr. Papish merely introduces himself and describes WHRB's operations. *See generally* WHRB Ex. 8000 (Papish WDT).

Neither Captain Kass nor Mr. Papish presented a rate proposal in the course of their respective live testimony at the hearing. The only hint of a proposal might be gleaned from a colloquy between the Judges and counsel[203] during closing arguments:

> [THE JUDGES]: So what exactly is IBS proposing here?
>
> MR. MALONE: All right. In our pleadings as early as the agreement between SoundExchange and CPB, NPR became public when you published it in the Federal Register, we have computed to the best of our ability that there is a rate per ATH of 0.0011940. And we think that this is a marketplace agreement entered into voluntarily by one of the big companies in the market, and we think that sets the appropriate rate.
>
> Then when you scale that down to show the number of ATH that these college stations, high school stations, academy stations, and the like are operating, it works out to around $20 a year.

7/21/15 Tr. at 7949 (Kass).

[203] William Malone, Esq., jointly represented IBS and WHRB in this proceeding. In closing arguments Mr. Malone, on behalf of WHRB, briefly discussed a matter related to terms. 7/21/15 Tr. at 7946. The remainder of his closing argument, including the colloquy quoted in the text, was apparently on behalf of IBS alone.

In its proposed findings, IBS directed its efforts to arguing against adoption of the SoundExchange/CBI settlement agreement[204] and, once again, failed to propose a royalty rate.[205] In short, the only arguable reference by IBS to a rate proposal was made by counsel in his closing arguments. The Judges do not credit this statement by counsel as a rate proposal by IBS for three reasons. First, introducing a rate proposal for the first time in closing arguments does not comply with the Judges' rules and is grossly unfair to the other parties. Section 351.4(b)(3) is extremely liberal regarding *revisions* to a party's rate proposal, but it presupposes that the party has made a proposal as part of its WDS, thus giving the other parties an opportunity to analyze it prior to presenting their rebuttal evidence.

Second, "around $20 a year" is not sufficiently definite or specific to constitute a rate proposal. For example, which noncommercial webcasters would pay "around $20 a year"? All of them? Only ones that transmit below a certain ATH threshold? What threshold? IBS does not say.

Third, even if the Judges were to consider this to be a proposal, IBS has offered only statements of counsel to support it. The record is devoid of *any* evidence to support IBS's "proposal" or the analysis from which it was purportedly derived. Nothing will come of nothing. Neither IBS nor WHRB has offered a rate proposal that the Judges can consider in this proceeding.

B. Analysis and Conclusions

1. Upper Threshold for Noncommercial Rate

The Judges have recognized noncommercial webcasting as a separate submarket in prior decisions only "up to a point." *Web II Original Determination*, at 24097. The Judges stressed that there must be limits to the differential treatment for noncommercials to avoid "the chance that small noncommercial stations will cannibalize the webcasting market more generally and thereby adversely affect the value of the digital performance right in sound recordings." *Id*. (internal quotes and citations omitted). The Judges concluded that any separate rate for noncommercial webcasters must "include safeguards to assure that, as the submarket for noncommercial webcasters that can be distinguished from commercial webcasters evolves, it does not simply converge or overlap with the submarket for commercial webcasters and their indistinguishable noncommercial counterparts." *Id*. at 24097-98. To avoid this convergence or overlap, the Judges adopted a cap on the size (as measured by audience size) of noncommercial

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[204] Those efforts were both untimely and not in accordance with the procedures established in the Act, the Judges' rules for submitting comments on a proposed settlement, and the Judges' Federal Register notice. *See* 17 U.S.C. § 801(b)(7)(A); 37 C.F.R. 351.2(b)(2); 79 Fed. Reg. 65609 (November 5, 2014) (SoundExchange/CBI agreement); 80 Fed. Reg. 15958 (March 26, 2015) (SoundExchange/NPR agreement).

[205] IBS goes through a series of computations in its PFF in an effort to show that the proposed settlement rates "in no way meet the comparability test for noncommercial royalty rates." IBS PFF, at 10. In the course of those computations, IBS comes up with a $20/year figure, but it is unclear what that figure represents. *Id*.

webcasting stations or channels that are eligible for the noncommercial rate. *See* 37 C.F.R. § 380.3(a)(2) (applying flat $500 royalty rate up to 159,140 ATH per month).[206]

SoundExchange's proposal to continue to impose of a limit on the size of noncommercial webcasters that are eligible for a separate noncommercial rate is supported by the testimony of Professor Thomas Lys. Professor Lys noted that, as a matter of economic logic, "there is no real difference between a noncommercial and a commercial broadcaster." SX Ex. 28 at ¶ 256 (Lys WRT); 5/29/15/15 Tr. at 6738. The Judges credit this testimony, but do not reach precisely the same ultimate conclusion as Professor Lys. While Professor Lys apparently argues that there should be no distinction between commercial and noncommercial rates, he did not consider (and was apparently unaware of) the revealed preference in the marketplace for a separate noncommercial rate. The Judges resolve the tension between Professor Lys's observation concerning economic logic and the revealed preference in the marketplace by limiting the differential treatment of noncommercial webcasters to smaller players that have a correspondingly smaller impact on the commercial market. The Judges thus agree with SoundExchange that eligibility for a noncommercial rate should be limited to those noncommercial webcasters whose audience size falls below a fixed threshold.

While SoundExchange proposes a threshold above which a noncommercial webcaster ceases to be eligible for a noncommercial rate, the NRBNMLC does not. The NRBNMLC does, however, propose a threshold above which a noncommercial webcaster must pay an additional flat royalty fee (this structure is described *supra*, section I.A.2). Under either proposal a flat fee of $500 pays for all performances of sound recordings up to the threshold.

SoundExchange proposes that the threshold remain the same as the current threshold for noncommercial webcasters: 159,140 ATH per month (218 concurrent listeners, on average, for a webcaster that transmits 24 hours per day). 307 C.F.R. § 380.3(a)(2). That is also the threshold in the SoundExchange/CBI settlement agreement above which a noncommercial educational webcaster (NEW) ceases to be eligible for the settlement rate. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings: Proposed Rule*, 79 Fed. Reg. 65609, 65611 (November 5, 2014) (proposed 37 C.F.R. § 380.22). By contrast, the NRBNMLC proposes a much higher threshold of 400 average concurrent listeners, or 3,504,000 ATH annually (292,000 ATH per month on average).[207]

The NRBNMLC argues that the existing threshold should be increased because it was originally established in 2006 (based on 2004 survey data). NRBNMLC PFF, at ¶ 143. In

[206] Although the Judges and the parties discuss the ATH threshold as a "cap" on eligibility for a reduced noncommercial rate, this is not entirely accurate. A noncommercial webcaster that exceeds the cap in any given month does not pay commercial rates for all of its transmissions in that month, but only those beyond the cap. This results in noncommercial webcasters paying a lower average per-play rate than a commercial webcaster (that pays at the commercial rate for every performance).

[207] This threshold effectively would be higher still as a result of the NRBNMLC's proposal to exclude certain non-music intensive programming from the definition of ATH.

addition, the NRBNMLC argues that an increase is necessary to provide noncommercial webcasters with "breathing room." *See* Emert WDT, at ¶ 40. These arguments are unpersuasive.

While it is correct that the current 159,140 ATH threshold was adopted originally in *Web II* based on survey evidence presented in that proceeding that is not the only source for that number. S*ee Web II*, 72 Fed. Reg. at 24099. SoundExchange and CBI adopted 159,140 ATH as the threshold in their settlement agreement, which is contemporaneous with this proceeding and covers the same rate period. *See* NRBNMLC Ex. 7034, Attachment, at 2-3 (SoundExchange / CBI Joint Motion to Adopt Partial Settlement). By contrast, the NRBNMLC cannot point to any marketplace agreement (contemporaneous or otherwise) that employs the threshold it proposes.

