UNITED STATES COPYRIGHT ROYALTY JUDGES

In the Matter of	)	
	)	
DETERMINATION OF RATES AND TERMS	)	
FOR PREEXISTING SUBSCRIPTION	)	**Docket No. 2006-1 CRB DSTRA**
SERVICES AND SATELLITE DIGITAL	)	
AUDIO RADIO SERVICES	)	
	)	

DETERMINATION OF RATES AND TERMS

I. INTRODUCTION

This is a rate determination proceeding convened under 17 U.S.C. 803(b) and 37 CFR 351. A Notice announcing commencement of proceeding with request for Petitions to Participate in such proceeding to determine the rates and terms of royalty payments under Sections 114 and 112 of the Copyright Act for the activities of preexisting subscription services ("PSS") and preexisting satellite digital audio radio services ("SDARS") was published in the **Federal Register** on January 9, 2006.[1] The rates and terms set in this proceeding apply to the period of January 1, 2008, through December 31, 2012 for PSS, and January 1, 2007, through December 31, 2012 for SDARS. 17 U.S.C. 804(b)(3)(B). The PSS royalty rates are provided in a separate order. For the SDARS, the instant order provides for a beginning rate of 6% of gross revenues, with increases during the term of the period. See *infra* at Section IV.C.3.d.

[1] 71 FR 1455, Docket No. 2006-1 CRB DSTRA.

II. THE PROCEEDING

The following entities filed Petitions in response to the January 9, 2006 request for Petitions to Participate: SoundExchange, Music Choice, Muzak LLC, XM, Sirius, Royalty Logic, Inc. ("RLI"), and THP Capstar Acquisition d/b/a DMX Music ("DMX"). The Copyright Royalty Judges ("Judges") dismissed Muzak as a party on January 10, 2007.[2] On August 21, 2006, the Judges referred a novel material question of substantive law regarding the universe of preexisting subscription services under 17 U.S.C. 114(j)(11)[3] to the Register of Copyrights.[4] On October 20, 2006, the Register transmitted a Memorandum Opinion to the Board that addressed the novel question of law.[5] The Register concluded that

> for purposes of participating in a rate setting proceeding, the term "preexisting subscription service" is best interpreted as meaning the business entity which operates under the statutory license. A determination of whether DMX is the same service that was identified by the legislative history in 1998 and has operated continuously

[2] Order Granting SoundExchange's Motion to Dismiss Muzak LLC, Docket No. 2006-1 CRB DSTRA.

[3] Section 114(j)(11) of the Copyright Act defines the term "preexisting subscription service" to mean "a service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998, and may include a limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service." 17 U.S.C. 114(j)(11).

[4] Order Granting in Part SoundExchange's Motion Requesting Referral of a Novel Question of Substantive Law and Denying Motion by THP Capstar Acquisition Corp. D/B/A DMX Music Requesting Proposed Briefing Schedule, Docket No. 2006-1 CRB DSTRA. In its motion SoundExchange contended that Sirius and DMX are not eligible for a statutory license for a "preexisting subscription service" because they are not the entities that were in existence and making digital audio transmissions on or before July 31, 1998, a requirement under Section 114 of the Copyright Act. *See* 71 FR at 64640.

[5] The Register's Memorandum Opinion was published in the **Federal Register** on November 3, 2006. 71 FR 64639.

> since that time requires a factual analysis that is beyond the scope of the Register's authority for questions presented under 17 U.S.C. 802(f)(1)(B).

71 FR 64640.

Subsequently, Sirius presented its case solely as an SDARS and not as a PSS in the instant proceeding. DMX withdrew from participation in the proceeding on October 30, 2006.[6] Following an unsuccessful negotiation period, the then-remaining parties filed written direct statements on October 30, 2006 (SoundExchange, Music Choice, Sirius, and XM) and on November 21, 2006 (RLI), respectively. RLI withdrew from the proceeding on March 16, 2007.[7] Music Choice and SoundExchange settled on June 12, 2007.[8] The Judges published the settlement for public comment in the **Federal Register** on October 31, 2007. 72 FR 61585.

Discovery was followed by live testimony. Testimony was taken from June 4, 2007, to July 9, 2007. XM presented testimony of the following witnesses: Mr. Gary Parsons, Chairman of the Board, XM; Mr. Eric Logan, Executive Vice President of Programming, XM; Mr. Mark Vendetti, Senior Vice President of Corporate Finance, XM; Mr. Stephen Cook, Executive Vice President for Automotive, XM; and Mr. Anthony Masiello, Senior Vice President of Operations, XM.

---

[6] Notice by DMX, Inc. of its Withdrawal from Participation in the 2006 Copyright Royalty Board Proceeding Entitled "Adjustment of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services," Docket No. 2006-1 CRB DSTRA.

[7] Notice by Royalty Logic, Inc. of Its Withdrawal from Participation in the 2006 Copyright Royalty Board Proceeding Entitled "Adjustment of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services," Docket No. 2006-1 CRB DSTRA.

[8] Notice of Settlement, Docket No. 2006-1 CRB DSTRA (June 12, 2007).

Sirius presented testimony from the following witnesses: Mr. Mel Karmazin, President and CEO, Sirius; Mr. Terrence Smith, Senior Vice President of Engineering, Sirius; Mr. Douglas Wilsterman, Senior Vice President and General Manager of the Automotive OEM Division, Sirius; Mr. Jeremy Coleman, Vice President and General Manager of Talk Entertainment and Information Programming, Sirius; Mr. Steven Cohen, Vice President of Sports Programming, Sirius; Mr. Steven Blatter, Senior Vice President of Music Programming, Sirius; Ms. Christine Heye, former Vice President, Research, Sirius; Mr. Michael Moore, Vice President, Customer Care and Sales Operations, Sirius; Mr. David J. Frear, Chief Financial Officer, Sirius; and Mr. Robert Law, Senior Vice President and General Manager of the Consumer Electronics Division, Sirius.

XM and Sirius jointly presented testimony from the following witnesses: Dr. John R. Woodbury, Vice President, CRA International and Mr. J. Armand Musey, President and Partner, New Earth, LLC.

SoundExchange presented testimony of the following witnesses: Dr. Yoram (Jerry) Wind, Professor of Marketing and a Lauder Professor, The Wharton School, University of Pennsylvania; Mr. Mark Eisenberg, Executive Vice President, Business and Legal Affairs, Global Digital Business Group, Sony BMG Music Entertainment; Ms. Barrie Kessler, Chief Operating Officer, SoundExchange, Inc.; Mr. Sean Butson, Chartered Financial Analyst and consultant; Mr. Edgar Bronfman, Jr., Chairman and CEO, Warner Music Group; Mr. Simon Renshaw, President, Strategic Artist Management; Dr. Janusz Ordover, Professor of Economics, New York University; Mr. Dan Navarro, singer, songwriter, recording artist; Mr. Edward Chemelewski,

President, Blind Pig Records; Mr. Michael Kushner, Senior Vice President, Business and Legal Affairs, Atlantic Records; Mr. Lawrence Kenswil, President of Universal eLabs, a division of Vivendi Universal's Universal Music Group; Mr. Charles Ciongoli, Executive Vice President and Chief Financial Officer, Universal Music Group North America; Dr. Michael Pelcovits, Principal, Microeconomic Consulting & Research Associates, Inc.

The remaining parties filed written rebuttal statements on July 24, 2007. The rebuttal phase of the trial occurred from August 15, 2007 to August 30, 2007. XM presented the rebuttal testimony of Mr. Vendetti. Sirius presented the rebuttal testimony of Mr. Karmazin and Mr. Frear. Sirius and XM presented the joint rebuttal testimony of Dr. Roger G. Noll, Professor Emeritus of Economics, Stanford University; Dr. Erich Joachimsthaler, CEO, Vivaldi Partners; Dr. George Benston, John H. Harlan Professor of Finance, Accounting and Economics at the Goizueta Business School and Professor of Economics, Emory University; Mr. Daryl Martin, Vice President, Consor Intellectual Assessment Management; Dr. John Hauser, Management Science Area Head and Kirin Professor of Marketing, Massachusetts Institute of Technology; Mr. Bruce Silverman, marketing consultant; and Dr. Woodbury.[9]

SoundExchange presented the rebuttal testimony of Mr. Ciongoli; Dr. Ordover; Mr. Bruce Elbert, President, Application Technology Strategy, Inc.; Mr. Butson; Dr. Pelcovits; Mr. Eisenberg; Ms. Kessler; Dr. Wind; Dr. Steven Herscovici, Managing Principal, Analyst Group, Inc.; and Mr. George Mantis, President, The Mantis Group, Inc.

