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

In the Matter of: **Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services**	**Docket No. 2011-1** **CRB PSS/Satellite II**

PROPOSED CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.

1. The purpose of this proceeding is to set statutory royalty rates and terms for transmissions of sound recordings, and related ephemeral recordings, by Preexisting Satellite Digital Audio Radio Services ("SDARS") and Preexisting Subscription Services ("PSS"). *See* 17 U.S.C. § 114(f)(1), 17 U.S.C. § 112(e) and 17 U.S.C. § 801(b)(1). The licenses apply to all sound recordings played on both "music" and "non-music" channels.

2. The Copyright Royalty Judges ("Judges" or "this Court") must set the rates and terms for the license period of January 1, 2013, through December 31, 2017. 17 U.S.C. § 803(b)(1)(A)(i)(V).

3. Pursuant to 17 U.S.C. § 803(a)(1), the Judges "shall act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress, the Register of Copyrights, copyright arbitration royalty panels (to the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights), and the Copyright Royalty Judges" to the extent those determinations are not inconsistent with a decision of the Register pursuant to Section 802(f)(1) or decisions of the court of appeals.

I. THE STATUTORY STANDARD

4. For the performances that are the subject of this proceeding, this Court must "determine reasonable rates and terms of royalty payments for subscription transmissions by preexisting subscription services and transmissions by preexisting satellite digital audio radio services." 17 U.S.C. § 114(f)(1)(A). These rates and terms must be calculated to achieve the statutory objectives set forth in 17 U.S.C. § 801(b)(1), and in establishing such rates and terms, the Court "may consider the rates and terms for comparable types of subscription digital audio

transmission services and comparable circumstances under voluntary license agreements" for subscription transmissions by the SDARS and PSS. 17 U.S.C. § 114(f)(1)(B); H.R. Rep. No. 105-796, at 85 (1998) (Conf. Rep.), *reprinted in* 1998 U.S.C.C.A.N. 639, 655-56.

5. The objectives set forth in § 801(b)(1) are as follows:

> (A) To maximize the availability of creative works to the public.
>
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
>
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
>
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

6. Under 17 U.S.C. § 112(e), a rate for making ephemeral copies is to be set in this proceeding as well. *SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220, 1225-26 (D.C. Cir. 2009). By the statute's terms, the rate for ephemeral copies is to be set pursuant to the willing buyer/willing seller standard. 17 U.S.C. § 112(e)(4); *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services* ("*SDARS I*"), 73 Fed. Reg. 4080, 4084 (Jan. 24, 2008). Here, the parties have stipulated that this Court should set royalty rates for PSS and SDARS that include the royalty payable for the Section 112 license bundled with the royalty payable for the Section 114 license. That is consistent with SoundExchange's proposed marketplace benchmarks, which include both performance and reproduction rights bundled together. The parties have also stipulated that the ephemeral royalty should constitute 5% of the total royalties payable under Sections 112 and 114. This Court has previously adopted combined Section 112/114 royalties with 5% attributable to the Section 112

license and 95% attributable to the Section 114 license. *See* 37 C.F.R. § 380.3 (webcasters), § 380.12 (broadcasters), § 380.22 (noncommercial webcasters), § 382.12 (SDARS), § 383.3 (new subscription services transmitting through video distributors). Such a structure is fully consistent with the Register's decision reviewing this Court's *SDARS I* determination, which required a percentage allocation between Section 112 and Section 114 royalties in the case of a combined royalty. *Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. 9143, 9145 (Feb. 19, 2008).

7. Congress first provided copyright protection for the performance of sound recordings in 1995. It did so with the goal of "address[ing] the concerns of record producers and performers regarding the effects that new digital technology and distribution systems might have on their core business." S. Rep. 104-128, at 13 (1995), *reprinted in* 1995 U.S.C.C.A.N. 356, 360. In addressing these concerns, Congress determined that "[j]ustice requires that performers and producers of sound recordings be accorded a public performance right." S. Rep. 104-128, at 13 (quoting the Register of Copyrights). Recognizing the critical role that the record industry plays in the creation of sound recordings and making those creative works available to the public, Congress determined that "in the absence of appropriate copyright protection in the digital environment, the creation of new sound recordings . . . could be discouraged, ultimately denying the public some of the potential benefits of the new digital transmission technologies." S. Rep. 104-128, at 14. Therefore, to more "effectively protect[]" recording artists and record companies, Congress granted copyright protection to the performance of sound recordings by the SDARS, PSS and other digital services. S. Rep. 104-128 at 14.

8. The resulting legislation – the Digital Performance Right in Sound Recordings Act of 1995 ("DPRA") – was thus a response to concerns "that certain types of subscription and

interactive audio services might adversely affect sales of sound recordings and *erode copyright owners' ability to control and be paid for use of their work*." S. Rep. 104-128 at 15 (emphasis added). Recognizing that these new "[s]ubscription and interactive audio services can provide multichannel offerings of various music formats in CD-quality recordings, commercial free and 24 hours a day," Congress concluded it was necessary "that copyright owners of sound recordings should enjoy protection with respect to" use of their intellectual property by such services. S. Rep. 104-128 at 15. Congress thus enacted the DPRA in order "to *protect the livelihoods* of the recording artists, songwriters, record companies, music publishers and others who depend upon revenues derived from traditional record sales." S. Rep. 104-128 at 14 (emphasis added). In light of the growing "commercial exploitation of new technologies in ways that may change the way prerecorded music is distributed to the consuming public," Congress created a performance right "to provide copyright holders of sound recordings with the ability to control the distribution of their product by digital transmissions." S. Rep. 104-128 at 15. At the same time, Congress created a compulsory license, requiring copyright owners to make their sound recordings available to new technologies making non-interactive transmissions – to prevent "hampering the arrival of new technologies" – while providing copyright protection to the sound recordings to ensure that record companies and recording artists were able to continue to earn adequate revenues. S. Rep. 104-128 at 14-15.