As to the NRBNMLC's argument that noncommercial webcasters need the "breathing room" that an increased threshold would provide, there is no persuasive record evidence to support that proposition. Mr. Emert did testify to this effect. Emert WDT, at ¶39; *see also* 5/21/15/15 Tr. at 5271-71 (Henes). However, that testimony was an expression of opinion, unsupported by any factual evidence. Mr. Emert's and Mr. Henes' testimony that that the dozen or so radio stations they operate stream *far* below the existing threshold tends to contradict their statements concerning the need to increase the threshold to accommodate future audience growth. *See* Emert WDT, at ¶ 29; Ex. 7010; 5/21/15/15 Tr. at 5275-77 (Henes). Their stations could achieve significant audience growth under SoundExchange's proposed rate structure without subjecting themselves to additional royalty costs.

To the contrary, there is ample record evidence to demonstrate that the vast majority of noncommercial webcasters do not exceed the existing threshold. SoundExchange payment data show that between 2010 and 2014, noncommercial webcasters[208] paid usage fees 112 times out of 3917 noncommercial webcaster payments (2.86%). NAB Ex. 4141; NAB Ex. 4149; *see also* SX Ex. 2 at 14 (Bender WDT) ("approximately 97% of noncommercial webcasters paid only [the] minimum fee"). The NRBNMLC seeks to counter this evidence with testimony from Mr. Emert and Mr. Henes that they were "aware of" some noncommercial broadcasters that impose listener caps on their simulcast streams to avoid exceeding the existing threshold. Emert WDT, at ¶ 38; 5/21/15 Tr. at 5271 (Henes). The NRBNMLC's evidence is vague and anecdotal. It was not derived from the witnesses' own experiences, but rather from something they heard elsewhere. Even if the Judges were to deem this testimony credible, the most that it reveals is the existence of some isolated instances of noncommercial webcasters that are constrained by the

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[208] These are webcasters that are coded "NCW-CRB" (noncommercial webcaster paying statutory rates), "NCW-WSA" (noncommercial webcaster paying WSA settlement rates) and "NCEDW" (noncommercial education webcaster paying under the SoundExchange/CBI settlement) in the SoundExchange data. For purposes of this analysis, the Judges have excluded noncommercial microcasters which, by definition, stream far below the threshold and pay no usage fees. *See* Noncommercial Microcasters, available online at http://www.soundexchange.com/service-provider/noncommercial-webcaster/noncommercial-microcaster-wsa/ (visited September 8, 2015). The Judges consider a webcaster to be paying usage fees if the fees collected by SoundExchange in a particular year (a) exceed the $500 flat fee, (b) do not equal $600 (which most likely represents the $500 flat fee plus a $100 proxy fee in lieu of census reporting) and (c) are not an even multiple of $500 (most likely representing payment of the minimum fee for multiple channels). This is the approach that the NRBNMLC employed in interpreting these data. *See, e.g.*, NRBNMLC PFF, at ¶ 95.

existing threshold. The testimony emphatically does not demonstrate that a substantial number of noncommercial webcasters are operating near the threshold and taking steps to keep below it.[209]

The NRBNMLC's proposal to increase the threshold to 400 concurrent listeners is unsupported by the record. By contrast, the evidence demonstrates that the current threshold of 159,140 ATH per month that SoundExchange proposes to retain has resulted, for the vast majority of noncommercial webcasters, in no additional liability for royalties beyond the minimum fee. Moreover, the willingness of SoundExchange and CBI to adopt that threshold in their current settlement agreement, after years of experience with the identical threshold under the current rates, demonstrates that it is reasonable and workable. The Judges hereby adopt it.

2. Consequences of Exceeding the Threshold

SoundExchange proposes that a noncommercial webcaster's transmissions beyond the 159,140 ATH threshold should no longer enjoy a reduced royalty rate. The NRBNMLC proposes that a reduced royalty rate – structured in $200 increments for each 876,000 ATH annually – should apply to transmissions beyond the threshold.

a. The NRBNMLC's Proposal

The Judges explained in *Web II* that the threshold on the noncommercial webcasting rate serves as a "proxy that aims to capture the characteristics that delineate the noncommercial submarket." *Web II Remand,* 72 Fed. Reg. at 24099. As discussed in section V.B.1, the Judges do this to assure that the submarket for noncommercial webcasters does not converge or overlap with the submarket for commercial webcasters. SoundExchange's proposal is consistent with this rationale; the NRBNMLC's is not. Not only would the NRBNMLC's proposal grant substantially reduced rates to large noncommercial webcasters whose operations compete with commercial webcasters', but the effective rate for such large noncommercial webcasters would actually *decline* as they grow larger due to the effect of the proposed $1,500 cap on royalties. The NRBNMLC offers no economic rationale for this result. *See* Lys WRT, at ¶¶ 256-257.

The NRBNMLC does not address this issue directly. Instead, the NRBNMLC argues that its proposed "tiered and capped flat rate structure" is what a willing buyer and a willing seller would agree to in an effectively competitive market (*i.e.*, a market rate). *See* NRBNMLC PFF, at ¶80. The NRBNMLC cited the testimony of its two witnesses as establishing the need of noncommercial webcasters for rates that are affordable and predictable. NRBNMLC Ex. 7011 ¶¶ 25-27 (Henes WDT), 30; Emert WDT, at ¶¶ 31-32, 34-37, 41. The fatal flaw in this argument is that it is unsupported by any marketplace evidence and any evidence of sellers who would be

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[209] The NRBNMLC candidly admits that it does not know the extent to which noncommercial webcasters impose listener caps, noting that "[t]here is no way of knowing exactly how many Noncommercial entities have done this …." NRBNMLC PFF at ¶ 23. This statement is only partially correct: the NRBNMLC could have surveyed its members or the broader noncommercial webcaster community. While such a survey may not have provided a definitive answer for the entire population of noncommercial webcasters, it would have revealed far more about the current state of affairs across the noncommercial webcasting market than the hearsay testimony of these two witnesses.

willing to accept the NRBNMLC's proposed structure. Mr. Henes and Mr. Emert may be willing, even eager to license music on this basis, but their testimony tells the Judges nothing about the sellers' side of the equation. As discussed in greater detail in the following paragraphs, none of the marketplace evidence that the NRBNMLC cites pertains to a rate structure remotely similar to the one proposed by the NRBNMLC.

As additional evidence to support their argument that a "tiered and capped flat rate structure" is a market rate, the NRBNMLC cites the SoundExchange/CBI settlement agreement, the SoundExchange/NPR settlement agreement, the rates established for musical works under 17 U.S.C. § 118, and the position taken by SoundExchange on legislation to create a public performance right for sound recordings that covers transmissions over terrestrial radio. *Id*. The Judges reach different conclusions based on this evidence.

The SoundExchange/CBI settlement agreement imposes a flat $500 fee on NEWs that transmit up to 159,140 ATH per month. Any NEW that exceeds that threshold loses its eligibility to operate under the settlement, and thus becomes subject to the CRB rate for noncommercial webcasters for the remainder of the year.[210] The NRBNMLC concludes that "no usage fees apply under the agreement" for a NEW that exceeds the threshold, and cites the agreement as support for a flat-rate structure with no usage fees. NRBNMLC PFF, at ¶ 93. The NRBNMLC's interpretation of the agreement is not credible. The parties' decision not to specify usage fees in the agreement does not mean that they contemplated that a NEW that exceeded the ATH threshold would not pay any usage fees. The existing CRB rates provide for usage fees above 159,140 ATH, and CBI could reasonably assume that SoundExchange's rate proposal (filed with the Judges on the same day as the proposed settlement) would also contain usage fees. At most, the omission of usage fees from the agreement reflected the parties' decision not to resolve the issue of what rates would apply beyond the threshold, and to leave it for the Judges to determine in the proceeding.

The NRBNMLC is correct in pointing out that the SoundExchange/NPR settlement agreement imposes a flat royalty rate with no additional usage fee. However, the SoundExchange/NPR settlement differs so fundamentally in so many ways from what the NRBNMLC is proposing that it cannot serve as a support for that proposal. The SoundExchange/NPR settlement entails a single annual payment by a single payer (CPB), in advance, to cover over 500 NPR member radio stations. 80 Fed. Reg. at 59590-91. The stations include a range of formats, some of which entail very limited use of recorded music. Unlike the NRBNMLC's rate proposal, the settlement does not include tiered payments above the flat royalty rate, but does include a cap on the aggregate amount of recorded music that may be performed. NPR consolidates the reports of use for all of the stations covered by the agreement. The NRBNMLC's proposal does not provide for consolidated reports of use. On the whole, the terms of the SoundExchange/NPR agreement provide SoundExchange with significant benefits—reduced risk of nonpayment; protection against large numbers of uncompensated

[210] The NEW may operate under the settlement in the following year, provided it takes affirmative steps (*e.g*., imposes listening caps) to ensure that it will not exceed the threshold again.

performances; reduced costs of processing usage data—that the NRBNMLC proposal does not. To pluck out a single element of the deal, the flat royalty rate, and cite it as support for the NRBNMLC rate proposal simply lacks credibility.