---

[9] The Services also sought to present the testimony of Professor William W. Fisher, III, but the Judges granted SoundExchange's motion to strike Professor Fisher's rebuttal testimony. 8/15/07 Tr. at 11.

At the close of the evidence, the record was closed. In addition to the written direct statements and written rebuttal statements, the Judges heard 26 days of testimony, which filled over 7700 pages of transcript, and over 230 exhibits were admitted. The docket contains over 400 pleadings, motions, and orders.

On October 1, 2007, after the evidentiary phase of the proceeding, the participants filed Proposed Findings of Fact and Conclusions of Law. Participants filed replies on October 11, 2007. Closing arguments occurred on October 17, 2007.

III. THE STATUTORY STANDARDS FOR DETERMINING ROYALTY RATES

Section 801(b)(1) of the Copyright Act, 17 U.S.C., provides that the Copyright Royalty Judges shall "make determinations and adjustments of reasonable terms and rates of royalty payments" for the statutory licenses set forth in Sections 112(e) and 114.[10] The section then prescribes that the royalty rates applicable under Section 114(f)(1)(B), which is the performance license for sound recordings at issue in this proceeding, shall be calculated to achieve the following objectives:[11]

> (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,

---

[10] The "reasonable" rates and terms requirement also applies to the statutory licenses set forth in 17 U.S.C. 115, 116, 118, 119, and 1004. Though the Section 119 license is referenced, there is currently no rate adjustment provided in the Copyright Act for that license.

[11] We note that the Section 801(b)(1) objectives, or factors, do not apply to the Section 112(e) license. For a discussion of this license's applicability to this proceeding, *see infra* at Section IV.D.

> 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.

17 U.S.C. 801(b)(1). Because of the importance of this language to our determination, the Copyright Royalty Judges undertake the following comprehensive review of the provisions and their interpretation.

A. LEGISLATIVE BACKGROUND

The Section 801(b)(1) factors owe their origin to the legislative process that produced the Copyright Act of 1976. The 1976 Act created three new statutory licenses[12]–cable, jukebox and noncommercial broadcasting–and established the Copyright Royalty Tribunal to adjust rates and terms and make royalty distributions to copyright owners where appropriate. An examination of the legislative history of the 1976 Act reveals that the motivation for adopting the Section 801(b)(1) factors arose from an exchange between Professor Ernest Gellhorn, on behalf of certain copyright users, and Professor Louis H. Pollack, on behalf of certain copyright owners, concerning the constitutionality of the Copyright Royalty Tribunal. Professor Gellhorn recommended that in order to bolster the constitutionality of the Tribunal, the Congress should, *inter alia*, adopt statutory standards beyond the vague criterion of "reasonableness." *Hearings on H.R. 2223 before the Subcomm. on Courts, Civil Liberties, and the Administration of Justice of the House Comm. on the Judiciary*, 94th Cong., 1922 (1975). The Register of Copyrights, in her second supplementary report on

[12] The lone statutory license under the 1909 Copyright Act, the section 115 "mechanical" license for the making and distribution of phonorecords, was carried forward into the 1976 Act.

the general revision of the copyright laws later that year, disputed the constitutional concerns of Professor Gellhorn but concluded that it would be "wise to establish, in the statute, certain criteria beyond 'reasonableness' that each Panel is to apply to its decision-making." *Second Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law*, Chapter XV, p. 31 (1975). The House Judiciary Committee, in its subsequent report on the Senate revision bill, took heed of the Register's advice and stated in the report (but not the bill), that "it is anticipated that the Commission[13] will consider the following objectives in determining a reasonable rate. . .":

> (1) The rate should maximize the availability of diverse creative works to the public.
>
> (2) The rate should afford the copyright owner a fair income, or if the owner is not a person, a fair profit, under existing economic conditions, in order to encourage creative activity.
>
> (3) The rate should not jeopardize the ability of the copyright user
>
> > (a) to earn a fair income, or if the user is not a person, a fair profit, under existing economic conditions, and
> >
> > (b) to charge the consumer a reasonable price for the product.
>
> (4) The rate should reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.

[13] The House revision bill created a Copyright Royalty Commission, whereas the Senate revision bill created a Copyright Royalty Tribunal. The Senate nomenclature was used in the final bill.

> (5) The rate should minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

H.R. Rep. No. 94-1476, at 173-174 (1976)(footnote added). The House and Senate Conference yielded the revision bill as enacted and set forth the Section 801(b)(1) factors in their current form. Unfortunately, the Conference Report does not offer any discussion of the final language.

B. PRIOR PROCEEDINGS

There have been three statutory license proceedings involving the reasonable rate standard and the Section 801(b)(1) factors: a Section 116 jukebox rate adjustment by the Copyright Royalty Tribunal; a Section 115 mechanical rate adjustment, also by the Tribunal; and a proceeding under the Copyright Arbitration Royalty Panel ("CARP") system administered by the Librarian of Congress for preexisting subscription services under the same Section 114(f)(1)(B) statutory license involved in this proceeding. All three of these decisions were the subject of judicial review.

1. The 1980 Jukebox License Proceeding

The Copyright Royalty Tribunal's first consideration of the reasonable rate standard and the Section 801(b)(1) factors involved the 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, better known as jukeboxes. 46 FR 884 (January 5, 1981). The Tribunal raised the $8 a year per jukebox fee that was set by statute in the 1976 Copyright Act to $50 per year phased in over a 2-year period. The rate remained in effect for a 10-year period from 1980 to 1990.

While the Tribunal's decision was somewhat lengthy, its consideration and application of the standard and the Section 801(b)(1) factors was not. Coming in the last

section of its decision and amounting to less than a page, the Tribunal applied the factors to the $50 rate it derived from its consideration of "marketplace analogies" and determined that the selected rate was consistent with each. 46 FR 889. In reviewing the Tribunal's decision, the U.S. Court of Appeals for the Seventh Circuit gave no attention to the Section 801(b)(1) factors or the Tribunal's application of them, focusing instead on the appropriateness of the Tribunal's choice of "marketplace analogies." *Amusement & Music Operators Ass'n. v. Copyright Royalty Tribunal*, 676 F.2d 1144 (7th Cir. 1982). The Tribunal decision was upheld.

2. The 1981 Mechanical License Proceeding

Less than one month after releasing the jukebox rate determination, the Tribunal issued its decision in the Adjustment of the Royalty Payable Under Compulsory License for Making and Distributing Phonorecords, better known as the mechanical license proceeding. 46 FR 10466 (February 3, 1981). The mechanical license requires payment to copyright owners of musical works (songwriters and music publishers) for the creation and distribution of phonorecords of their works. In a lengthy decision, the Tribunal nearly doubled the existing rates and established a complex system for future interim adjustments during the 7-year license period to reflect increases in the average list price of record albums.

Unlike the jukebox proceeding, the Tribunal offered its views as to the "reasonable" royalty standard and the Section 801(b)(1) factors. As to the "reasonable" royalty standard, the Tribunal stated that "[i]t is our opinion that the term reasonable in the statute is of dominating importance in reaching a final determination in this proceeding." 46 FR 10479. As to the meaning of the term "reasonable," the Tribunal

recalled Professor Gellhorn's and the Register of Copyrights' admonitions to the Congress to adopt standards in the 1976 Copyright Act and observed that "Congress drafted the (Section 801(b)(1)) criteria in the broadest terms that it could, consistent with its intent to prevent a challenge to the constitutionality of the Tribunal." *Id.* (parenthetical added). The Tribunal went on and "conclude[d], consistent with its Congressional mandate, that this Tribunal's adjustment must set a 'reasonable' mechanical royalty rate designed to achieve four objectives, set forth in Section 801 of the Act . . ." *Id.* The Tribunal then undertook an application of the record evidence to each of the Section 801(b)(1) factors and concluded that the 4 cent rate it had derived from the evidence and economic testimony of the parties satisfied all of the factors. *Id.* at 10479-81.