9. To alleviate the administrative burdens that digital distribution services would face if they had to negotiate separately with individual copyright owners, Congress created a statutory blanket license and permitted the new digital services to negotiate with one entity (or a limited number of entities) for the right to perform any copyrighted sound recording. 17 U.S.C. § 114(e). Although the statute permits and encourages the parties to negotiate a rate on a

voluntary basis, by providing for a license even absent a successful negotiation, and by authorizing the record industry to bargain collectively (and thereby to exercise more market power than in the markets in which the record companies bargain on an individual basis), Congress also concluded it was appropriate to authorize an adjudicatory body (at that time a Copyright Arbitration Royalty Panel) to set rates based on the terms ultimately set out in § 801(b)(1) of the Act.

10. In 1998, Congress further amended the copyright laws by passing the Digital Millennium Copyright Act ("DMCA")

> to achieve two purposes: first, to further a stated objective of Congress when it passed the [DPRA] *to ensure that recording artists and record companies will be protected as new technologies affect the ways in which their creative works are used*; and second, to create fair and efficient licensing mechanisms that address the complex issues facing copyright owners and copyright users as a result of the rapid growth of digital audio services.

H.R. Conf. Rep. 105-796 at 79-80 (emphasis added). In amending the DPRA, Congress left intact the *conditions* that applied to the SDARS and the PSS under the DPRA – primarily the "five conditions for eligibility for a statutory license" – because this handful of companies had commenced operations or were in the process of developing their systems. H.R. Conf. Rep. 105-796 at 81. Thus, Congress "grandfathered" the eligibility conditions that applied to the PSS and the SDARS, as well as the statutory standard applicable to setting the royalty rates for these services.

11. Thus, the overriding purpose of the DPRA and the DMCA was and continues to be "to protect the livelihoods" of record companies and recording artist copyright owners and to ensure that their copyrighted works receive adequate protection in this age of rapid technological development and transition to digital transmission of sound recordings so that the record

companies and artists continue to produce creative works for dissemination to and enjoyment by the public.

II. THE APPROPRIATE METHOD TO BE USED IN SETTING A RATE UNDER SECTION 801(B)(1)

12. The first step in determining an appropriate rate under Section 801(b)(1) is to look at voluntary transactions in comparable markets – *i.e.*, marketplace benchmarks – making appropriate adjustments to account for differences between the benchmark and target markets to best reproduce a rate that would represent a hypothetical marketplace transactions between a willing SDARS or PSS buyer and a willing record company seller. *See Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding ("Mechanicals II")*, 74 Fed. Reg. 4510, 4517 (Jan. 26, 2009); *SDARS I*, 73 Fed. Reg. at 4084, 4088; *SoundExchange v. Librarian*, 571 F.3d at 1222; *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings* ("*PSS I*"), 63 Fed. Reg. 25394, 25399, 25404 (May 8, 1998).

13. Anchoring statutory rates determined under Section 801(b)(1) in voluntarily negotiated market transactions has been a fundamental principle of copyright rate setting since the first proceeding before this Court's predecessor the Copyright Royalty Tribunal. *See Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players* ("*Jukeboxes*"), 46 Fed. Reg. 884, 889 (Jan. 5, 1981) (analyzing marketplace benchmark rate and finding no need to adjust the market rate to achieve the objectives in § 801(b)(1)(A)); *Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144, 1148 (7th Cir. 1982) (approving tribunal's decision under § 801(b)(1) to "rely[] primarily on marketplace analogies").

14. After determining appropriate marketplace benchmarks (using the criteria discussed in the immediately following section, *infra* Section III), the next step in calculating reasonable rates pursuant to § 801(b)(1) is to "measure the rate or rates yielded by that process

against the statutory objectives to reach [the Court's] decision." *SDARS I*, 73 Fed. Reg. at 4084; *accord PSS I*, 63 Fed. Reg. at 25399, 25404. This is not a "beauty pageant where each factor is a stage of competition to be evaluated individually to determine the stage winner and the results aggregated to determine an overall winner." *SDARS I*, 73 Fed. Reg. at 4094. Instead, "the issue at hand is whether these policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence." *SDARS I*, 73 Fed. Reg. at 4094; *see also Mechanicals II*, 74 Fed. Reg. at 4523. Thus, the Judges review "the other evidence in the record offered with respect to the four policy considerations" to determine if the result of the benchmark analysis "requires any adjustment." *SDARS I*, 73 Fed. Reg. at 4094. The D.C. Circuit has approved this basic approach. *SoundExchange v. Librarian*, 571 F.3d at 1222-24.

15. Consideration of the Section 801(b)(1) objectives warrants an adjustment only when a "relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment." *SDARS I*, 73 Fed. Reg. at 4094-95. Where a marketplace benchmark adequately addresses the statutory objectives, adjustments to that benchmark are unnecessary. *See, e.g.*, *Mechanicals II*, 74 Fed. Reg. 4523 ("available evidence . . . related to these policy objectives does not reasonably weigh in favor of any further adjustments"); *SDARS I*, 73 Fed. Reg. at 4094 (finding that the record does not support any adjustment for the first objective); *Jukeboxes*, 46 Fed. Reg. at 889 (same).

III. SELECTING AN APPROPRIATE BENCHMARK UNDER SECTION 801(b)(1)

16. An appropriate benchmark for use in setting a rate under 801(b)(1) should "reflect accurately the characteristics and dynamics of the industries subject to the proposed rate." *PSS I*, 63 Fed. Reg. at 25404 n.24; *see also Mechanicals II*, 74 Fed. Reg. at 4519 ("the essence of a benchmark analysis" is "reasonably reflect[ing] market conditions today for comparable

products"). "Potential benchmarks are confined to a zone of reasonableness that excludes clearly noncomparable marketplace situations." *Mechanicals II,* 74 Fed. Reg. at 4519; *SDARS I*, 73 Fed. Reg. at 4088. Where there are "substantial differences" between a proposed benchmark market and the hypothetical market "so as to make them poor comparators," the proposed benchmark should be rejected. *SDARS I*, 73 Fed. Reg. at 4089.