The musical works rate under the section 118 statutory license suffers from a similar lack of comparability to the rates the Judges must set in this proceeding. Rates under section 118 are in a different market, with different sellers and for different copyrighted works. The NRBNMLC has presented no evidence to demonstrate how a rate structure in that market, and with those sellers, reflects what a willing buyer and a willing seller would agree to in the sound recordings market.

Finally, SoundExchange's position on legislation has little or no bearing on what constitutes a market rate. The compromises and tradeoffs that parties are prepared to make in the legislative arena have only the remotest resemblance to the give and take of the marketplace. The record industry does not currently enjoy any legal right with respect to the transmission of its sound recordings over terrestrial radio. There is no basis for the Judges to conclude that what the industry may be willing to accept in legislation that establishes such a right is the same as what it would bargain for in an arms-length transaction against the backdrop of an existing statutory right of remuneration.

b. SoundExchange's Proposal

Although SoundExchange's proposal to impose commercial rates above the 159,140 ATH threshold is consistent with the Judge's rationale for limiting the applicability of noncommercial rates, the NRBNMLC levels multiple criticisms against it. These include:

- SoundExchange's entire rate proposal for noncommercial webcasters lacks evidentiary support;
- The specific usage rates that SoundExchange proposes are "inappropriate for commercial webcasters and even more inappropriate for noncommercial webcasters"; and
- The fact that few noncommercial webcasters have paid usage fees confirms that the proposed fees are unreasonable.

NRBNMLC PFF, at ¶ 113.

i. Evidentiary Support (or Lack thereof) for SoundExchange's Rate Proposal

As Professor Rubinfeld readily conceded, there are no current marketplace benchmarks from which to derive SoundExchange's entire rate proposal for noncommercial webcasters. Rubinfeld CWDT, at ¶¶ 33, 246. The only contemporary agreements in evidence that cover noncommercial webcasters are the two settlement agreements between SoundExchange, on the one hand, and CBI and NPR, respectively, on the other hand. As discussed in the preceding section, there are a number of elements of the SoundExchange/NPR agreement that render it a poor benchmark for setting noncommercial rates generally. The SoundExchange/CBI agreement lends support for some elements of SoundExchange's rate proposal (*e.g.*, a flat $500 rate for noncommercial webcasters that transmit up to 159,140 ATH), but not for the proposed rate for usage beyond the ATH threshold.

That does not mean, however, that SoundExchange's rate proposal is entirely without evidentiary support. As discussed, *supra* section V.B.1, expert economic testimony supports treating transmissions by noncommercial webcasters above a certain ATH threshold the same as transmissions by commercial webcasters. This is what the SoundExchange proposal seeks to achieve. The rates that SoundExchange proposes for transmissions above the ATH threshold are the same that SoundExchange proposes for commercial webcasters.

ii. Inappropriateness of Specific Usage Rates Proposed by SoundExchange

The NRBNMLC pursues two lines of attack against the specific usage rates that SoundExchange proposes. The first, concerning Professor Rubinfeld's interactive benchmark analysis, essentially repeats the licensee services' criticisms of SoundExchange's proposal for commercial webcasting rates. *See* NRBNMLC PFF, at ¶ 122. The Judges discuss those arguments *supra*, section I.A.3. The Judges, in fact, do not adopt the specific rates that SoundExchange proposes, precisely because they find SoundExchange's benchmark analysis lacking in certain respects. Rather, the Judges adopt the same rates for transmissions in excess of the 159,140 ATH threshold by noncommercial webcasters as they do for commercial webcasters.

The second line of attack is that Professor Rubinfeld's benchmark analysis is inapplicable to noncommercial webcasters because none of the licensees under any of the benchmark agreements were noncommercial webcasters. *Id*. at ¶ 123. As discussed, *supra* section V.B.1, the Judges apply commercial rates to noncommercial webcasters above the ATH threshold because economic logic dictates that outcome, not because it was observed in benchmark agreements.

iii. Small Number of Noncommercial Webcasters Paying Usage Fees Confirms that the Fees are Excessive

The NRBNMLC notes that few noncommercial webcasters pay usage fees and, of those that do, most pay a lower settlement rate in lieu of the rates set by the Judges for commercial webcasters. NRBNMLC PFF ¶ 131. Based on this evidence, the NRBNMLC concludes that the commercial webcaster rates are excessive, and that noncommercial webcasters are imposing listener caps or taking other affirmative steps to avoid paying them.

Of the 3,917 documented payments by noncommercial webcasters between 2010 and 2014, 112 included payments for usage above the ATH threshold. NAB Ex. 4141; NAB Ex. 4149. Of these, 13 were at the commercial rate determined by the Judges and 99 were at a lower rate established under a WSA settlement.[211] *Id*.; *see also* 5/6/15/15 Tr. at 2099-100 (Rubinfeld) (25-30 noncommercial licensees pay lower rates under settlement agreements).

These facts do no support the NRBNMLC's conclusions. In itself, the fact that more than 97% of noncommercial webcaster payments do not include usage fees could just as easily support the conclusion that the vast majority of noncommercial webcasters – like the noncommercial webcasters that testified in this proceeding – operate well below the 159,140

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[211] The noncommercial webcasters' WSA settlement agreement is "nonprecedential." The Judges are not permitted to take into account the rate structure, fees, terms and conditions of that agreement in setting rates in this proceeding. 17 U.S.C. § 114(f)(5)(C).

ATH threshold. Without evidence that a substantial number of noncommercial webcasters are operating near the threshold, or are imposing listening caps, the Judges cannot conclude that the threshold operates as a significant constraint or that the usage fees are excessive.

The evidence that most noncommercial webcasters that paid usage fees did so under an alternative rate structure also does not support the NRBNMLC's conclusions. These webcasters made a rational choice to pay an available lower rate. That tells the Judges nothing about their willingness to pay the higher statutory rate in the absence of settlement. Conversely, though, it strongly suggests that nearly all of the webcasters that opted for the statutory rate structure or the NEW settlement expected that they would not exceed the threshold.

3. Cap on Royalties

The NRBNMLC proposes that the total obligation of a noncommercial webcaster to pay royalties should be capped at $1,500, regardless of the number of sound recordings the webcaster performs. As with the other elements of its rate proposal, the NRBNMLC contends that the cap on fees is supported by marketplace evidence. Neither of the two noncommercial agreements in evidence employs the cap that the NRBNMLC proposes. The SoundExchange/CBI settlement imposes a flat royalty rate, but caps eligibility for that rate at 159,140 ATH. Beyond that threshold, the noncommercial webcaster must pay under the noncommercial rate structure determined in this proceeding. The SoundExchange/NPR settlement agreement employs a flat-fee structure (which serves as a cap on royalties), but also imposes a cap on music usage. *See* 80 Fed. Reg. at 15961.

There is no other evidence of any kind that a copyright owner would willingly license unlimited use of its sound recordings for a fixed fee of $1,500. The Judges reject the NRBNMLC's proposed royalty cap.

4. IBS's Additional Arguments

IBS did not direct any criticism directly at either the SoundExchange or the NRBNMLC rate proposal. IBS's rate-related arguments were directed (or misdirected[212]) at the SoundExchange/CBI settlement agreement. Nevertheless, had IBS applied those arguments to the rate proposals before the Judges, the Judges would have rejected them.

a. Lobbying Prohibition

Captain Kass testified that many IBS members are a part of state-funded educational institutions that are barred by state law from providing funds to organizations that lobby. IBS argues that these laws prevent certain IBS members from paying royalties to SoundExchange.