The U.S. Court of Appeals for the District of Columbia Circuit upheld the Tribunal's determination of the rates, but set aside the Tribunal's mechanism for adjusting the rates within the licensing period as being beyond the Tribunal's statutory authority. *Recording Industry Ass'n. of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981). In reviewing the rates, the Court discussed the Section 801(b)(1) factors not in the context of the Tribunal's interpretation or application of them, but rather in terms of the judicial standard of review to be applied. The Court concluded at least three aspects of the factors increased the deference owed to the Tribunal's conclusions. First, subsections (A) and (D)–the maximization of the availability of creative works to the public and minimization of disruption to the industries–"require determinations 'of a judgmental or predictive nature,' and the court must be aware that 'a forecast of the direction in which the future public interest lies necessarily involves deductions based on

the expert knowledge of the agency.'" *Id*. at 8 (citations omitted). Second, the Court noted that subsections (B) and (C)–the fair return and income to owners and users and relative roles of owners and users in the product–call for policy choices that should be owed considerable deference. *Id*. at 8-9. Finally, the Court observed:

> [T]he statutory factors pull in opposing directions, and reconciliation of these objectives is committed to the Tribunal as part of its mandate to determine "reasonable" royalty rates. Both the House and Senate had originally passed bills whose only instruction to the Tribunal was to assure that the royalty rate was reasonable, although the House report had stated objectives that it "anticipated that the Commission will consider." As part of the compromise that produced the final structure of the Tribunal, most of those objectives were written into the statute, . . ., but the Tribunal was not told which factors should receive higher priorities. To the extent that the statutory objectives determine a range of reasonable royalty rates that would serve all these objectives adequately but to differing degrees, the Tribunal is free to choose among those rates, and courts are without authority to set aside the particular rate chosen by the Tribunal if it lies within a "zone of reasonableness."

Id. at 9 (footnotes omitted).

3. The Digital Performance Right in Sound Recordings Proceeding

The Tribunal never had occasion again to conduct a Section 801(b)(1) rate adjustment, and it was abolished in 1993 and replaced by the CARP scheme administered by the Librarian of Congress. Copyright Royalty Tribunal Reform Act of 1993, Pub. L. No. 103-198, 107 Stat. 2304. Subsequent to the Tribunal's abolition, Congress passed the Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336, which created the Section 114 digital performance right license that is the subject of this proceeding. Unlike prior statutory licenses where the Congress fixed the initial rates within the statute, the rates for the new digital performance right license were

left to resolution by a CARP. The Librarian convened a CARP in 1997 for PSS and SDARS. The SDARS settled with copyright owners and withdrew from the proceeding,[14] and the CARP rendered a determination only with respect to the PSS. The Librarian reviewed the CARP's determination and rejected it with respect to the rate as well as to certain terms, and the U.S. Court of Appeals for the District of Columbia Circuit reviewed the Librarian's decision. The Court upheld the Librarian's rate determination but remanded certain terms adopted by the Librarian for lack of supporting evidence. *Recording Industry Ass'n of America, Inc. v. Librarian of Congress*, 176 F.3d 528, 532 (D.C. Cir. 1999).

While the CARP offered nothing by way of interpretation of the Section 801(b)(1) factors, it took a decidedly different approach from the Tribunal in applying them. Whereas the Tribunal first analyzed the economic benchmarks submitted by the parties, selected a royalty fee and then applied the factors sequentially to the record evidence to determine if the selected fee satisfied them, the CARP instead began its analysis with the factors. The CARP did not analyze the factors in order, instead beginning with subsection (C), followed by subsections (D), (A) and then (B). Curiously, the CARP's consideration of the parties' benchmarks occurred under its consideration of subsection (B), the factor requiring a balancing of fair return to the copyright owner and fair income to the copyright user. Then, at the end of the determination, the CARP provided a less than one-page conclusion resolving all of the factors in favor of the PSS. *In re: Determination of Statutory License Terms and Rates for Certain Digital*

[14] The terms and conditions of the agreement were never publicly disclosed.

Subscription Transmissions of Sound Recordings, Report of the Copyright Arbitration Royalty Panel, Docket No. 96-5 CARP DSTRA, p. 62 (November 28, 1997).

The CARP's approach did not particularly vex the Librarian, but its terse conclusion that subsection (A)–maximization of creative works to the public–favored the PSS certainly did.

> There is no record evidence to support a conclusion that the existence of the digital transmission services stimulates the creative process. Instead, the Panel made observations concerning the development of another method for disseminating creative works to the public–a valid and vital consideration addressed in the statutory objective concerning the relative contributions from each party–but fails to discuss how the creation of a new mode of distribution will itself stimulate the creation of additional works.

Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings (Final Rule and Order), 63 FR 25394, 25406 (May 8, 1998) (codified at 37 CFR part 260) ("*1998 PSS Rate Determination*"). The Librarian also faulted the CARP for failing to reconcile its conclusion with the Tribunal's determination in the 1980 jukebox rate adjustment proceeding that jukeboxes did not contribute to the maximization of creative works to the public. *Id.* at 25406-7. As to the other Section 801(b)(1) factors, the Librarian affirmed the CARP's determination, but he concluded that an upward adjustment of the rate was necessary because he found that the CARP's reliance upon a single private license agreement offered as a benchmark and its subsequent manipulation of the license fee amounted to arbitrary action. *Id.* at 25409. The Librarian increased the 5% of annual revenues fee proposed by the CARP to 6.5%, stating that the 6.5% rate met all of the Section 801(b)(1) factors. *Id.* at 25410.

Only the Recording Industry Association of America, Inc. ("RIAA") challenged the Librarian's decision. In its petition for review, RIAA argued that the Librarian misinterpreted Section 801(b)(1) by equating "reasonable" royalty rates with those that are calculated to achieve the objectives of the Section 801(b)(1) factors. Rather, in RIAA's view, the statutory language imposes two separate requirements: the royalty fee must be (1) a "reasonable copyright royalty rate," and (2) it must be then "calculated to achieve" the Section 801(b)(1) objectives. RIAA argued that a "reasonable copyright royalty rate" was one that affords fair market compensation, thus making market rates the starting point for application of the Section 801(b)(1) factors. *Recording Industry Ass'n of America, Inc. v. Librarian of Congress*, 176 F.3d 528, 532 (D.C. Cir. 1999).

The U.S. Court of Appeals for the District of Columbia Circuit rejected RIAA's position, ruling that the Librarian's interpretation of the statute was permissible under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). 176 F.3d at 533. The Court went further and observed: "Here, the Librarian determined that 'reasonable rates' are those that are calculated with reference to the four statutory criteria. This interpretation is not only permissible but, given that [Section] 114 rates are to be 'calculated to achieve' the four objectives of [Section] 801(b)(1), it is the most natural reading of the statute." *Id.*; *see also,* 176 F.3d at 534 ("Because it was reasonable for the Librarian to find that the term 'reasonable copyright royalty rates' is defined by the four statutory objectives, there is no need to look to Tribunal precedent interpreting the term 'reasonable rates' in other contexts."). The Court did not discuss the Librarian's

application of the Section 801(b)(1) factors to the record evidence, but "den[ied] RIAA's petition for review with respect to the establishment of a 6.5 percent rate. *Id*. at 535.[15]

C. APPROACH OF THE COPYRIGHT ROYALTY JUDGES

Based upon the above discussion, the path for the Copyright Royalty Judges is well laid out. We shall adopt reasonable royalty rates that satisfy all of the objectives set forth in Section 801(b)(1)(A)-(D). In so doing, we begin with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach our decision. Section 114(f)(1)(B) also affords us the discretion to consider the relevance and probative value of any agreements for comparable types of digital audio transmission services that submit voluntary agreements under 17 U.S.C. 114(f)(1)(A). *See*, 17 U.S.C. 114(f)(1)(B)("[I]n addition to the objectives set forth in Section 801(b)(1), the Copyright Royalty Judges *may* consider the rates and terms for comparable types of subscription digital audio transmission services and comparable circumstances under voluntary license agreements described in subparagraph (A).") (emphasis added).

IV. <u>DETERMINATION OF ROYALTY RATES</u>

A. APPLICATION OF SECTION 114 AND SECTION 112

Based on the applicable law and relevant evidence received in this proceeding, the Copyright Royalty Judges must determine rates for the Section 114 performance licenses and the associated Section 112 ephemeral reproduction licenses utilized by SDARS.

As previously discussed, the Copyright Act requires that the Copyright Royalty Judges establish rates for the Section 114 license that are reasonable and calculated to

---

[15] The RIAA was successful in convincing the Court to vacate and remand the Librarian's determination with respect to terms on the grounds of lack of record evidence to support them. *Id*.

achieve the following four specific policy objectives: (A) to maximize the availability of creative works to the public; (B) to afford the copyright owner a fair return for his 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; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. 17 U.S.C. 114(f)(1)(B) and 17 U.S.C. 801(b)(1).