17. It is sometimes possible to make adjustments to account for differences between the proposed benchmark market and the hypothetical market, and thereby make useful a proposed benchmark that otherwise would have to be rejected. The closer a marketplace benchmark is to the target market, the fewer adjustments that need to be made for the benchmark to "reflect accurately the characteristics and dynamics of the industries subject to the proposed rate." *PSS I*, 63 Fed. Reg. at 25404 n.24. For a proposed adjustment to be proper, it must be supported by the evidence, and within the limits of reasonable estimation, account for key differences between the proposed benchmark market and the target market so as to resolve the lack of comparability. *See SDARS I*, 73 Fed. Reg. at 4089, 4093.

18. An appropriate benchmark must be sufficiently transparent and reflective of market dynamics that it provides useful information on the equilibrium struck in the marketplace that is reflected in the benchmark rate. When there is an imbalance in the sophistication, resources and/or market power between buyers and sellers in the proposed benchmark market, the result may be rates outside the reasonable range. *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings ("Webcasting I")*, 67 Fed. Reg. 45,240, 45,245 (July 8, 2002).

19. The benchmarks proposed by SoundExchange in this proceeding satisfy these requirements. In *SDARS I*, this Court accepted a benchmark that was similarly based on interactive subscription services*:*

> we find Dr. Ordover's second category of proffered benchmarks—certain channels for the distribution of digital music—more useful. In particular, the interactive subscription market is a benchmark with characteristics reasonably comparable to the non-interactive SDARS, particularly after Dr. Ordover's reasonable adjustment for the difference in interactivity. Both markets have similar sellers and a similar set of rights to be licensed. While the buyers may be different entities, there is no persuasive evidence that the buyers in the target market have less relative market power than the buyers in the benchmark market. Both markets are input markets and demand for these inputs is driven by or derived from the ultimate consumer markets in which these inputs are put to use. In these ultimate consumer markets, music is delivered to consumers in a similar fashion and consumers pay a monthly subscription fee for access irrespective of the hours of programming accessed. However, in the interactive case, the choice of music actually delivered is usually influenced by the ultimate consumer, while in the non-interactive case of the SDARS the consumer usually plays a more passive role limited to selecting a particular channel of music programming. But this difference is reasonably accounted for in Dr. Ordover's interactivity adjusted per subscriber rates.

SDARS I, 73 Fed. Reg. at 4093.

20. By contrast, the benchmarks proposed by Sirius XM must be rejected as a matter of law. Voluntary agreements negotiated in the shadow of a compulsory license – including both the Last.fm agreements and the direct licenses advances by Sirius XM – are not good benchmarks, because the compulsory license distorts the marketplace around it. When rights are subject to a compulsory license, the buyers of those rights have no incentive to agree to rates higher than the statutory rate. The statutory rate functions as a cap. *See Mechanicals II*, 74 Fed. Reg. at 4520 (noting that voluntary mechanical licenses proffered as benchmark were negotiated in environment in which the statutory rate assertedly functions as a "ceiling"); *Noncommercial Educational Broadcasting Compulsory License*, 63 Fed. Reg. 49823, 49834 (Sept. 18, 1998) ("it

is difficult to understand how a license negotiated under the constraints of a compulsory license, where the licensor has no choice but to license, could truly reflect 'fair market value.'"). Even where there is uncertainty concerning statutory rates for a future period, "serious negotiations" will be "impeded" because licensees know that they can wait for the statutory rate determination. *Webcasting I*, 67 Fed. Reg. at 45,245.

21. Differences in bargaining power also can be magnified when proposed benchmark agreements are negotiated in the shadow of a compulsory license. *Webcasting I*, 67 Fed. Reg. at 45,245. Thus, this Court's predecessors have held that negotiated rates for the rights covered by the statutory license "could only [be] consider[ed]" if contained in an agreement between parties with "comparable resources and bargaining power." *Id*.

22. In its pursuit of direct licenses, Sirius XM followed precisely the converse of the strategy that RIAA was found to have pursued in *Webcasting I*. There, RIAA proposed as benchmarks 26 voluntary agreements with webcasters covering the same rights as the statutory license. 67 Fed. Reg. at 45,241. The Panel rejected 25 of the 26 as benchmarks. *Id.* at 45,248. The Panel's rejection of these agreements as benchmarks was grounded in the following findings:

- "Before negotiating its first agreement, RIAA developed a strategy to negotiate deals for the purpose of establishing a high benchmark for later use as precedent, in the event a CARP proceeding were necessary. The RIAA Negotiating Committee reached a determination as to what it viewed as the 'sweet spot' for the Section 114(f)(2) royalty, both on a percent-of-revenue basis and per-performance basis. It then proceeded to close only those deals (with the exception of Yahoo!) that would be in substantial conformity with that 'sweet spot.'" Report of the Copyright Arbitration Royalty Panel in Docket No. 2000-9 ("*Webcasting I Panel Decision*"), at 48 (Feb. 20, 2002), *available at* http://www.copyright.gov/carp/webcasting_rates.pdf.

- "[I]n the statutory marketplace, one would expect to find some buyers – for various reasons – that are willing to pay higher rates for a product than most other buyers pay. But, if a seller is in a position to *temporarily* sacrifice volume, it can afford to negotiate deals only with those buyers willing to pay above-market rates. By

engaging in this conduct, the Panel finds, RIAA created a virtually uniform precedent with rates above those that most buyers would be willing to pay." *Id.* at 50.

- "RIAA devoted extraordinary efforts and incurred substantial transactional costs to negotiate successfully a relatively small number (26 agreements out of hundreds of services) of license agreements with mostly minor services – services that promised very little actual payment of royalties." Such sacrificial conduct makes economic sense only if calculated to set a high benchmark to be later imposed upon the much larger constellation of services." *Id.* at 50-51 (citations omitted).

- "RIAA reached agreement with only 26 of the 60 services with which it had 'meaningful discussions.' And RIAA offered virtually no evidence to explain why the majority of these services did not conclude an agreement. In the absence of alternative explanations, the Panel infers that this majority of buyers was simply unwilling to agree to the rates RIAA was seeking. Indeed, had RIAA *not* pursued this negotiating strategy, we would have expected to see a much broader range of negotiated rates. The tight range of rates among the 25 non-Yahoo! agreements suggests a take-it-or-leave-it approach." *Id.* at 51 (citations omitted).