This argument is unavailing for several reasons. First, IBS failed to provide any legal authority or expert testimony to support Captain Kass's interpretation of these state laws. Even if the Judges accept as true the assertion that these state laws prohibit certain IBS members from remitting funds to lobbying organizations, it is far from clear whether those laws would prevent

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[212] *See supra* note 204.

the same IBS members from paying statutory license royalties to an organization designated by regulation as a collective under a Federal statute.

Second, there is no evidence in the record concerning SoundExchange's lobbying activities, *vel non*. The Judges have no basis for concluding that the state laws to which IBS refers even apply to SoundExchange.

Third, and most fundamentally, the entire question is not relevant to the Judges' task of setting rates for noncommercial webcasters. If IBS contends that its members may webcast sound recordings but are forbidden under state law to pay royalties to SoundExchange that is an argument that must be resolved by a Federal District Court in an infringement action. It has no bearing on the particular rate structure that the Judges must determine for noncommercial webcasters.

b. Lack of "Proportionality"

IBS argues that royalty payments for noncommercial webcasters must be proportional to their use of sound recordings. While IBS's argument has a superficial appeal, it suffers from several shortcomings.

IBS does not and cannot cite any statutory authority for its argument. The statute directs the Judges to set willing buyer/willing seller rates.17 U.S.C. § 114(f)(2)(B). Willing buyers and willing sellers may, and often do, agree to rates that are not strictly proportional to usage. The SoundExchange/NPR and SoundExchange/CBI agreements are examples of agreements that incorporate a flat-rate structure where royalties are not strictly proportional to use.

The statutory requirement of a minimum fee also runs counter to IBS's argument. By definition, a minimum fee (whatever its level) is not proportional to usage.

IBS also fails utterly to provide any evidentiary basis for concluding that the rates proposed by SoundExchange or the NRBNMLC are so disproportional to noncommercial webcasters' usage as to be unreasonable. To be sure, some noncommercial webcasters transmit a very small number of performances of recorded music. *See* Kass WDT, at 3 ("instantaneous listenership to such music on member stations is typically on the order of five listeners, with the exception of course-related music …"). Noncommercial webcasters – even those that are IBS members – are a heterogeneous group, with some operating above SoundExchange's proposed 159,140 ATH threshold. *See supra*, section V.B.1. IBS has not even proposed, much less provided an evidentiary basis to adopt, subcategories of noncommercial webcasters.

C. Conclusion

For the rate period 2016-2020 the Judges adopt an annual rate of $500 per station or channel for all transmissions by noncommercial webcasters up to a threshold of 159,140 ATH. For transmissions in excess of 159,140 ATH, noncommercial webcasters shall pay royalties for 2016 at the commercial rate (*i.e.*, $0.0017 per-performance), and for such transmissions in excess of 159,140 ATH in the remainder of the statutory term, at the commercial rate as adjusted annually for changes in the Consumer Price Index, as set forth in the regulations.

VI. Minimum Fee

Sections 112 and 114 of the Act require the Judges to establish minimum fees as part of any rate structure under the respective statutory licenses. 17 U.S.C. §§ 112(e)(3),(4) and 114(f)(2)(A),(B).

A. Commercial Webcasters

1. Parties' Proposals

a. SoundExchange

SoundExchange proposes a $500 per station or channel annual minimum fee. The minimum fee would be nonrefundable, but would be credited against royalties incurred during the applicable year. The minimum fee would be capped at $50,000 annually for a webcaster with 100 or more stations or channels. SoundExchange Rate Proposal, at 2 (October 7, 2014).

b. Pandora

Pandora does not make an explicit proposal for a minimum fee. Pandora does, however, propose that, apart from those terms for which it proposes changes, "the terms currently set forth in 37 C.F.R. § 380 be continued." Proposed Rates and Terms of Pandora, at 2 (Oct. 7, 2015). Those terms include the current minimum fee of $500 per station or channel (capped at $50,000) for commercial webcasters.

c. iHeartMedia

iHeartMedia does not propose a minimum fee.

d. Sirius XM

Sirius XM does not make an explicit proposal for a minimum fee. Sirius XM does, however, propose that "other than the royalty rate, the terms currently applicable to commercial webcasters be retained in their current form." Introductory Memorandum to the Written Direct Statement of Sirius XM, at 1-2 (Oct. 7, 2014). Those terms presumably include the current minimum fee of $500 per station or channel (capped at $50,000) for commercial webcasters.

e. NAB

NAB proposes a $500 annual minimum fee for each terrestrial AM or FM radio station that a broadcaster webcasts. For purposes of calculating the minimum fee, each individual stream (*e.g.*, primary radio station, HD multicast radio side channels, different stations owned by a single licensee) is to be counted as a separate radio station, except that identical streams for simulcast stations will be treated as a single stream if the streams are available at a single Uniform Resource Locator (URL). NAB Proposed Rates and Terms, at 4.

The minimum fee would be nonrefundable, but would be credited against royalties incurred during the applicable year. The minimum fee would be capped at $50,000 annually for a webcaster with 100 or more stations or channels. *Id*.

2. Analysis and Conclusion

All participants that proposed a minimum fee for commercial webcasters asked the Judges to retain the current annual minimum fee that the Judges adopted in *Web III* pursuant to a settlement. *See Web III Remand Decision*, 79 Fed. Reg. at 23104. The minimum fee settlement in *Web III* kept in place a settlement of the minimum fee for commercial webcasters that the parties reached in *Web II*. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, final rule*, 75 Fed. Reg. 6097 (February 8, 2010) (Web II Minimum Fee Settlement). That settlement, in turn, retained a $500 minimum fee that was determined by a CARP, and upheld by the Librarian, in *Web I*, *see Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, Final Rule and Order,* 67 Fed. Reg. 45240, 45262-63 (July 8, 2002), but adding a $50,000 cap for a webcaster with 100 or more stations or channels. *See Web II Minimum Fee Settlement*, 75 Fed. Reg. at 6098.

While there is no settlement of the minimum fee issue in the current proceeding, the convergence of the parties' proposals on the existing $500 minimum fee (capped at $50,000) counsels strongly in favor of its retention. In addition, the Judges follow their earlier determination that commercial and noncommercial webcasters alike should have to pay a minimum fee that at least defrays a portion of SoundExchange's costs to administer the statutory licenses. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Determination after Second Remand*, 79 Fed. Reg. 64669, 64672 (Oct. 31, 2014). Mr. Jonathan Bender, SoundExchange's Chief Operating Officer, testified that "SoundExchange does not track its administrative costs on a licensee-by-licensee, station-by-station, or channel-by-channel basis and, as a result, there is no precise way to determine exactly" how much SoundExchange spends on that basis. Bender WDT, at 16-17. The costs to SoundExchange vary depending on such factors as the quality of the data a service submits. *Id*. at 16. In 2013, the average administrative costs per licensee (*i.e.*, the total administrative costs divided by the number of licensees) were $11,778. *Id*. at 17.

SoundExchange's average administrative cost per licensee is substantially higher than the minimum fee it proposes to charge each licensee. While a higher minimum fee could be justified on this record, no party has requested anything higher than the current level of $500.

The current $500 minimum fee for commercial webcasters has been in force for more than a dozen years,[213] and has been voluntarily re-adopted by licensors and licensees on two occasions. It has been proposed by licensors and licensees in this proceeding. SoundExchange's administrative costs (which the minimum fee is intended to defray, in part) exceed the proposed minimum fee by a wide margin. The Judges find the proposed minimum fee (including the $50,000 cap) to be reasonable and supported by record evidence, and will therefore adopt it.

B. Noncommercial Webcasters

1. Parties' Proposals

a. SoundExchange

SoundExchange proposes a $500 per station or channel annual minimum fee for noncommercial webcasters. The minimum fee would be nonrefundable, but would be credited against royalties incurred during the applicable year. SoundExchange Rate Proposal, at 4.

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[213] The $50,000 cap which has been in force since 2010, (applicable to the rate period beginning January 1, 2006).

b. NRBNMLC

NRBNMLC proposes a $500 per station or channel annual minimum fee. The minimum fee would be nonrefundable, but would be credited against royalties incurred during the applicable year.

c. IBS and WHRB

As discussed *supra*, section I.A.3, IBS and WHRB did not submit rate proposals.