With respect to the Section 112 license, the Copyright Act requires that the Copyright Royalty Judges establish rates for this license that most clearly represent those "that would have been negotiated in the marketplace between a willing buyer and a willing seller" and to take into account evidence presented on such factors as (1) whether the use of the services may substitute for or promote the sale of phonorecords and (2) whether the copyright owner or the service provider makes relatively larger contributions to the service ultimately provided to the consuming public with respect to creativity, technology, capital investment, cost and risk. 17 U.S.C. 112(e)(4).

Having carefully considered the relevant law and the evidence received in this proceeding, the Copyright Royalty Judges determine that the appropriate Section 114 performance license rate is 6.0% of gross revenues for 2007 and 2008, 6.5% for 2009, 7.0% for 2010, 7.5% for 2011 and 8.0% for 2012 and, further, that the appropriate Section 112 reproduction license rate is deemed to be embodied in the Section 114 license rate.

---

at 536.

The applicable rate structure for the Section 114 license is the starting point for the Copyright Royalty Judges' determination.

B. THE RATE PROPOSALS OF THE PARTIES AND THE APPROPRIATE ROYALTY STRUCTURE FOR SECTION 114 PERFORMANCE LICENSE APPLICABLE TO SDARS

1. Rate Proposals

The contending parties present several alternative rate structures. In its second amended rate proposal, SoundExchange argues in favor of a monthly fee equal to the greater of: a percentage of gross revenues varying from 8% to 23% or a per subscriber rate varying from $0.85 per subscriber to $3.00 per subscriber. These applicable fees vary based on the actual number of subscriptions reported by the service. For example, the lowest fee (i.e., the greater of 8% of gross revenues or $0.85 per subscriber) would be applicable for a number of subscriptions equal to less than 9 million. At the opposite extreme, the highest fee (i.e., the greater of 23% of gross revenues or $3.00 per subscriber) would be applicable for a number of subscriptions equal to or more than 19 million. While proposing that the percent of revenues alternatives increase only in response to subscriber growth over the license period, SoundExchange proposes that the per subscriber alternatives associated with particular subscriber numbers would be additionally adjusted at the beginning of each year starting with January, 2008 by the change in the consumer price index (CPI-U) over the preceding 12 months ending on November 1. SoundExchange Second Amended Rate Proposal (July 24, 2007) at 1-4.

Subsequently, SoundExchange defensively offered, in the alternative, a second "option" in which applicable rates would continue to vary with subscriber numbers but also would vary at each subscriber interval based on a per broadcast/per subscriber

metric. For example, at the low end of this alternative proposal, if the number of subscriptions were equal to less than 9 million for an SDARS, $0.0000028 per subscriber would be applicable to each broadcast of a sound recording for the first 150,000 sound recordings broadcast each month and $0.0000008 per subscriber would be applicable to each broadcast of a sound recording thereafter. At the high end of this alternative, if the number of subscriptions were equal to more than 19 million for an SDARS, $0.00001 per subscriber would be applicable to each broadcast of a sound recording for the first 150,000 sound recordings broadcast each month and $0.000003 per subscriber would be applicable to each broadcast of a sound recording thereafter. With respect to this "option," SoundExchange also proposes that the royalty rates associated with particular subscriber numbers would be additionally adjusted at the beginning of each year starting with January, 2008 by the change in the CPI-U over the preceding 12 months ending on November 1. SoundExchange Third Amended Rate Proposal (August 6, 2007) at 1-8.

By contrast, XM and Sirius initially proposed only a percentage of revenues fee structure equal to 0.88% of a licensee's quarterly gross revenues resulting from residential services in the United States to be applicable for the duration of the 2007-2012 license period. XM Rate Proposal (January 17, 2007) at § 26_.3; Sirius Rate Proposal (January 17, 2007) at § 26_.3. This proposal was subsequently revised in an amended

proposal[16] that called for the establishment in 2007 of a quarterly license fee of $1.20 per play[17] of a copyrighted sound recording during the quarter, with subsequent years of the license period beginning with 2008 adjusted each year by the percentage change in combined SDARS subscribers during the preceding year. XM Amended Rate Proposal (July 24, 2007) at § 3_.3; Sirius Amended Rate Proposal (July 24, 2007) at § 3_.3. A further revision of this proposal was submitted as the Services' Second Amended Proposal of Rates and Terms and provided for the establishment in 2007 of a quarterly license fee of $1.60 per play of a copyrighted sound recording during the quarter, again with subsequent years of the license period beginning with 2008 adjusted each year by the percentage change in combined SDARS subscribers during the preceding year. Second Amended Proposal of Rates and Terms of Sirius Satellite Radio Inc. and XM Satellite Radio Inc. (October 1, 2007) at § 3_.3.

In other words, while the parties on both sides initially proposed rates based on a percentage of gross revenues (albeit with somewhat different definitions of gross revenues), they both subsequently submitted royalty payment proposals that could generally be described as "per play" or "per broadcast" rates. However, their purposes in

[16] While the XM and Sirius amended rate proposal omits any specific mention of a revenue basis, their chief economic expert, Dr. Woodbury, nevertheless supplies a revised estimate of his recommended revenue-based rate in the course of his rebuttal testimony and uses that revised revenue-based rate as the basis for the SDARS' amended and second amended "per play" proposals. At bottom then, the SDARS' amended rate proposal does not scrap its revenue basis, but rather simply translates the revenue-based recommendation of 1.20% into a per play rate by dividing the revenues that would be garnered from the application of the revised revenue-based rate by the total number of estimated compensable plays broadcast by the SDARS in 2006. This results in a per play rate of $1.20 in their amended proposal based on 2006 revenues and a per play rate of $1.60 in their second amended proposal based instead on 2007 revenue projections. Woodbury WRT at 22; SDARS PFF at ¶¶ 845-846.

[17] "Play" is defined as the transmission of a sound recording by the SDARS, regardless of the number of listeners who tune in or listen to the transmission. XM Amended Rate Proposal (July 24, 2007) at § 3_.2(d); Sirius Amended Rate Proposal (July 24, 2007) at § 3_.2(d).

proposing "per play" or "per broadcast" rates differ. While admitting the likelihood of increased administrative costs, the SDARS maintain that their "per play" mechanism is superior to a revenue-based rate structure because: (1) it allows the SDARS to respond to any substantial increases in fees by economizing on the use of music so as to reduce their payments and (2) it preserves the incentives of the SDARS to acquire more attractive nonmusic programming or to improve the quality of their radio devices. Woodbury WRT at 21. SoundExchange, on the other hand, while recognizing that there are benefits to a per performance rate structure such as adopted by the Judges in the recently concluded webcasting proceeding[18] (i.e., where a performance refers to one play of one sound recording to a single listener at a time), also recognizes that its "per broadcast" alternative is not the functional equivalent of a per performance rate structure. As a result, SoundExchange admits that its "per broadcast" mechanism does not engender the benefits of the usage metric adopted in *Webcaster II* and, further, that it is inferior to a percentage of revenue structure. Pelcovits WRT at 19, 25-26. At bottom, SoundExchange's alternative proposal is submitted defensively to protect against the possibility that, notwithstanding these weaknesses, this Court might nevertheless settle upon a per play or per broadcast approach without reducing what SoundExchange identifies as "the most significant distortion in a static proposal of this nature"–the lack of proportionality between total listening and the number of broadcasts. Pelcovits WRT at 23. For this reason, SoundExchange offers a two-tier structure associated with seven specific subscriber intervals as part of its per broadcast/per subscriber proposal to help

[18] *Digital Performance Right in Sound Recordings and Ephemeral Recordings (Final Rule and Order)*, 72 FR 24084 (May 1, 2007) (codified at 37 CFR part 380) ("*Webcaster II*").

mitigate the potential adverse revenue impact of a decline in music broadcasts that is not fully matched by an equivalent decline in music listenership. Pelcovits WRT at 23-25.

2. Rate Structure

Because we have no true per performance fee proposal before us nor sufficient information from evidence of record to accurately transform any of the parties' proposals into a true per performance fee proposal, the Copyright Royalty Judges conclude that a revenue-based fee structure for the SDARS is the most appropriate fee structure applicable to these licensees.