- "Because RIAA was apparently able to close deals at its 'sweet spot' with only a minority of licensees, the Panel finds that these non-Yahoo! agreements do not establish a reliable benchmark." *Id.*

23. Sirius XM's direct licenses here are the product of the same kind of strategy that the *Webcasting I* Panel found RIAA to have pursued. Sirius XM adopted a strategy to negotiate direct licenses to produce a benchmark for use in this proceeding. At the outset it identified the "sweet spot" range of rates at which it was prepared to conclude deals. It then devoted considerable effort and expense to the pursuit of agreements with relatively small number of copyright owners controlling a small part of its playlist. In these negotiations, it adopted a "take-it-or-leave-it approach." Because its offers were not viewed as a good deal, the vast majority of labels turned down Sirius XM's offers. Sirius XM ultimately was able to conclude agreements with only a small number of those labels that were prepared to accept the low rates in Sirius XM's sweet spot. These agreements account for only a tiny part of its playlist and royalty obligations. *See* SoundExchange's Proposed Findings of Fact ("SoundExchange PFOF") at VI.

Just as RIAA's proposed *Webcasting I* direct licenses were rejected as unreliable, so too are Sirius XM's direct licenses inherently unreliable.

24. The musical works benchmark proposed by the PSS also must be rejected. It is clear that the rate paid by a service for musical works is not a reasonable benchmark from which to begin analysis of an appropriate rate for sound recordings here. That benchmark has been employed only once, in the first proceeding to set PSS rates, when the digital performance right and digital music services were so new that there was no relevant marketplace evidence of the relative valuation of sound recording and musical work performances, and all the other potential benchmarks proffered by the parties had been rejected. Even then, the Register was clear that the musical works benchmark is not "determinative of the marketplace value of the performance right in sound recordings." *PSS I*, 63 Fed. Reg. at 25,404. Indeed, the most the Register could say about the musical works benchmark was that "there was insufficient evidence to determine that the performers and record companies deserve a larger percentage from the Services than that received by the copyright holders in the musical works." *PSS I*, 63 Fed. Reg. at 25,405.

25. The marketplace subsequently provided ample evidence of the kind found lacking in *PSS I*. Since that time, no other proposed benchmark has been so thoroughly or frequently discredited and rejected as the musical works benchmark:

- In *Webcasting I*, the Copyright Office noted that in *PSS I*, "the outcome might have been different" if there had been evidence to support the conclusion that "the value of sound recordings exceeds the value of musical works." *Webcasting I*, 67 Fed. Reg. at 45,247. It emphasized that in *PSS I*, "the only reason the Register and Librarian focused on the musical works benchmark was because it was the only evidence that remained probative after an analysis of the Panel's decision." *Id*. Because the record

included evidence of negotiated agreements involving sound recordings, the Panel rejected the musical works benchmark, and the Register and Librarian agreed. *Id*.

- In *Digital Performance Right in Sound Recordings and Ephemeral Recordings ("Webcasting II")*, 72 Fed. Reg. 24,084 (May 1, 2007), this Court found the musical works benchmark "fatally flawed," *id.* at 24,094, and "not useful," *id.* at 24,095. This Court cited several reasons for this conclusion: (1) "the sellers are different and they are selling different rights"; (2) the "substantially greater investment . . . in sound recordings as compared to musical works"; and (3) "substantial empirical evidence shows that sound recordings are paid multiple times the amounts paid for musical works." 72 Fed. Reg. at 24,094.
- The musical works benchmark was again proposed in *SDARS I*. This Court found the proposed benchmark "similarly flawed," *SDARS I*, 73 Fed. Reg. at 4089, and again pronounced it "not useful," *id.* at 4090. The Court concluded that "a reasonable rate for sound recordings could *not* be as low as the musical works rate." *Id.*
- Most recently, a webcaster asked this Court to provide an aggregator discount purportedly based on musical works analogies. This Court rejected that proposal, again noting differences between the sound recording and musical work markets. *Digital Performance Right in Sound Recordings and Ephemeral Recordings ("Webcasting III")*, 76 Fed. Reg. 13,026, 13,037-38 (Mar. 9, 2011).

The musicals work benchmark simply cannot be the starting point for a valid analysis under the applicable rate standard.

IV. APPLICATION OF THE § 801(b)(1) STATUTORY OBJECTIVES

26. Once the Court has established the appropriate benchmark rates or range of rates from which to set a reasonable royalty, it must then "evaluate" that rate to ensure that it achieves the statutory objectives set forth in § 801(b)(1). *See, e.g.*, *Jukeboxes*, 46 Fed. Reg. at 889; *PSS I*, 63 Fed. Reg. at 25,399, 25,404. In doing so, the question is whether "these policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence" such that the result of the benchmark analysis "requires any adjustment." *SDARS I*, 73 Fed. Reg. at 4094; *see also Mechanicals II*, 74 Fed. Reg. at 4523.

27. As discussed below, the first three statutory objectives promote policies that are generally advanced through market transactions. That is, an effective market will tend to set prices that appropriately maximize the availability of creative works, provide a fair return and a fair income to the parties involved, and reflect the relative roles of the parties. Thus, there will not tend to be a difference between a proper benchmark market and the hypothetical target market as to these objectives that would necessitate an adjustment to the benchmark rate.

28. Here, as discussed in SoundExchange's Proposed Findings of Fact and below, SoundExchange's marketplace benchmarks sufficiently achieve the statutory objectives set forth in Section 801(b)(1), and none of the objectives requires adjustments to these benchmarks.

A. Section 801(b)(1)(A): Maximizing Availability of Creative Works

29. Section 801(b)(1)(A) seeks to "maximize the availability of creative works to the public." This objective reflects the purpose of copyright, which is to advance public welfare by providing economic incentives to the creation of new works. *See, e.g.*, *Mechanicals I*, 46 Fed. Reg. at 10,479 (the first objective is to provide "an economic incentive and the prospect of pecuniary reward" for the copyright owner's "creative efforts"). As the Supreme Court has recognized – and the Librarian has affirmed – the goal of maximizing the availability of creative

works "is achieved by allowing the copyright owners to receive a fair return for their labors." *Twentieth Century Music v. Aiken*, 422 U.S. 151, 156 (1975) ("The immediate effect of our copyright law is to secure a fair return from an author's creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good."); *PES I*, 63 Fed. Reg. at 25,406. Ensuring additional income for existing works also helps "to finance the production and publication of new works." *Eldred*, 537 U.S. at 207 & n. 15 (quoting testimony of Marybeth Peters, Register of Copyrights).