2. Analysis and Conclusion

Both the SoundExchange and NRBNMLC rate proposals include a $500 annual per station or channel minimum fee for noncommercial webcasters—*i.e.*, retention of the current minimum fee. No other participant proposed a minimum fee for noncommercial webcasters,[214] although CBI and SoundExchange agreed to retain the existing $500 minimum fee as part of their settlement covering noncommercial educational broadcasters. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule*, 80 Fed. Reg. 58201, 58206 (Sept. 28, 2015) (37 C.F.R. § 380.22(a)).

Although WHRB and IBS do not attack the SoundExchange and NRBNMLC minimum fee proposals directly, they argued against adoption of the SoundExchange/CBI settlement which incorporates the same $500 minimum fee, and they repeat those arguments in this proceeding. The Judges addressed their objections to the SoundExchange/CBI settlement in the *Federal Register* notice adopting the settlement terms. *See id*. at 58203-04. The Judges have also addressed WHRB's and IBS's objections in the context of the SoundExchange and NRBNMLC rate proposals. For the same reasons articulated in the *Federal Register* notice and *supra*, section V.B.4, the Judges reject WHRB's and IBS's objections as they may apply to the proposed minimum fee for noncommercial webcasters.

The current $500 annual minimum fee for noncommercial webcasters has been in force since *Web I*. *See* 37 C.F.R. § 261.3(e)(1) (2003). It was adopted by SoundExchange and CBI in a settlement agreement covering the rate period of this proceeding. It has been proposed by SoundExchange and the NRBNMLC, the only noncommercial webcaster to file a rate proposal in this proceeding. It constitutes a small (but nontrivial) fraction of the costs that SoundExchange incurs in administering the statutory license. *See supra*, section VI.A.2. The Judges find the proposed minimum fee to be reasonable and supported by record evidence, and will therefore adopt it.

VII. Ephemeral License Rate and Terms

Section 112(e) grants entities that transmit performances of sound recordings a statutory license to make ephemeral recordings. SoundExchange proposes that the Judges bundle the royalties for Section 114 and 112 and allocate five percent (5%) of the Section 114 performance

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[214] As noted *supra*, section I.A.3, neither of the other two noncommercial webcasters that participated in this proceeding (WHRB and IBS) submitted a rate proposal.

right royalty deposits to the Section 112(e) ephemeral recording right, a rate structure that would continue the extant arrangement. SX PFFCL at ¶ 1369. SoundExchange contends that its proposal regarding the bundled rate for the Section 112 license is supported by the designated testimony of Dr. Ford. SX PFFCL at 1370 & n.64. SoundExchange also cites as support for its Section 112 proposal certain license agreements that were introduced into evidence. SX PFFCL at ¶ 1374 (*citing* agreements between [redacted] and [redacted] agreements with [redacted] and [redacted]’s agreements with [redacted] and [redacted] for the [redacted] service).

SoundExchange contends that no participant offered evidence of a benchmark agreement that does not bundle performance rights and the right to make ephemeral copies. SX PFFCL at ¶ 1375. SoundExchange further contends that “[a]s of the *Web III* proceeding, recording artists and record companies had reached an agreement that five percent of the ‘payments for activities under Section 112(e) and 114 should be allocated to Section 112(e) activities.’” SX PFFCL at ¶ 1377, *quoting* Dr. Ford. According to SoundExchange, no participant has presented evidence in support of a different allocation between artists and record companies. SX PFFCL at ¶ 1377. SoundExchange concludes that “[b]ecause SoundExchange’s Board represents both artists and copyright owners, its proposed rate of 5% for ephemeral copies is appropriate evidence and ‘credibly represents the result that would in fact obtain in a hypothetical marketplace negotiation between a willing buyer and the interested willing sellers under the relevant constraints.’” SX PFFCL at ¶ 1378, *quoting* Dr. Ford.

Other participants that address the rate for the Section 112 license do not contradict SoundExchange’s assertions. *See* iHeart Reply PFFCL at 203 (“iHeartMedia supports the current bundling of the § 112 and § 114 royalties”); Sirius XM PFF at ¶ 2 (“Sirius XM maintains that the Section 112 ephemeral license has no value independent of the Section 114 performance license, and consequently proposed that the royalty for the Section 112 license be deemed included within the Section 114 royalty payment. Sirius XM takes no position at this time as to what, if any, percentage of the Section 114 royalty should be deemed attributed to the Section 112 ephemeral license.”); NRBNMLC PFFCL at ¶ 151 (“[t]here is no dispute between SoundExchange and the NRBNMLC regarding how the royalties for the ephemeral recording statutory license specified in 17 U.S.C. § 112(e) should be set. Both participants propose that those royalties for ephemeral reproductions used solely to facilitate transmissions made pursuant to the 17 U.S.C. § 114(f) statutory license be deemed to be ‘included within, and constitute 5% of’ the section 114(f) statutory license payments made by a particular service” *quoting* the respective proposals of SoundExchange and NRBNMLC); NAB PFFCL at ¶ 226 (“no dispute between SoundExchange and NAB regarding how the royalties for the [Section 112(e) license] should be set.”) and Pandora PFFCL at ¶ 416 (“[c]onsistent with past proceedings and the Merlin Agreement (which has no separate ephemeral recording fee), Pandora proposes that the royalty payable for ephemeral recordings be included within the Section 114 royalty. There is no dispute on this point: SoundExchange has proposed the same.”).

The Judges accept SoundExchange’s proposal to continue the current bundling of the Section 112 and 114 rates. The Judges find persuasive the designated testimony of Dr. Ford and the license agreements that SoundExchange cites in its PFFCL that willing buyers and willing sellers would prefer that the rates for the two licenses be bundled and that they would be agnostic with respect to the allocation of those rates to the Section 112 and 114 license holders.[215] The Judges also find that the minimum fee for the Section 112 license should be subsumed under the minimum fee for the Section 114 license, 5% of which shall be allocable to the Section 112 license holders, with the remaining 95% allocated to the Section 114 license holders.

SoundExchange and the services disagree, however, on the terms with respect to the Section 112(e) license. CRB Rule 380.3(c), which addresses ephemeral recordings, states: "The royalty payable under 17 U.S.C. 112(e) for the making of Ephemeral Recordings used by the Licensee solely to facilitate transmissions *for which it pays royalties* shall be included within, and constitute 5% of, the total royalties payable under 17 U.S.C. 112(e) and 114." 37 CFR 380.3(c), emphasis added.

Pandora proposes that the Judges strike the italicized language and replace it with the phrase "made pursuant to 17 U.S.C. 114." Pandora believes the current language "creates the possibility (likely unintended) that ephemeral copies of sound recordings that are used by a service for non-compensable performances under Section 114 might not be authorized under the regulations." Pandora PFFCL at ¶ 416. Pandora also proposes that the Judges add the following sentence to the current amended regulation: "A Licensee is authorized to make more than one Ephemeral Recording of a sound recording as it deems necessary to make noninteractive digital audio transmissions pursuant to 17 U.S.C. 114." Pandora PFFCL at ¶ 417. Pandora contends that such "as necessary" language is consistent with industry practice. *Id*. at ¶ 418. SoundExchange proposes that the current regulation be carried over into the new rate period but appears to acknowledge that authorizing the making of more than one ephemeral copy is not inconsistent with current industry practice.[216]

The Judges adopt Pandora's proposed language and do not carry forward the language "for which it pays royalties" in the current regulation because they believe that the phrase could be construed in a way that would limit the application of the Section 112 license to certain transmissions made consistent with Section 114 that are not royalty generating, such as skips. The Judges also are sympathetic to the Services' contention that, in certain circumstances (*e.g.*, where different file format requirements may necessitate the creation of multiple copies), it may be necessary to make more than one ephemeral copy to facilitate transmissions made pursuant to

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[215] SX Ex. 1931 (designated testimony of Dr. George S. Ford). Dr. Ford testifies that "in the marketplace deals between record companies and webcasters for non-statutory forms of licenses, it is typical for ephemeral copy rights to be expressly included among the grant of rights provided to the webcasters…[incorporating the rate for the ephemeral copy] into the overall rate that the webcaster pays for the ephemeral copy rights and performance rights." *Id*. at 10-11. He also concluded that "recording artists and record companies have reached an agreement that five percent (5%) of the payment for activities under Section 112(e) and 114 should be allocated to Section 112(e) activities [and] that appears to be a reasonable proposal." *Id*. at 15.