First, the absence of a true per performance fee proposal that seeks to tie payment directly to actual usage of the sound recording by the licensees makes all the various alternative fee proposals of the parties into proxies for a usage metric at best. Although revenue merely serves as a proxy for measuring the value of the rights used, so also do the per play and per broadcast alternatives offered by the parties. Neither of the parties' alternatives to a revenue-based metric really measures actual usage. The SDARS "per play" proposal makes no attempt to measure the number of listeners to any particular sound recording, but rather transforms the revenue-based metric into a "per play" metric by applying that revenue rate to the transmission of a sound recording without regard to the number of listeners who tune in or listen to the transmission. Woodbury WRT at 22 and XM Amended Rate Proposal (July 24, 2007) at § 3_.2(d); Sirius Amended Rate Proposal (July 24, 2007) at § 3_.2(d); Second Amended Proposal of Rates and Terms of Sirius Satellite Radio Inc. and XM Satellite Radio Inc. (October 1, 2007) at § 3_.2(d).

Indeed, since the number of "plays" (i.e. transmission of a sound recording) for which the SDARS propose payment is not further related to the number of listeners to

such transmissions, Dr. Woodbury admits that the per play rate is not even as good a proxy for usage as revenue without further annual adjustments for growth in subscribers. Woodbury WRT at 22. Similarly, the SoundExchange "per broadcast" rate proposal fails to relate royalty payments directly to usage. Even though the SoundExchange "per broadcast" proposal is tied to the number of SDARS subscribers, it remains, at best, a proxy for actual usage because, as Dr. Pelcovits admits, "subscribers" are not the functional equivalent of "listeners" and because the available data does not permit the precise determination of whether the music listened to by SDARS subscribers refers solely to the compensable sound recordings at question in this proceeding. Pelcovits WRT at Appendix at 1-3. In short, as Dr. Pelcovits states, "the per broadcast/per subscriber metric simply does not provide an accurate and dynamic measure of listening/consumption." Pelcovits WRT at 25.

Second, the advocates of the "per play" and "per broadcast" rate structures effectively admit that, as proxies for usage, such measures are no better than revenue-based measures, as shown by their attempts to use changes in general subscriber levels as a rough proxy for measuring the impact of changes in the number of listeners. For example, Dr. Woodbury, after noting that the "per-play payment does *not* account for any changes in aggregate music listening time during the license period," suggests "accounting for such changes in an *approximate* way by increasing the per-play rate by the actual annual percentage change in the number of SDARS subscribers." Woodbury WRT at 22 (emphasis added). Similarly, SoundExchange's "per broadcast/per subscriber" rate proposal, ultimately ties increases in royalty rates to the achievement of specific subscriber levels that are only roughly related to the actual number of listeners to

any given sound recording. SoundExchange Third Amended Rate Proposal (August 6, 2007) at 5-7. In short, both parties ultimately focus on a major driver of revenue growth (i.e., subscriber growth) as a proxy for usage because, without this additional adjustment, "per play" and "per broadcast" metrics are clearly poorer substitutes for a usage-based metric compared to a percentage of revenue approach. Consequently, notwithstanding the various adjustments made by advocates of the "per play" or "per broadcast" proposals they remain inextricably focused on revenues. Moreover, because the adjustments suggested to improve the "per play" and "per broadcast" proposals result in additional ambiguities rather than more precision, these alternatives may be even less satisfactory proxies for a usage-based metric than the percentage of revenue approach.

Third, upon careful review, we find that the SDARS' two proffered advantages of a "per play" metric as compared to a percentage of revenue measure are less advantageous than claimed. The SDARS argue that a "per play" rate provides the SDARS with more business flexibility because it allows them to respond to any substantial increases in fees by economizing on the plays of sound recordings so as to reduce their royalty costs. Woodbury WRT at 20; Karmazin WRT at 13. While the general proposition of enhancing business flexibility is usually advantageous (at least to the party obtaining such flexibility), the probability of obtaining the specific advantage described by Dr. Woodbury and Mr. Karmazin is reduced by the myriad of economic circumstances which must coalesce as necessary preconditions.[19] Further, the same

[19] From an economic point of view, for example, it would only make sense for the SDARS to reduce their use of music as an input in response to a royalty fee increase if the revenue they earned from the last dollar spent on music programming came to be outstripped by the revenue they earned from spending the same dollar on nonmusic programming. This assumes that a variety of relative revenue generation and relative input pricing circumstances have been simultaneously satisfied.

flexibility may be achieved by other means.[20] At the same time, this business flexibility "advantage" raises serious questions of fairness precisely because the SDARS "per play" metric is a less than fully satisfactory proxy for listenership. Thus, fewer stations (ergo fewer plays) could be offered by the SDARS without a proportionate reduction in the number of transmissions actually heard. Under such circumstances, the copyright owner's per performance revenue would decline because of the shortcomings of the "per play" metric in question as a proxy for measuring actual usage. SX PFF at ¶¶ 1442-9. It is not fair to so clearly fail to properly value the performance rights at issue in this proceeding. Such a result is additionally at odds with the stated policy objective of the statute to afford the copyright owner a fair return for his creative work. 17 U.S.C. 801(b)(1). Similarly, the SDARS' contention that the adoption of a "per play" rate structure would preserve their incentives to improve the quality of their service (by leaving them with more revenue to acquire more attractive nonmusic programming or to improve the quality of their radio devices), is not an advantage equitably experienced by both parties. Rather, the advantage runs to the SDARS who stand to gain revenue while the copyright owner experiences a decline in the value of the performance rights at issue in this proceeding. Again, this is because number of plays can be reduced with a less than proportionate reduction in listenership. Furthermore, there is no guarantee that the SDARS will spend any additional revenue so acquired to improve the quality of their

[20] For example, in light of the definition of "gross revenues" herein below in this determination, the SDARS could offer wholly nonmusic programming as an additional, separately priced premium channel/service without having the revenues from such a premium channel/service become subject to the royalty rate and, thereby, achieve the desired flexibility of offering more lucrative nonmusic programming without sharing the revenues from that programming with the suppliers of sound recording inputs.

services; thus "preserving an incentive" is not the equivalent of insuring action of the type suggested by Dr. Woodbury based on that incentive.

In short, given that the two "advantages" of the "per play" approach stated by Dr. Woodbury are neither clear-cut nor of estimable likelihood, we are persuaded that the "countervailing consideration" of greater administrative costs raised by Dr. Woodbury clearly outweighs the tenuous benefits of the SDARS "per play" fee structure. SoundExchange in its proposed "per broadcast/per subscriber" approach attempts to mitigate some of the untoward effects of the SDARS "per play" approach through the addition of a two-tier fee structure that partially and indirectly addresses the absence of a true per performance measure reflective of actual listenership. However, we agree with Dr. Pelcovits that even as so modified, this approach still yields less than satisfactory results. Pelcovits WRT at 25 ("the per broadcast/per-subscriber [sic] metric simply does not provide an accurate and dynamic measure of listening/consumption"). Moreover, the tradeoff for this modest conceptual improvement in the "per play" fee structure is reliance on less than precise estimates of listenership and additional complexity in administration. On balance, then, we conclude that neither the SDARS' "per play" metric nor SoundExchange's "per broadcast/per subscriber" measure is superior to a revenue-based fee structure as a proxy for a true per performance fee structure for the services in this proceeding. Furthermore, a revenue-based fee structure at least offers clear administrative advantages to these parties and, therefore, reduced transactions costs compared to the "per play" and "per broadcast/per subscriber" alternatives proposed by the parties.

Fourth, while in *Webcaster II* we concluded that the evidence in the record of that proceeding weighed in favor of a per performance usage fee structure for both commercial and noncommercial webcasters, we further suggested that, in the absence of some of the more egregious problems noted therein, the use of a revenue-based metric as a proxy for a usage-based metric might be reasonable. *Webcaster II*, 72 FR 24090. In particular, one of the more intractable problems associated with the revenue-based metrics proposed by the parties in *Webcaster II*, 72 FR 24090, was the parties' strong disagreement concerning the definition of revenue for *nonsubscription* services. This was further complicated by questions related to applying the same revenue-based metric to noncommercial as well as commercial services. *See Webcaster II*, 72 FR 24094 n.15. The same degree of difficulty is not presented by the applicable facts in this proceeding. The parties to this proceeding, at least initially, all proposed a revenue-based metric and, while there were some differences in the definition of revenues in their initial proposals, no party has submitted any evidence regarding the impossibility of applying or complying with a revenue-based metric. That is not surprising, inasmuch as the parties have until now lived under a revenue-based regime. Therefore the parties are most familiar, and perhaps most comfortable, with the operation of a revenue-based metric. The value of such familiarity lies in its contribution towards minimizing disputes and, concomitantly, keeping transactions costs in check. Because XM and Sirius are both commercial subscription services and music is an integral part of each subscription service, focusing on gross revenues attributable to those subscriptions or derived in connection with the use of music in SDARS programming (e.g., advertising or

sponsorship revenues attributable to such programming) provides a straightforward method of relating music fees to the value of the rights being provided.