30. Although the SDARS and PSS are just two of many ways that the public is able to avail itself of creative works, this objective is nonetheless important. The continued availability of creative works to the public requires that each class of user contribute "incrementally" more revenue to copyright owners and performers. *Jukeboxes*, 46 Fed. Reg. at 889; *PSS I*, 63 Fed. Reg. at 25,406.

31. The proper degree of contribution from a class of service to the creation of new works is fully addressed by a benchmark reflecting a properly-functioning market:

> We agree with Dr. Ordover that "voluntary transactions between buyers and sellers as mediated by the market are the most effective way to implement efficient allocations of societal resources." An effective market assures absence of both below-market prices and supracompetitive prices, so that suppliers will not reduce output and innovation in response to the former and consumers will not experience a reduction in consumer welfare in response to the latter. In other words, an effective market determines the maximum amount of product availability consistent with the efficient use of resources.

SDARS I, 73 Fed. Reg. at 4094.

32. This Court and its predecessors have repeatedly rejected claims that those who use and disseminate copyrighted works are entitled to a below-market rate based on this objective. In *Mechanicals II*, this Court rejected the idea "that simply lowering the . . . rates . . .

will necessarily increase the public's access to . . . creative works." 74 Fed. Reg. at 4524. Likewise, in *Mechanicals I*, the Copyright Royalty Tribunal rejected arguments that § 801(b)(1)(A) benefited those who use copyrights, finding instead that this objective focused on encouraging the creation and dissemination of copyrighted works and such encouragement "takes the form of an economic incentive" for the copyright owners. 46 Fed. Reg. at 10,479; *see also PSS I*, 63 Fed. Reg. at 25,407 ("the record companies and the performers make the greater contribution in maximizing the availability of the creative works to the public").

33. In *SDARS I*, the services argued that they should "win" this objective based in part on the "promotional effect of their airplay." 73 Fed. Reg. at 4094. This Court properly found there to be no difference between the interactive services benchmark market and the SDARS market that would warrant an adjustment to the interactive services benchmark rate. *SDARS I*, 73 Fed. Reg. at 4094-95.

34. However, this Court erred in *SDARS I* to the extent it suggested that promotion itself might be a valid consideration under the first objective. The issue addressed by the first objective is instead the creation of new works. In *PSS I*, the Librarian reversed the decision of the CARP on this very point. There, the Panel relied upon considerations of promotion in finding that this objective counseled a rate on the low side. The Register found this arbitrary, because the Panel departed from prior constructions of this objective with "no record evidence to support a conclusion that the existence of the digital transmission services stimulates the creative process." *PSS I*, 63 Fed. Reg. at 25,406. Thus, promotion would only be relevant to this objective and counsel an adjustment to a marketplace benchmark if it could be shown that (1) there is a linkage between any purported promotional effects and "the creation of additional works" *see id.*, and (2) there are differences between the benchmark market and the hypothetical

target market such that adopting the benchmark rate in the target market would not equally result in the creation of additional works.

35. For these reasons, achievement of the objective set forth in § 801(b)(1)(A) – maximizing the availability of creative works to the public – requires a rate fully at the level indicated by marketplace benchmarks and does not require any downward adjustment of a benchmark market rate.

B. Section 801(b)(1)(B): Affording the Copyright Owner a Fair Return and the Copyright User a Fair Income

36. The second statutory objective requires the Court to adopt a rate that results in a fair return for the copyright owner and a fair income for the copyright user. This Court and its predecessors have consistently held that fairness to both parties under this provision is best accomplished by replicating to the greatest extent possible the returns that would exist in workably competitive markets, where producers and distributors are rewarded for their risks and for the value of what they bring to the market. *See, e.g.*, *SDARS I*, 73 Fed. Reg. at 4095 ("a fair income is more consistent with reasonable market outcomes"); *PSS I*, 63 Fed. Reg. at 25409 ("[u]sually this balance is struck in the marketplace through arms-length negotiations"; recommended rate based on consideration of "proposed marketplace benchmarks" achieves second objective); *Mechanicals I*, 46 Fed. Reg. at 10479 ("in most instances, the rate of return afforded the copyright owner is determined on the free market.").

37. This Court's *SDARS I* decision provides significant guidance concerning what is, and what is not, comprehended by this objective:

- The kind of circumstance that might warrant an adjustment to a marketplace benchmark to achieve this objective is "substantial evidence of the exercise of unfair

market power in the setting of prices in the benchmark marketplace." *SDARS I*, 73 Fed. Reg. at 4095.

- "Affording copyright users a fair income is not the same thing as guaranteeing them a profit in excess of the fair expectations of a highly leveraged enterprise. Nor is a fair income one which allows the [service] to utilize its other resources inefficiently." *Id.*
- "[C]oncerns with respect to meeting their cash flow and income goals sooner rather than later . . . are more properly raised . . . in the context of the fourth policy objective . . . ." *Id.*

38. That copyright owners and performers are also compensated by other uses of their works provides no basis for reducing the return here. Thus, the CRT has held that the fact that copyright owners receive most of their revenues from the sale of sound recordings provides no basis for denying them a return consistent with the marketplace under the second statutory objective. *Jukeboxes*, 46 Fed. Reg. at 889.

C. Section 801(b)(1)(C): To Reflect the Relative Roles of the Copyright Owner and the Copyright User With Respect To Contributions, Investments, Costs, and Risks

39. The third statutory objective, § 801(b)(1)(C), seeks to "reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication." This objective, also, is one that "marketplace evidence, standing alone" can address. *Amusement & Music Operators*, 676 F.2d at 1157; *see also Mechanicals II*, 74 Fed. Reg. at 4525 (making no adjustment based on this objective).