[216] *Compare* SX Reply PFFCL at ¶ 1247 ("SoundExchange believes that Pandora's proposed changes [to CRB regulations] should be rejected outright") *with* SX PFFCL at ¶ 1374 (referencing agreements between labels and services wherein services are authorized to create and store a reasonable, limited number of ephemeral copies).

Section 114. Nevertheless, the circumstances must be necessary and commercially reasonable. The language the Judges adopt includes this standard.

VIII. Terms

One of the purposes of this proceeding is to establish terms for the administration of the rates the Judges determine for the rate period 2016 to 2020. The parties proposed changes for Subchapter E of Chapter III, title 37 C.F.R., relating to the Copyright Royalty Board. In addition to the proposed terms concerning licensing ephemeral recordings discussed in the preceding section, the Judges have weighed the proposals and the arguments of the parties in support of or opposed to the proposals and adopt the Terms as detailed in "Exhibit A" to this determination. The parties' proposals, and the Judges' rulings, include the following.

Collective. The Judges designate SoundExchange as Collective.[217]

Payment due date. SoundExchange proposes shortening the period from 45 days to 30 days. Pandora and SiriusXM do not oppose the change, but the NAB, NRBNMLC, and IHM do. SoundExchange argues that the shorter term would allow them to distribute payments more quickly and that the majority of agreements in the industry have payments terms of 30 days. The NAB and IHM argue that because of the unique character of their respective business models, shortening the term would cause additional burdens and create inaccuracies and overpayments that potentially would not be refunded. The Judges also are considering this issue in a rulemaking proceeding that is currently pending before them. The Judges do not believe that the record before them in this ratemaking proceeding supports the change that SoundExchange seeks. Although the Judges can perceive the costs to the Services that the shortened reporting period would impose, it is less clear that the benefits to SoundExchange from such a change would justify those costs. Nevertheless, the Judges will continue to consider this issue in the broader context of the pending rulemaking proceeding.

Auditor qualifications. SoundExchange proposes that the regulations allow non-CPAs to perform audits if they have the requisite industry-specific expertise arguing that it is difficult to find CPAs with the expertise and that other actors in the market allow content owners to audit royalty payments. The NAB and NRBNMLC counter with the argument that CPAs inspire confidence in the audit results because of the standards of their profession and that they can rely on experts in the industry to assist them if necessary. SoundExchange has argued in past proceedings for a change to allow in-house auditors to perform audits. The Judges rejected that change. Final Rule and Order, Docket No. 2005-1 CRB DTRA ("Web II"), 72 Fed. Reg. 24084, 24109 (May 1, 2007). For the same reasons, they do not adopt a change to the requirement that the auditor be a CPA. The Judges further insert the qualifier "independent" into the definition of "Qualified Auditor" for the sake of regulatory efficiency. The judges do not adopt

[217] In the provision relating to the potential dissolution of SoundExchange as the Collective, Pandora and SoundExchange agree that the phrase "that have themselves authorized the Collective" in current CRB Rule 380.4(b)(2)(i) is unnecessary and should be deleted. *See* SXPFFLC Reply at ¶ 1231, n.74. Accordingly, the applicable provision the Judges adopt does not carry over that unnecessary language.

SoundExchange's proposed change. They do, however, adopt language proposed by the NAB and NRBNMLC concerting the licensing of an auditor.

Acceptable verification process. SoundExchange proposes removing this provision because it allows audits to be routine financial audits instead of specialized "royalty examinations." SX PFF at ¶ 1285-86. Although the services do not oppose this change, SoundExchange offered no evidence of the ineffectiveness of the audits to date due to the existence of the provision, and therefore the Judges do not adopt the proposed change. A Service's recent financial audit need not preclude a business audit that focuses on the Service's royalty policies and procedures.

Late fees. Pandora proposes a single late fee for both a late payment and a late Statement of Account. It argues that a late fee for each of these is duplicative and unnecessary. SoundExchange counters that it incurs duplicative costs when both items are late and that it is fair to hold a late payor accountable for such costs. In addition, SoundExchange's ability to enforce compliance and make efficient distribution relies on late fees for each of these. The Judges agree that such fees encourage compliance for each required item. As a result, the Judges do not adopt this proposed change.

Late fee rate. iHeart, the NAB, and NRBNMLC propose that the late fee rate be reduced from 1.5% (the equivalent of 18% per year) to a more "reasonable" fee; that is, one similar to statutory interest rates on judgments and tax underpayments. iHeart points out that its agreements with the Indies contain no late fee provision and that Warner has never asked them to pay the late fee when they have submitted a late payment. SoundExchange argues that the high fee provides an incentive for timely payments and covers costs due to late payments. The evidence shows that late fees in market agreements range from no fees to 1.5% and include the proposed fee. The 1.5% rate is an accepted rate in the market, and the services produced no evidence of actual hardship from the current rate of 1.5%. For this reason, the Judges do not adopt this proposed change.

Overpayments and corrections to payments. Pandora proposes a change to allow Licensees to make adjustments to their Statements of Accounts. iHeart proposes changes that would allow Licensees to recoup overpayments. SoundExchange argues that the proposals are unreasonable because of, *inter alia*, the window of time within which, and the number of times a Licensee could make adjustments. In addition, SoundExchange complains that the administrative burden of such a proposal could be excessive. SoundExchange also notes that the money may not be recoupable once it is paid to artists. Pandora argues that making good faith adjustments are part of the normal course of business and that SoundExchange's technological advances will make the administration of adjustments manageable. Pandora RFF at 192-193. iHeart points out that SoundExchange has a method for reversing its own inadvertent overpayments. IHM PFF at 203; IHM RFF at 202;*see* PAN PFF at 171-72. The Judges agree with SoundExchange. The burden for accuracy is on the Licensee. In addition, the record contains no evidence to guide the Judges in determining a reasonable time frame for, or number of, adjustments. Therefore, the Judges do not adopt this proposed change.

Signature attestation. Pandora proposes adding a sentence to the required language in a Statement of Account—just below the sentence where the signatory attests to the statement's accuracy and completeness—that would allow Licensees to amend their Statements of Accounts. This proposal is related to iHeart's proposal regarding overpayment and corrections to payments.

The proposed sentence contains no time limit for making amendments to the Statements of Accounts and is therefore an unreasonable addition to the Statement of Account. The Judges do not adopt this proposed change.

Notice and cure. The NAB proposes adding a notice and cure provision to apply in case of breach because it is customary in contracts and is included in some of the agreements in evidence. SoundExchange wants the option to use informal methods of dealing with breach, but the NAB argues this provision would not preclude such efforts; it would only be required in case of a material breach that SoundExchange plans to assert. Such a provision is not necessary merely because it is customary, and informal or formal methods of notice are always available to the parties. Therefore, the Judges do not adopt this proposed change.

Emails acknowledging receipt of payment. NRBNMLC proposes that SoundExchange send emails (similar to those that the musical works collectives send) with reminders that annual payments are due, which would serve a function similar to an invoice. NRBNMLC also proposed a provision requiring SoundExchange to email acknowledgments of receipt of payment, which would function like a receipt and which is a common business practice, including in the nonprofit arena. SoundExchange argues there is no need for a regulation because it already sends reminders. It also argues that an acknowledgment email would be challenging because it does not have current email addresses for each of its licensees, and the cost would outweigh the benefit. SoundExchange countered that it will soon have an online payment portal, a fact that NRBNMLC points out shows that SoundExchange realizes that the receipts would be useful. The Judges find that the online portal should address the receipt concern and that the practice of sending reminders does not warrant a regulation. Therefore, the Judges do not adopt this proposed change.

Unclaimed funds. Pandora proposes that the provision in the regulations dealing with the Collective's use of unclaimed funds may not be consistent with state escheatment laws. SoundExchange opposes changes to this provision, which allows the Collective, under certain circumstances, to use unclaimed funds for administrative purposes. SoundExchange argues that the changes that Pandora has proposed, which would require that the Collective use unclaimed funds in a manner consistent with applicable law, could impose an unnecessary regulatory burden on the Collective. The Judges adopt the changes substantially as proposed by Pandora. The Copyright Act does not expressly authorize the Judges to adopt rules that preempt state law. Although the Judges do not believe that the unclaimed funds provision in the current regulations does so, in an abundance of caution and to avoid potential confusion in the upcoming rate period, the Judges adopt the more neutral drafting that Pandora proposes to ensure that the Collective's use of unclaimed funds comports with applicable law.