For all of the above reasons, the Copyright Royalty Judges conclude that evidence in the record weighs in favor of a revenue-based fee structure for the SDARS. We find a sufficient clarity of evidence based on the record in this proceeding to produce a revenue-based metric that can serve as adequate proxy for a usage-based metric. Furthermore, there was no substantial evidence offered by any party to readily guide the calculation of a usage-based (i.e. per performance) metric as a substitute for the revenue-based approach long employed by the parties. Indeed, in stark contrast to the record in *Webcaster II*, neither the SDARS nor SoundExchange provided substantial evidence to indicate that a true per performance rate was susceptible of being calculated by the parties to this proceeding. Therefore, we find that a revenue-based measure is currently the most effective proxy for capturing the value of the performance rights at issue here, particularly in the absence of any substantial evidence of how some readily calculable true per performance metric could be applied to the SDARS.

3. Revenue Defined

In order to properly implement a revenue-based metric, a definition of revenue that properly relates the fee to the value of the rights being provided is required.[21] Although the SDARS and SoundExchange offered somewhat different formulations of how revenue should be defined in their initial rate proposals, the parties offered little evidence to support their respective proposed definitions of revenue. SoundExchange proposed an expansive reading of revenue to include "all revenue paid or payable to an

[21] Dr. Ordover simply describes the main consideration as follows: "In sum, rates should reflect purchasers' willingness to pay for *music* content." Ordover WDT at 21 (emphasis added).

SDARS that arise from the operation of an SDARS service . . ." SoundExchange Third Amended Rate Proposal (August 6, 2007) at § 38_.2(g). However, SoundExchange offers scant evidentiary support for this particularly broad yet vague definition. The SDARS, by contrast, offer a definition of gross revenues that apparently seeks to largely adapt the existing PSS definition of gross revenues, 37 CFR 260.2(e), to the nature of current SDARS services. XM Rate Proposal (January 17, 2007) at § 26_.2 (d); Sirius Rate Proposal (January 17, 2007) at § 26_.2(d). With one exception, we find that the SDARS "gross revenue" definition in their initial fee proposal more unambiguously relates the fee to the value of the sound recording performance rights at issue in this proceeding. For example, the SDARS definition of "gross revenues" excludes monies attributable to premium channels of nonmusic programming that are offered for a charge separate from the general subscription charge for the service. The separate fee generated for such nonmusic premium channels is not closely related to the value of the sound recording performance rights at issue in this proceeding. Therefore, this proposed exclusion serves to more clearly delineate the revenues related to the value of the sound recording performance rights at issue in this proceeding.

The one exception to the SDARS definition of revenues that fails to meet the test of unambiguously relating the fee to the value of the sound recording performance rights is the use of the SDARS definition of a Music Channel in two places in their gross revenue definition–once in connection with a limitation on advertising revenues and again in an exclusion of subscription revenues solely derived from nonmusic channels. The SDARS define Music Channels to mean channels where sound recordings constitute 50% or more of the programming at SDARS proposed regulation § 26_.2(f), but their

gross revenue definition at SDARS proposed regulation § 26_.2(d)(vi)(B) also implies that nonmusic channels are channels that are characterized as those with only "incidental" performances of sound recordings.[22] Because the latter interpretation is more consistent with the test of unambiguously relating the fee to the value of the sound recording performance rights at issue in this proceeding and because the SDARS offer no substantial evidence to support their 50% breakpoint, we decline to adopt the more cramped position stated in the SDARS' proposed definition of a Music Channel. Rather, we adopt the SDARS "incidental" performance of sound recordings formulation. Using the latter formulation, gross revenues would exclude both subscription and advertising revenues associated with channels that use only "incidental" performances of sound recordings as part of their programming.[23, 24]

A further consequence of the Copyright Royalty Judges adopting the revenue-based metric as a proxy for a usage-based metric with the definition of gross revenue described hereinabove is to eliminate the need for a rate structure formulated as a "greater of" comparison between gross revenue-based metrics and alternative revenue-based metrics that focus on the dollar value of subscriptions alone.

---

[22] The latter definition is more consistent with current SDARS programming. See Woodbury Amended WDT at 6-7 and Ex. 3 and Ex. 4. It is also more consistent with the notion of music channel espoused by SDARS' expert economist, Dr. Woodbury, who identifies all channels using commercially released sound recordings as "music channels" in his analyses. Woodbury Amended WDT at 7 and n.22.

[23] *See infra* at 88-9.

[24] The Judges do not address here the compensability of "incidental" performances of sound recordings; rather, the Judges find that reference to such "incidental" performances facilitates an unambigous definition of nonmusic channels identifying substantial revenue generation unrelated to the sound recording rights at issue in this proceeding and which arises under circumstances clearly distinguishable from the joint music/nonmusic product typically offered by the SDARS.

Although SoundExchange proposes an alternative per subscription dollar amount, the Judges do not find the basis for this alternative structure to be supported by persuasive evidence. For example, SoundExchange's expert economist, Dr. Pelcovits, simply asserts that its rate proposal "sensibly follows a 'greater of' rate structure common to certain marketplace agreements" without more. Pelcovits WDT at 4. Indeed, Dr. Pelcovits' recommended SDARS rate itself is not stated as a "greater of" alternative, but rather as *equivalent* dollar per subscriber or percent of revenue rates. Pelcovits WDT at 32, Pelcovits WRT at 39. SoundExchange's other economic expert, Dr. Ordover, similarly reads SoundExchange's per subscriber and percent of revenue rates as equivalent alternatives. Ordover WDT at 4. Neither Dr. Pelcovits nor any other SoundExchange witness offers a solid explanation of why a "greater of" rate structure makes sense in other marketplaces *together with* an explanation of how that rationale is also applicable to this marketplace, notwithstanding any differences observed between the marketplaces in question. Nor does SoundExchange present any persuasive evidence that the availability of this per subscription alternative is necessary because it is easier to administer and thus will reduce transactions costs. Finally, given the parameters of gross revenues as defined hereinabove, there is no evidence in the record to suggest that gross revenues could be reduced below the amount of revenues otherwise due from applicable subscriptions. For all these reasons, the Judges decline to establish such a duplicative structure.

C. THE SECTION 114 ROYALTY RATES FOR THE SDARS

1. The Applicable Standard

As previously noted hereinabove, *supra* at Section IV.A., the Copyright Act requires that the Copyright Royalty Judges establish rates for the Section 114 license that are reasonable and calculated to achieve the following four specific policy objectives identified in Section 801(b): (A) to maximize the availability of creative works to the public; (B) to afford the copyright owner a fair return for his 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; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. 17 U.S.C. 114(f)(1)(B) and 17 U.S.C. 801(b)(1).

Both the copyright owners and the SDARS agree that a good starting point for the determination of what constitutes a reasonable rate encompassing the four policy factors is to focus on comparable marketplace royalty rates as "benchmarks," indicative of the prices that prevail for services purchasing similar music inputs for use in digital programming ultimately made available to consumers. SDARS PFF at ¶ 810 and SX PFF at ¶ 279. We agree that "comparability" is a key issue in gauging the relevance of any proffered benchmarks. Although the applicable Section 114 statutory standard provides a broader scope for analyzing relevant "benchmark" rates than the "willing buyer, willing seller standard" applicable to the *Webcaster II* proceeding, nevertheless

potential benchmarks are confined to a zone of reasonableness that excludes clearly noncomparable marketplace situations.