40. A nearly identical statutory provision is part of the "willing buyer/willing seller" standard governing rates paid by webcasters for the use of sound recordings. *Compare*

§ 801(b)(1)(C) *with* 17 U.S.C. § 114(f)(2)(B)(ii). Specifically, section 114(f)(2)(B)(ii) states that the Court should consider "the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk." In analyzing these § 114(f)(2)(B)(ii) objectives in the webcasting market, this Court has twice concluded "that such considerations have already been factored into the negotiated price in the benchmark agreements." *Webcasting III*, 76 Fed. Reg. at 13,036; *accord Webcasting II*, 72 Fed. Reg. at 24,092, 24,095; *see also Webcasting I*, 67 Fed. Reg. at 45,244.

41. With respect to the various subfactors that make up the third statutory objective, prior decisions provide a number of insights. First, the claimed creative contribution of services is limited to music channels, and there, the creative contribution of a service "is certainly subsidiary to and dependant on the creative contributions of the record companies and artists to the making of the sound recordings that are the primary focus of those music channels." *SDARS I*, 73 Fed. Reg. at 4096; *see also PSS I*, 63 Fed. Reg. at 25,407 (Panel "credited the performers and the record companies for their work in making the musical work come alive"; service "contribution was seen as more limited, since it merely enhanced the presentation of the final work").

42. Second, "record companies undertake 'significant and irreversible investments to develop talent and produce new works and in order to maximize their incentives to do so, it is important to receive from each distribution channel revenues that reflect the value of their contributions.'" *SDARS I*, 73 Fed. Reg. at 4096 (quoting testimony of Dr. Ordover).

43. Third, digital music services are generally similar enough to each other with respect to technological contributions, capital investment, cost, risk and the opening of new

markets that differences in the relative contributions of different types of services do not generally compel adjustment of a benchmark based on the third objective. *See SDARS I*, 73 Fed. Reg. at 4096 ("there is little to distinguish their relative contribution in this market from those of other digital music distributors in their markets"). Among other things, music services are not generally innovators of basic technologies, but merely users of technologies developed by third parties, and cannot claim credit for the technological contributions of others. *SDARS I*, 73 Fed. Reg. at 4096 ("the SDARS' claimed technological contributions take credit for not only their own efforts but also for the substantial technological contributions of others").

44. Fourth, in *SDARS I*, the one type of expenditure incurred by the SDARS that may have distinguished them from other digital music distributors with respect to this objective was their expenditure for satellites. However, this Court also recognized countervailing considerations that may have made the SDARS' satellite expenditures more analogous to the capital investment of other digital music services. In particular, "[t]his type of investment spending has a useful life that typically extends beyond the limited period of a single licensing period as currently defined by statute; therefore, all of the costs of spending on this technology cannot properly be ascribed to a single licensing period." *SDARS I*, 73 Fed. Reg. at 4096-97. Likewise, "such technology may have a recoverable asset value even if the SDARS that made the investment ceases to operate." Ultimately, this Court was persuaded that "new satellite investment, unlike other costs, cannot be postponed without a serious threat of disruption to the service the SDARS provide," and hence that this particular question should be considered in the context of the fourth objective, rather than the third. 73 Fed. Reg. at 4097.

45. Fifth, the trends that each industry is facing in the marketplace are relevant to analyzing this objective, although only to the extent these trends are different from the

benchmark marketplace. In the *PSS I* Proceeding, the CARP and the Librarian found it relevant that the business model of the PSS was undergoing change as they were no longer able to sell their service as they had previously (as subscriptions), whereas the record companies had seen sales and revenues regularly increasing over a decade. *PSS I*, 63 Fed. Reg. at 25,407. Here, the opposite is true. The record companies are seeing their business model change radically and have faced a long decline in sales and revenues, while at the same time the SDARS are seeing their revenues and subscribership increase dramatically. *See* SoundExchange PFOF Section VIII.C. The question here, as always, "is whether these policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence." *SDARS I*, 73 Fed. Reg. at 4094. Because these services are generally doing comparably well to other digital music services, the only adjustment that may be warranted is an increase.

46. Finally, the services have made much of perceived competition they face. However, neither this Court nor its predecessors have found legitimate competition faced by individual companies in a proceeding to be "risk" (or anything else) relevant to the third objective. The companies participating in rate proceedings always have competitors – generally among the other participants in the proceeding. There is no indication that Congress intended the third objective to insulate copyright users from competition. And it would be impossible for this objective to insulate copyright users from competition, since all the users in a proceeding typically compete with each other – and would continue to do so regardless of what rate was set for all of them. Moreover, the services constituting the benchmark market all compete with each other. Thus, there is nothing about the competitive environment faced by the PSS and SDARS that warrants an adjustment to the marketplace benchmarks.

47. In sum, because the statutory objectives of the third objective "'would have already been factored into the negotiated price' in the benchmark agreements," *Webcasting II*, 72 Fed. Reg. at 24092, further adjustment of these benchmark rates would double-count for these objectives and is therefore both inappropriate and unnecessary. And in any event, an evaluation of the benchmark market rates in light of the statutory objective set forth in § 801(b)(1)(C) reveals that little, if any, adjustment to these benchmark rates is required, considering the greater contributions, risks, and investments incurred by the record companies as compared to the SDARS. *See* SoundExchange PFOF Section VIII.B.

D. Section 801(b)(1)(D): Minimize Any Disruptive Impact on the Structure of the Industries

48. The fourth statutory objective seeks to "minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices." § 801(b)(1)(D). This is the one statutory objective that "marketplace evidence, standing alone, does not address." *Amusement & Music Operators*, 676 F.2d at 1157. However, this objective functions only to blunt the transition to new rates indicated by marketplace benchmarks as adjusted with reference to the other three objectives. This objective emphatically does not require maintaining non-market rates in the long term. *See Jukeboxes*, 46 Fed. Reg. at 889 (holding that the fact that jukebox industry "pays reasonable market prices for all other goods and services they require" demonstrates that a market rate is not disruptive).