Definition of ATH. The NAB and NRBNMLC propose to redefine ATH to allow for a reduction in reported ATH for broadcast time devoted to talk radio. SoundExchange counters that NRBNMLC provided no evidence to justify a reduction different from the one established (and used) by NPR stations. SoundExchange points out that all the rates would have to be recalculated if the basic assumption regarding ATH is changed at this point. The Judges agree. If the definition changes, the threshold needs to change as well, and there is no basis in the record for making those changes. The Judges do not adopt this change.

Definition of "Performance". In the current regulations, a "performance" is defined as "each instance in which any portion of a sound recording is publicly performed to a listener…."

See, e.g., 37 C.F.R. § 380.2. The Services propose various changes to the definition of performance. Parties can and do alter the definition of "performance" and change other DMCA provisions in directly negotiated licenses. The Judges cannot, however, make regulations that are contrary to the requirements of the Act.

Pandora seeks to add "in the United States" to the definition. The NAB and NRBNMLC ask for an alternate parenthetical description and a reference to the section in the Copyright Act regarding performances that do not require a license.

More substantively, the NAB and NRBNMLC also add two exclusions to the definition, one regarding performances of very short duration and one very technical one regarding second connections from the same IP address. SoundExchange argues that rights owners should be compensated for all use of their work, and thus that services should not allow skipping of songs. It also points out that the proposed rates were calculated based on the current statutory definition of "performance" and that any narrowing of the definition would require adjustments to the proposals. The second exclusion is not necessary because SoundExchange's witness, Mr. Bender, agreed that reconnections are not performances under the current regulations, which specify that a "performance" requires a listener.

The definition of performance in the regulations has long been established. The NAB and NRBNMLC argue that performances of very short duration are of no value to the listener or the service, and they point out that listeners cannot skip songs on their services. The Judges agree that performance as it has been defined continues to apply. The Judge do not adopt these changes.

Definition of Broadcast Retransmission. The NAB and iHeart propose a change in the definition of simulcast to cover anything that is at least 51% identical to its antecedent terrestrial broadcast. This proposal is a companion proposal to the NAB's proposal of separate royalty rates for simulcasters. The Judges decline to establish separate rates for simulcasters and do not, therefore, adopt this change.

Sound recording performance complement. iHeart proposes changes to the statutory definition of sound recording performance complement to reflect the practice in private agreements, IHM PFF ¶ 425. According to iHeart, because programs on terrestrial radio stations can play entire albums, iHeart should be allowed to simulcast the programs without altering them to satisfy the performance complement requirement, and the Judges have the authority to modify such "background terms of the statutory license" where willing buyers and sellers would negotiate such terms absent the statute. IHM COL ¶ 34-35. SoundExchange argues that statutory changes can only be made by Congress. The Judges agree. The Judges do not adopt this change.

Definition of "Broadcaster" to include "affiliate of". The NAB and NRBNMLC propose to change the definition of Broadcaster, but do not provide a reason for the change. The Judges do not adopt this change.

Completion of audit within six months. The NAB and NRBNMLC propose to add what they term a reasonable deadline for completion of audits because of the potential for abuse and the burden that lengthy audits place on Broadcasters. They point to comments in a rulemaking proceeding regarding the burden. SoundExchange argues that the length of an audit is in the control of the services more than of the auditor and that the NAB and NRBNMLC point to no such provisions in private agreements. The comments in the rulemaking procedure are not evidence in this proceeding. What is reasonable is the ultimate finding of fact. The parties submitted no evidence on what would be a reasonable time within which to complete an audit. The Judges do not adopt this proposal.

Third party programming. The NAB proposes a waiver of census reporting on any material that is transmitted by a simulcaster that is programmed by a third party, *i.e.*, not the station owner/operator whose broadcasts are retransmitted. The NAB proposes estimating ATH for third party programming because the stations are unable to get the necessary data from the program originators. SoundExchange argues that some broadcasters use a lot of third party material and that they should be required to get that data in order to make accurate reporting to SoundExchange. If broadcasters use third party programming, SoundExchange should not have to bear the risk of inaccurate reporting. In addition, the broadcaster is in the best position to incorporate costs of census reporting into their negotiated payments with the third-party programmers. The Judges do not adopt this change.

Waiver of small broadcasters' reporting requirement. NAB proposes that the regulation regarding distribution of royalties provide relief for small broadcasters from reporting requirements. NAB Proposed Terms at 6. This is an argument NAB makes in the pending rulemaking proceeding and does not make in this proceeding other than to add the language to its proposed terms. SoundExchange's response is lodged in that proceeding. *See* Docket No. 14-CRB-0005 (RM). The forum for that request is the rulemaking, not this proceeding. The Judges do not adopt this.

Exemption from report of use regulation for small stations. NRBNMLC proposes that "small broadcasters" not be required to file reports of use to the Collective if they elect to be treated as a small station. NRBNMLC Proposed Terms at 6 ("except that in the case of electing Small Broadcasters, the Collective shall distribute royalties based on proxy usage data…."). The proposed changes NRBNMLC makes to several parts of regulation 380 indicated that small broadcaster and small streaming stations and small stations mean the same thing. SoundExchange refers to the proposal as regarding an undefined category of services. Technically that is true because "small broadcasters" is not defined in NRBNMLC's proposal. Nevertheless, this is an issue that has been raised in the pending rulemaking regarding the provisions of 17 CFR 370. Because the issues in that rulemaking have not yet been resolved, it would be premature to make NRB's proposed change. The Judges do not adopt this change.

Minimum fee. The NAB proposes a revision to the minimum fee provision that removes fees for individual channels, leaving only fees for individual *stations*. SoundExchange argues that this is not necessary because of the annual cap on total amount of minimum fees that any licensee must pay; that fees would no longer be in proportion to SoundExchange's costs; and that stations would game the system by streaming on multiple channels in order to reduce fees. The NAB explains that its rate proposal and terms apply only to stations that simulcast, and that side channels would have different rates and terms. According to the NAB, this proposed change is a "conforming change" that presumably brings this term in line with the NAB's proposed rate for simulcasters. The Judges do not set a separate rate for simulcasters and do not adopt the proposed revision.

Waiver of requirement to destroy ephemeral recordings after six months. iHeart proposes to add a provision that exempts Broadcasters from the statutory six-month limitation on the retention of ephemeral recordings subject to certain conditions. The provision would "ensure[] that Broadcasters do not need to alter the content of their radio broadcasts simply because they have elected to simulcast those broadcasts over the Internet". IHM Rate and Terms Proposal at 2-3. SoundExchange argues that the Judges are not authorized to make changes to the statute by enacting regulations, and the Judges agree. The Judges cannot and do not adopt this proposal.

IX. Royalty Rates Determined by the Judges

A. Annual Rates and Price Level Adjustments

The Judges will set statutory rates for the year 2016. For the years 2017 through 2020, the rates shall be adjusted to reflect any inflation or deflation, as measured by changes in a particular Consumer Price Index (the CPI-U) announced by the Bureau of Labor Statistics (BLS), in November of the immediately preceding year, as described in the new regulations set forth in this determination. In this regard, the Judges concur with Dr. Shapiro, who testified that a regulatory provision requiring an annual price level adjustment is preferable to an implicit or explicit prediction of future inflation (or deflation). 5/19/15 Tr. 4608-10 (Shapiro).

The Judges shall also adjust any effective *benchmark rate* on which they rely in this proceeding to reflect inflation (or deflation) as measured by the CPI-U in the calendar years between the last calendar year in which the data was collected for the benchmark and 2016, as reflected in the applicable November announcement by the BLS.

B. Commercial Rates

1. Commercial Subscription Rates

Based on the analysis in this determination, the Judges shall set two separate rates for commercial noninteractive webcasting. One rate shall apply to performances on *subscription-based* commercial noninteractive services. A separate rate shall apply to performances on *nonsubscription (advertising-supported free-to-the-listener) services*.

The Judges have identified two usable benchmark rates for commercial noninteractive subscription services for 2016.