2. Comparability of Marketplace Rates

Notwithstanding their apparent general agreement that beginning with a relatively comparable marketplace benchmark is the best way to undertake the requisite analysis here, the parties disagree about what constitutes an appropriate benchmark. The SDARS argue that the most appropriate benchmarks, as analyzed by their expert economist, Dr. Woodbury, are (1) PSS rates applicable to cable subscription offerings by Music Choice; and (2) agreements between performing rights organizations (ASCAP and BMI) and the SDARS covering the digital public performance of musical works. On the other hand, SoundExchange maintains that the most appropriate benchmark agreements, as analyzed by its expert economists, Dr. Michael Pelcovits and Dr. Janusz Ordover, are: (1) the SDARS nonmusic programming content expenditures; (2) market agreements between record companies and a variety of services that digitally distribute their sound recordings; and (3) agreements between content providers and satellite television operators. We find, based on the available evidence before us, that no single market benchmark offered in evidence wholly satisfies the requisite analysis here, but rather that some evidence offered by both the SDARS and SoundExchange can serve to identify the parameters of a reasonable range of rates within which a particular rate most reflective of the four 801(b) factors can be located.

a. The Woodbury Benchmarks

The SDARS' expert economic witness, Dr. Woodbury, offers two alternative benchmarks for consideration as the starting point for rate determination in the instant

matter: (1) the 2004-7 rate paid by Music Choice for sound recordings used in its cable subscription offering, or 7.25% of gross revenues, subject to certain adjustments which would reduce the effective rate for the SDARS to 1.20% of gross revenues; and (2) the aggregate current musical works rates paid to ASCAP and BMI, or 2.35% of gross revenues. In addition, the SDARS argue that certain other evidence in the record "corroborates Dr. Woodbury's PSS-Derived Rate" (e.g., the "custom radio" agreement between Yahoo! and Sony BMG, again subject to certain adjustments which would reduce the effective rate if applied to the SDARS to 2.57% of revenue.)

i. An Adjusted Music Choice PSS Rate

With respect to the first of these proferred benchmarks, we find that Dr. Woodbury's assertion that the Music Choice cable television music offering is comparable to the services offered by the SDARS is unpersuasive. The Music Choice audio service is included as a part of a bundle of primarily audiovisually oriented services (i.e., television channels) offered over cable television systems to cable television subscribers at fixed locations, while the SDARS music channels are a substantial part of purely audio services provided to subscribers over devices designed in large part to compete with terrestrial radio in terms of equivalent mobility. Further, no evidence has been presented to indicate that cable TV subscribers utilize the Music Choice audio service except as incidental to their primary activity of television channel usage, while substantial evidence has been provided by both the SDARS and SoundExchange to indicate that music listening is an integral part of consumer activity with respect to SDARS transmissions. SX PFF at ¶¶ 333-5; Woodbury Amended WDT at 34. In short, the consumer products from which demand is derived for music inputs are clearly not

comparable in these two markets. Furthermore, in contrast to the core SDARS product, there is evidence that consumer demand for the Music Choice offering on cable TV is relatively weak. SX PFF at ¶¶ 1298-1300. Since demand for the music input is a demand *derived* from its use in the consumer service offered and, in this case, the ultimate uses of the Music Choice music programming and SDARS music programming exhibit substantial differences so as to make them poor comparators, we find that the Music Choice "benchmark" provides little if any guidance as to a reasonable price for the music input used in the SDARS service.

We are also not persuaded that the so-called "functionality" adjustment applied by Dr. Woodbury in a purported effort to make his proposed Music Choice benchmark market more comparable to the SDARS target market achieves the desired result. The Woodbury "functionality" adjustment does not address adequately the salient consumer product differences noted above. In that sense, to refer to this adjustment as a "functionality" adjustment is a misnomer. Dr. Woodbury's "functionality adjustment" merely lists key characteristics of the music made available to SDARS consumers (e.g. mobility, quality of reception, broader playlists than typically available on terrestrial radio, etc.) for which music consumers are willing to pay enhanced revenues and then attributes *all* of the revenue associated with these characteristics to other inputs such as satellite technology under the unsubstantiated theory that such other inputs could produce the same level of revenue[25] absent any music to broadcast. Therefore, the Woodbury

[25] Although Dr. Woodbury uses the "costs" associated with these other inputs in his adjustment, he makes clear that those costs merely serve as a proxy for revenues attributable to the use of inputs. Woodbury Amended WDT at 23 ("The SRPR [sound recording performance right] fee paid by XM and Sirius would be higher only because of the added revenue (reflecting higher costs) attributable to providing an end-to-end mobile service, not necessarily because of the

"functionality" adjustment is seriously flawed and makes little contribution to resolving the lack of comparability between the Music Choice cable TV music programming proposed benchmark market and the SDARS target market.

We conclude from the record before us that there is no basis to support the notion that music inputs in both these markets are equally productive in generating revenues for the users. That notion is artificially and inappropriately created by Dr. Woodbury's reduction of the capabilities associated with the music inputs used by the SDARS by restricting their use to the more limited capabilities of the music inputs used by Music Choice in its cable TV offering (e.g., no mobility, etc.). If anything, rather than adding to the downward adjustment to the Music Choice rate already made by Dr. Woodbury to account for music/nonmusic differences, it would seem more appropriate to adjust the proffered SDARS rate upwards to account for these particular mobility differences.[26]

In sum, the consumer products from which demand is derived for music inputs are clearly not comparable in these two markets and the proferred adjustments do not remedy this shortcoming. Because of the large degree of its incomparability, particularly as adjusted by Dr. Woodbury, the proposed Music Choice benchmark clearly lies outside the "zone of reasonableness" for consideration in this proceeding. Therefore, we find this particular benchmark cannot serve as a starting point for the 801(b) analysis that must be undertaken in this proceeding.

---

inherently higher value of music.") Dr. Woodbury describes the costs of these other inputs as "subscriber distribution and acquisition costs." Woodbury Amended WDT at 22.

[26] This is not to say that the music input that is sold to consumers as "mobile music" is *wholly* responsible for the consumer revenues generated by the product over and above the revenues that are generated by an otherwise identical but "nonmobile music product," any more than the technical distribution vehicle is *wholly* responsible for those added revenues.

ii. The Musical Works Rates

The musical works rates benchmark proposed by the SDARS also fails to provide a reasonable benchmark in terms of comparability. This benchmark analysis tracks some similar arguments that failed to prevail in *Webcaster II*.

The Copyright Royalty Judges find that the musical works benchmark analysis offered by Dr. Woodbury is similarly flawed here for several reasons. First, the musical works benchmark analysis is based on a marketplace in which, while the buyers may be the same as in the SDARS marketplace, the sellers are different and they are selling different rights. *Webcaster II*, 72 FR 24094. The fact that an SDAR requires both sets of rights does not make them equivalent. Many products and services require several essential inputs, but that fact alone does not lead to price parity across those inputs. Ordover WRT at 19.

Second, contrary to Dr. Woodbury's assertions that the prices paid for the rights in each respective market should be the same, substantial empirical evidence shows that sound recording rights are paid multiple times the amounts paid for musical works rights in most digital markets (e.g., ringtones, digital downloads, music videos).[27] *Webcaster II*,

[27] The SDARS attempt to discount these particular disparities by implying that since the sound recording rates are negotiated in an unconstrained marketplace while the ASCAP musical works rates in these markets are subject to court supervision, the latter must necessarily be relatively lower because they are constrained by the threat of court intervention. (*See*, for example, SDARS RFF at ¶ 90). But this argument is not persuasive, because it fails to show that the negotiated sound recording rates are greater than "the price that a willing buyer and a willing seller would agree to in an arm's length transaction" (i.e., the rate court standard for reasonableness as articulated in *U.S. vs. ASCAP (Salem Media)*, 981 F. Supp 199, 210 (S.D.N.Y., 1997)).

The SDARS also appear to argue that the Librarian's statement in the *1998 PSS Rate Determination,* at 63 FR 25405, that copyright owners of musical compositions and record companies "do not share equal power to set rates in an unfettered marketplace," recognized that sound recordings enjoy relatively higher rates compared to musical works in other digital markets because of the exercise of relatively greater market power by the record companies as compared to the more constrained musical works seller. Yet, the SDARS reliance on the Librarian's

72 FR 24094; SX PFF at ¶¶ 1381-87, 1389-93. Thus, we conclude that the marketplace evidence from other digital markets submitted by SoundExchange casts substantial doubt on the reasonableness of using the proferred musical works rates as a benchmark for the sound recording rates to be determined in this proceeding, except as an indicator that a reasonable rate for sound recordings could *not* be as low as the musical works rate.