49. This Court has adopted a very specific standard of what constitutes disruption under the fourth objective: a rate change can be disruptive "if it directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for [the parties impacted by the rate] to adequately adapt to the changed circumstances produced by the rate change and, as a consequence, such adverse impacts threaten the viability of

the music delivery service currently offered to consumers under this license." *Mechanicals II*, 74 Fed. Reg. at 4525 (quoting *SDARS I*, 73 Fed. Reg. at 4097) (bracketed change in *Mechanicals II* decision).

50. This standard requires a very high level of adverse impact, not just on individual companies but on the "industries involved," 17 U.S.C. § 801(b)(1)(D), before a rate indicated by the first three objectives will be limited based on the fourth objective. For a limit to be imposed by operation of this objective, the adverse impact of a rate change not only must be "substantial," but the consequences of moving to the rate indicated by the other three objectives must be so severe that the rate would "threaten the viability of the music service currently offered to consumers under this license." *SDARS I*, 73 Fed. Reg. at 4097. Put another way, the rate change would have to "cause the [service] to cease operating or dramatically change the nature of its product." *Id*.

51. It is clear that the substantiality component of this Court's disruption standard requires much more than a mere change in the rates. Thus, this Court has agreed that "'simply causing an increase in costs to the Services or a decline in royalties to the record companies' is not substantial enough to qualify as a disruptive impact." *Id*. (quoting Dr. Herscovici); *see also Mechanicals I*, 46 Fed. Reg. at 10486 ("[t]he fact that an increase in the rate will increase costs is not per se an argument against raising the rate" under § 801(b)(1)(D)); *id.* at 10,481 ("[w]e reject the contention that any immediate increase in the mechanical royalty payable to copyright owners, would be disruptive on the record industry"). In *SDARS I*, a one-year increase in the rate paid from between 2% and 2.5% to 6% (an increase of over 3.5% and a near-trebling of the rate) was found sufficiently to avoid disruption, and so not to have a "substantial" adverse impact based on the record of that case.

52. Section 801(b)(1)(D) requires that substantiality be assessed not at the level of individual companies, but at the industry level. The objective is not to coddle particular companies, but to "minimize disruptive impact on the *structure of the industries* involved." 17 U.S.C. § 801(b)(1)(D) (emphasis added). An "industry" is "[a] particular form or branch of productive labor; an aggregate of enterprises employing similar production and marketing facilities to produce items having markedly similar characteristics." Black's law Dictionary 845 (9th ed. 2009); *see also Brune v. Morse*, 339 F. Supp. 159, 161-62 (E.D. Mo. 1972) (distinguishing industries based on goods and services provided and whether they are a "distinct branch of trade"); *Dessen v. Dep't of labor and Industs. of Wa.*, 66 P.2d 867, 869 (Wa. 1937) (it would be "illogical and unjust" to view operators with certain differences in their businesses as not in the same industry when both are in "a distinct branch of business"). An "industry" is clearly more than one company (like Sirius XM) and a different concept than technology platform (like satellite) or regulatory classification (like SDARS or PSS). An industry is much more like the analogous antitrust concept of a "market." *See, e.g.,* U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines § 4 (Aug. 19, 2010) (defining market based on demand substitution factors), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.html.

53. It is not necessary to define the relevant industries with precision to understand that the PSS' deliveries of music to television sets are part of the same industry with the new subscription services subject to 37 C.F.R. Part 383. Their services are functionally the same, and are marketed and delivered through the same kinds of distributors (cable and satellite television operators). That a couple of companies in the industry were in business before July 31, 1998 and are therefore entitled to have the statutory royalty rate for their sound recording inputs

determined in a separate proceeding, *see* 17 U.S.C. § 114(j)(11), does not make them any less part of the same "industry" with later entrants providing the same service. To the extent that the SDARS compete with Internet radio, that would likewise suggest that the SDARS and Internet radio are part of the same industry. *See Webcasting III*, 76 Fed. Reg. at 13,035 (commercial broadcasters and other commercial webcasters part of the same market segment, while certain noncommercial webcasters are part of a distinct market segment); *Webcasting II*, 72 Fed. Reg. at 24, 095, 24,097 (same).

54. Viewed at the industry level, the PSS' and SDARS' claims of disruption are overstated. Increasing the royalty rates paid by industry participants who have paid less than their competitors to a level more consistent with their competitors cannot be said to have a substantial adverse impact on the structure of the industry in which they all participate. Rather, it would remove interference in the industry and distortion of the marketplace by the regulatory structure of the statutory license. *See Jukeboxes*, 46 Fed. Reg. at 889 ("failure of this Tribunal to establish a reasonable fee for jukebox performance could interfere with performing rights societies receiving reasonable fees from similar users of music, whose rates are not established in accordance with statutory provisions"). It is only to the extent that a higher rate increase is indicated by the other objectives that the possibility of disruption to the structure of the industry might arise.

55. This court's standard for disruption also incorporates an element of timing that highlights the purely transitional nature of this objective. A rate change is only cognizable as disruption under this objective if would have an adverse impact that is "immediate and irreversible in the short-run." *SDARS I*, 73 Fed. Reg. at 4097. The standard assumes that, given a reasonable time, the parties must adapt to rates that are indicated by marketplace benchmarks

as adjusted with reference to the other three objectives. For that reason, this Court and its predecessors have addressed this objective by providing a "phasing-in approach to fee increases" that "'adequately reflect[s]' concern for the impact of the change on all parties involved" under the fourth statutory objective. *Amusement and Music Operators*, 676 F.2d at 1148; *see also SDARS I*, 73 Fed. Reg. at 4097-98; *Jukeboxes*, 46 Fed. Reg. at 889.

56. Read together, the substantiality and timing components of this Court's disruption standard command that the implementation of a rate change necessitated by reference to the other three objectives occur as quickly as possible consistent with avoiding adverse impacts that threaten the viability of the industries involved. SoundExchange has done that with the phased rate increases it has proposed in this proceeding.