The first is the steering-adjusted rate derived from the benchmark developed by Dr. Rubinfeld on behalf of SoundExchange. Dr. Rubinfeld established a subscription-based benchmark rate of $0.002376. SX Ex. 59 (Rubinfeld CWDT Ex. 16(a); *see also* SX PFF ¶¶ 344; 393.

As noted in this determination, the Judges apply a steering adjustment to this benchmark rate to reflect the rate-reducing effect of steering as indicated in the Pandora/Merlin Agreement.[218] In the present case, the steering adjustment derived from the evidence is 12%, calculated as follows:

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[218] Dr. Shapiro's rate data covered a period through the third quarter of 2014. Shapiro WDT at 32.

(1) The unsteered subscription service rate for *2015* in the Pandora/Merlin Agreement is $0.[redacted]. *See* Pan Ex. 5014, ¶ 3(a)(ii).

(2) Pandora's effective rate at the [redacted]% (low end) of steering for *2016*, as derived by Dr. Shapiro, is $0.002238. *See* Shapiro WDT at 35.

(3) Dr. Shapiro's $0.002238 steered rate for 2016 includes a 2.2% *anticipated* inflation factor that the Judges do not apply. *See id.*

(4) Backing out that 2.2% inflation factor indicates a *2015* steered rate of $0.002189 (*i.e.*, $0.002238/1.022).

(5) Adjusting for the actual inflation in 2015 of 0.5% (announced by the BLS on December 15, 2015[219]) increases the above steered rate marginally to $0.002194, which the Judges round to $0.0022.

(6) The unsteered 2015 subscription service rate of $0.[redacted] (step 1) minus the steered rate of $0.0022 equals $0.0003.

(7) The percentage change in the subscription service rate for 2015 is 12% (*i.e.*, $0.0003/$0.[redacted]).

Accordingly, Dr. Rubinfeld's proposed benchmark rate of $0.002376 must be reduced by 12% to reflect an effectively competitive rate. A reduction of 12% brings that subscription service rate to $0.0021 (rounded).

However, Dr. Rubinfeld's data covered the period 2011 through 2014. As noted *supra*, the Judges reject Dr. Rubinfeld's linear $0.0008 year-over-year increase. Instead, the Judges apply the CPI-U inflation adjustment of 0.5% to reflect the inflation announced by the BLS on December 15, 2015. That adjustment raises the rate derived from Dr. Rubinfeld's proposed steering-adjusted benchmark marginally, to $0.0021105, which the Judges round to $0.0021.

The second steering-based subscription rate that the Judges credit is the rate in the Pandora/Merlin Agreement, which already incorporates a steering adjustment. That proposed benchmark rate (at 12.5% steering) is $0.002238, rounded to $0.0022. *See* Shapiro WDT at 35.

Thus (and perhaps not surprisingly), the steering and inflation-adjusted subscription rates under both proposed benchmarks establish an extremely tight zone of reasonableness, separated by only $0.0001.[220]

Based on the foregoing, the Judges determine, in their discretion, that the appropriate per-play rate for royalties paid by licensees to licensors in the noninteractive subscription market under section 114 for the year 2016 is $0.0022. As discussed *supra*, the rate for the remainder of

[219] *See* Bureau of Labor Statistics, Economic News Release (Dec. 15, 2015) (available at bls.gov).

[220] From an economic perspective, these rates suggest that a hypothetical willing seller would have a WTA of $0.0021 in this subscription market, and a hypothetical noninteractive service would have a WTP of $0.0022. In such a hypothetical market, the parties could consummate a contract at any price point between $0.0021 and $0.0022 per play.

the statutory term—2017- 2020—shall reflect the foregoing rate of $0.0022 per performance, as adjusted annually upward or downward to reflect changes in the CPI-U over the preceding year, pursuant to the applicable regulations.

2. Commercial Nonsubscription Rates

The Judges have identified two usable benchmark rates for commercial noninteractive nonsubscription services for 2016. First, the Judges have identified the adjusted, effective average per-play rate derived from the iHeart/Warner Agreement. That rate, as developed, *supra*, is $0.[redacted] per play.

Second, the Judges have identified the effective per-play rate in the Pandora/Merlin Agreement (with steering at [redacted]%) as a usable benchmark. The effective benchmark rate from that agreement is $0.[redacted].

Thus, the Judges identify a zone of reasonableness in this market segment as well. That is, the zone embraces a low effective rate of $0.[redacted] and high effective rate of $0.[redacted]. As noted earlier in this determination, it would be improper based on the present record, to set separate rates for Indies and Majors

However, as the Judges have also explained, *supra*, a fundamental difference between these two benchmarks is that the iHeart/Warner benchmark reflects an effective rate between a Major and a noninteractive service, whereas the Pandora/Merlin Agreement reflects an effective rate between Indies and a noninteractive service. The evidence at the hearing indicated that the Majors' sound recordings comprise 65% of noninteractive streams, and the Indies' sound recordings comprise 35% of noninteractive streams. *See*, *e.g.*, SX Ex. 269 at 73.

Based on the foregoing factors, the Judges find that the appropriate statutory rate within this zone of rates, for nonsubscription, ad supported (free-to-the-listener) services is $0.0017 per performance, as adjusted annually upward or downward to reflect changes in the Consumer Price Index over the preceding year, as set forth in the regulations.

3. Ephemeral Recording Rate

In accordance with the Judges' analysis *supra*, section VII, the royalty rate for ephemeral recordings under 17 U.S.C. § 112(e) applicable to commercial webcasters shall be included within, and constitute 5% of the royalties such webcasters pay for performances of sound recordings under section 114 of the Act.

B. The Noncommercial Rates

1. NPR-CPB/SoundExchange Settlement

The Judges have previously adopted the settlement agreement between SoundExchange, on one hand, and National Public Radio and the Corporation for Public Broadcasting, on the other, for simulcast transmissions by public radio stations. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule*, 80 Fed. Reg. 59588 (Oct. 2, 2015). The rates and terms governing transmissions and ephemeral recordings by the entities that are covered by that settlement agreement for the period 2016-2020 shall be as set forth in the agreement and codified at 37 C.F.R. §§ 380.30-380.37 (subpart D).

2. CBI/SoundExchange Settlement

The Judges have previously adopted the settlement agreement between SoundExchange, and College Broadcasters, Inc., for transmissions by Noncommercial Educational Webcasters (NEWs). *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule*, 80 Fed. Reg. 558201 (Sep. 28, 2015). The rates and terms governing transmissions and ephemeral recordings by NEWs for the period 2016-2020 shall be as set forth in the agreement and codified at 37 C.F.R. §§ 380.20-380.27 (subpart C).

3. All Other Noncommercial Webcasters

In accordance with the Judges' analysis *supra*, section V, the royalty rate for webcast transmissions by all other noncommercial webcasters during the 2016-2020 rate period shall be $500 annually for each station or channel for all webcast transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, for each year in the rate term. In addition, if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 ATH on any individual channel or station, the noncommercial webcaster shall pay per-performance royalty fees for the transmissions it makes on that channel or station in excess of 159,140 ATH at the rate of $0.0017 per performance, as adjusted annually upward or downward to reflect changes in the Consumer Price Index over the preceding year.

4. Ephemeral Recording Rate

The royalty rate for ephemeral recordings under 17 U.S.C. § 112(e) applicable to noncommercial webcasters shall be the same as the rate applicable to commercial webcasters; that is, royalties for ephemeral recordings shall be included within, and constitute 5% of the royalties such webcasters pay for performances of sound recordings under section 114 of the Act.

X. Conclusion

On the basis of the foregoing, the Judges propound the rates and terms described in this Determination. Unless the Judges alter or amend this Determination pursuant a timely filed Motion for Rehearing, this Determination shall be final on the date of publication.

ISSUE DATE: December 16, 2015.

Suzanne M. Barnett
Chief Copyright Royalty Judge

Jesse M. Feder
Copyright Royalty Judge

David R. Strickler
Copyright Royalty Judge

Exhibit A

Exhibit A, containing the regulatory language implementing the Judges' Determination, was released to the public on December 16, 2015. The most current version of Exhibit A can be found on the Copyright Royalty Board website at www.loc.gov/crb.