57. By contrast, no court or tribunal has ever accepted the claim that this objective calls on the Court to protect investor expectations or assure that copyright users are in a position to make up past losses. Such arguments have been rejected in analogous rate-setting contexts. *See Williams v. WMATC,* 415 F.2d 922, 970 (D.C. Cir. 1968) (regulated rate need not preserve company's dividend or stock price); *Adjustment of the Royalty Rate for Cable Systems*, 47 Fed. Reg. 52,146, 52,152-53 (1982) (extensive capital investment and long years to profitability do not preclude rate increase; task not "to ascertain if the cable industry after paying for all other regular costs of operation has adequate remaining revenue for payment of reasonable copyright fees" but to "strike a balance between copyright owner and user").

58. Finally, the evidence establishes that the recording industry is in a state of dramatic transformation, transitioning from a business model based predominantly on the sale of physical products to one dependent upon revenue from digital streams. *See* SoundExchange PFOF at Section VIII.B.2. Since the survival of the recording industry depends on its ability to

earn a fair return from digital revenue sources, as a matter of law adjustments to the rate under the fourth objective must account for the record companies' financial situation as well as the SDARS'. Moreover, in any event, any rate, regardless of its impact on the SDARS, must also be consistent with the other three statutory objectives, including ensuring a fair return to copyright owners and performers – at least above the level to compensate them for the opportunity cost caused by satellite radio.

59. In sum, the fourth statutory objective – to minimize the disruptive impact on the structure of the industries – does not require this Court to set an unfair rate that does not adequately compensate copyright owners and performers for the use of their works. It is clear that an increased royalty rate – one that fairly provides copyright owners and performers with compensation for the full value of their content – will not create legally cognizable disruption on the structure of the industries in which the PSS and SDARS participate.

V. OTHER LEGAL ISSUES

A. Designation of the Collective

60. This Court has repeatedly found "that designation of a single Collective 'presents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses." *Webcasting III*, 76 Fed. Reg. at 13,042 (quoting Webcasting *II*, 72 Fed. Reg. at 24,104); *see also SDARS I*, 73 Fed. Reg. 4099. Furthermore, the D.C. Circuit has held that "in selecting SoundExchange as the sole collective, the Judges fulfilled Congress's expectation that they would designate a single entity to receive royalty payments from licensees." *Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 574 F.3d 748, 771 (D.C. Cir. 2009).

61. This Court has also repeatedly designated SoundExchange as that single Collective. *Webcasting III*, 76 Fed. Reg. at 13,042-43; *SDARS I*, 73 Fed. Reg. 4099; Webcasting *II*, 72 Fed. Reg. at 24,104.

62. The same facts that previously warranted SoundExchange's designation as single collective are true here. No party other than SoundExchange has requested to be selected as the collective; no party has proposed multiple collectives; no party has opposed the designation of SoundExchange as the Collective; and SoundExchange has presented evidence of its proven track record of administering the statutory licenses efficiently and in the best interests of royalty recipients. Accordingly, SoundExchange should be designated as the sole collective for 2013-2017.

B. Terms

63. Sections 112(e)(3) and 114(f)(1)(A) require this Court to adopt terms for the Section 112 and 114 statutory licenses. This Court has concluded that in setting terms, it "should consider matters of feasibility and administrative efficiency." *Webcasting II*, 72 Fed. Reg. at 24,102; s*ee also Webcasting III*, 76 Fed. Reg. at 13,042 ("we are obligated to 'adopt royalty payment and distribution terms that are practical and efficient.'"); *SDARS I*, 73 Fed. Reg. at 4098.

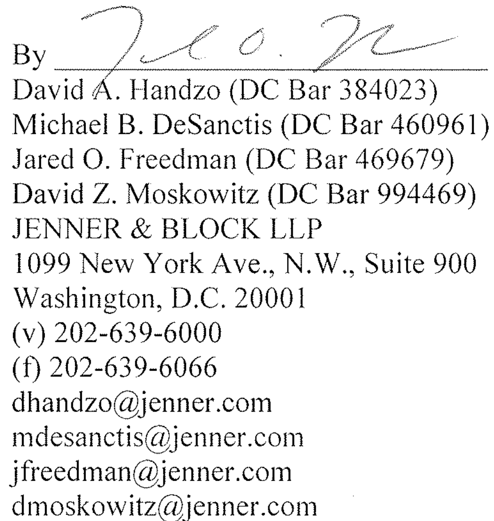
64. This Court has also emphasized the importance of consistency of terms across statutory licenses. This Court has stated that in adopting terms, "we seek to maintain consistency across the licenses set forth in Sections 112 and 114. Consistency promotes efficiency thereby reducing the overall costs associated with the administration of the licenses." *SDARS I*, 73 Fed. Reg. at 4,098-99; *see also Webcasting III*, 76 Fed. Reg. at 13,042. Although terms across the statutory licenses may vary, the "burden is upon the parties to demonstrate the need for and the

benefits of variance." *SDARS I*, 73 Fed. Reg. at 4,099; *see also Webcasting III*, 76 Fed. Reg. at 13,042.

65. In this proceeding, in the interests of consistency and efficiency, SoundExchange has in large part sought the same terms that this Court previously set in the *SDARS I* and *Webcasting III* proceedings. Where SoundExchange has sought new or revised terms, it has demonstrated why such variances are necessary and beneficial.

66. Among other terms, SoundExchange has proposed that the terms adopted in this proceeding omit the requirement that the signature on a statement of account be "handwritten." The current handwritten signature requirement is quite possibly unenforceable. *See* 15 U.S.C. § 7001(a) ("with respect to any transaction in or affecting interstate or foreign commerce . . . a . . . record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form"). In any event, Congress has expressed a clear preference that the federal government embrace the use of electronic signatures, and imposed limitations on the ability of federal agencies to adopt regulations inconsistent with that preference. *See* 15 U.S.C. § 7004(b)(2). This Court should follow Congress' expressed preference, and not adopt a term that requires a handwritten signature on a statement of account.

Respectfully submitted,

By 

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CERTIFICATE OF SERVICE

I, David Moskowitz, do hereby certify that copies of the foregoing were sent via electronic mail and First Class mail on the 26th day of September 2012, to the following:

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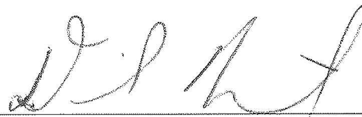

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