Third, the Copyright Royalty Judges find that Dr. Woodbury's equivalence argument also is flawed because of his effective reliance on the assumption of "sunk costs" as a justification. This assumption fails on both theoretical and empirical grounds for the same reasons that we rejected it in *Webcaster II*. Dr. Woodbury claims that, while the sellers in his benchmark market are not the same as in the target market, they stand in a similar position because for both musical works and sound recordings, the costs of producing the underlying intellectual property are effectively sunk, meaning that there is no incremental cost imposed on the sellers of either the musical work or sound recording by virtue of making the underlying intellectual property available for digital performance. Woodbury Amended WDT at 37. As a matter of theory, then, Dr. Woodbury's proposed benchmark analysis ignores the long-established pattern of investment in the recording industry. As we noted in *Webcaster II* at 72 FR 24094, not only are there some *initial*

---

decision in the *1998 PSS Rate Determination* is misplaced insofar as the Librarian was not focusing on comparative musical works and sound recording rate data from these other *digital* markets where record companies do not sell directly to consumers in the 1998 decision, but rather was evaluating the merits of an RIAA contention that record companies should receive more value from the performance right in sound recordings because the record companies garner more revenue from the use of the mechanical license than do the songwriters and composers. In other words, the focus was on the relevance of the wholesale market for CDs and cassette tapes. Indeed, the Librarian specifically criticized the RIAA offering for failing to "explain why the relative value of the mechanical license to the various owners and users has any application to the determination of the value of digital performance in sound recordings." *1998 PSS Rate Determination* at 63 FR 25405.

sunk investments, but there is a requirement of *repeated* substantial outlays year after year or, in other words, the repeated "sinking" of funds; and, if sellers are faced with the prospect of not recovering such sunk costs, then the incentive to produce sound recordings is diminished. In this case there is also substantial evidence of a substantially greater investment of this type in sound recordings as compared to musical works. SoundExchange PFF at ¶¶ 1399-1401, 1407. Furthermore, recording companies will necessarily make future investment decisions based on their best estimates of the revenue sources available to them in the future from all sources including revenue streams derived from the SDARS' use of sound recordings. Ordover WRT at 14 ("Record companies' incentives to produce new music are based on revenues from all available sources"). As we recognized in *Webcaster II* at 72 FR 24094 n. 28, this is a dynamic economic process concerned with obtaining greater resources for future creative efforts. To suggest that the sound recording copyright owners should ignore such costs in their approach to pricing in the SDARS market makes little sense. At bottom, then, we find Dr. Woodbury's equivalence rationale for his proposed benchmark to be severely flawed. Moreover, as we pointed out above, there is ample empirical evidence in the record from other digital marketplaces to controvert Dr. Woodbury's premise that the market for sound recordings and the market for musical works are necessarily equivalent. SX PFF at ¶¶ 1381-87, 1389-93.

For all these reasons, the Judges find that Dr. Woodbury's proffered musical works benchmark is not useful as a starting point for our determination of a reasonable sound recording rate in this market and, further, that marketplace evidence from other

digital markets submitted by SoundExchange shows that a reasonable rate for sound recordings could not be as low as the musical works rate.

iii. SDARS' Corroborative Evidence for PSS-Derived Rate

The SDARS argue that certain other evidence in the record corroborates Dr. Woodbury's PSS-derived rate of 1.2% of revenues: (1) the prior SDARS-RIAA agreement (in the range of 2.0% to 2.5% of revenues); (2) the SDARS Musical Works Agreements (suggested benchmark rate of 2.35%); (3) a "custom radio" agreement between Yahoo! and Sony BMG, subject to certain adjustments which would reduce the effective rate if applied to the SDARS to 2.57% of revenue; and (4) Dr. Pelcovits' nonmusic programming benchmark, also subject to certain adjustments which would reduce the effective rate if applied to the SDARS to 3.51% of revenue. We find that rates which are virtually 2 or 3 times as great (e.g. 2.35% or 3.51%) as the rate they are being used to corroborate (i.e. 1.2%) only serve to undermine any reasonableness that might be ascribed to the Woodbury PSS-derived rate of 1.2%. That is, even if the Woodbury PSS-derived rate was derived from an arguably comparable benchmark, this "corroborative" data all points in the direction that it is too low as adjusted.

Furthermore, we find that the musical works benchmark and the adjusted Pelcovits nonmusic programming benchmark themselves suffer from serious flaws. See *supra* at Section IV.C.2.a.ii. and *infra* at Section IV.C.2.b.ii. In addition, the SDARS-RIAA current agreement cannot be corroborative of a *reduced* rate going forward since it is not accompanied by any evidentiary showing that economic circumstances in this market have deteriorated. Finally, the rate terms from a "custom radio" agreement between Yahoo! and Sony BMG (which were not introduced to corroborate the PSS-

adjusted rate but rather were introduced by Dr. Woodbury to ostensibly test the sensitivity of Dr. Ordover's analyses of other markets): (1) were not shown to be representative of this category's agreements; and (2) suffer from the same flawed "functionality" adjustment as Dr. Woodbury's PSS-derived rate. In short, we find no persuasive evidence proffered by the SDARS that would cause us to alter our earlier finding that the PSS-derived rate as adjusted by Dr. Woodbury (i.e., 1.2% of revenues) clearly lies outside the "zone of reasonableness" for consideration in this proceeding.

b. The Pelcovits Benchmarks and Analyses

SoundExchange's expert economic witness, Dr. Pelcovits, offers two benchmarks for consideration as the starting point for determination of a royalty rate applicable to the SDARS: (1) royalties of 23% for sound recordings based on Sirius' payments to Howard Stern for nonmusic content (Pelcovits Amended WDT at 8); and (2) royalties of 18.6% for sound recordings based on payments made in the aggregate by the SDARS for nonmusic programming, including payments made to Howard Stern (Pelcovits Amended WDT at 10). In addition, Dr. Pelcovits offers an alternative analysis that yields royalties of 18% for sound recordings based on a "division of surplus" analysis between nonmusic content and music content (Pelcovits WRT at 39 n.64).

i. The Stern Benchmark

Dr. Pelcovits offers his Stern analysis on the assumption that nonmusic content and music content are substitutes. He then focuses on one particular type of non-music content, Howard Stern's programming on Sirius. He next estimates that Sirius paid about 50% of revenue to Stern for each incremental subscriber that his programming attracted to Sirius. Using the results of a survey undertaken by Dr. Wind that purports to show that

56% of all Sirius' subscriber revenues would be lost if it offered no music channels, Dr. Pelcovits then concludes that just as Howard Stern is paid 50% of the revenues for the customers attributed to him, the music input should likewise be paid 50% of the revenues for the 56% of SDARS customers attributed to it. Subtracting the music publishers' royalty and the SDARS' internal production costs for music channels, Dr. Pelcovits is left with a bottom line royalty of 23% for sound recordings. We find this analysis suffers from several serious shortcomings.

First, Dr. Pelcovits' assertion that "different kinds of content are substitutable inputs" (see Pelcovits WDT at 10) is questionable in light of the fact that both inputs are required to produce the SDARS primary offering–a joint music-nonmusic consumer service. As currently constituted in this joint offering, these two types of different content, by definition, may well be classified as complementary (e.g., similar to the joint requirement for a fishing rod and a fishing reel in order to engage in the activity of fishing). No substantial evidence regarding the relevant cross-price elasticities of demand was presented by Dr. Pelcovits to support his assertion that music programming and nonmusic programming are substitutes *as currently utilized by the SDARS*.[28] Indeed, Dr. Pelcovits recognizes this *complementary* aspect of the various programming inputs when he declares, with respect to the current Sirius service, that "a large catalog of music is *essential* to a music-based service and attracts customers to Sirius *just as* Stern attracts customers." Pelcovits WDT at 13 (emphasis added).

[28] A positive cross-price elasticity of demand for music programming associated with an increase in the price of nonmusic programming would indicate that the two inputs were substitutes, while a negative cross-price elasticity of demand under the same circumstances would indicate that the two inputs were complements.

Second, Dr. Pelcovits makes several unjustifiable leaps in his analysis. He asserts that since Sirius paid 50% of revenues for each incremental subscriber that Stern's programming attracted to Sirius, the same 50% figure "ought to apply equally to music content as to Stern" without performing any comparable *incremental* revenue analysis for music programming. Pelcovits WDT at 13. Given the weaknesses of the 50% calculation for Stern, his assertion without any attempted analysis of the same 50% figure for music content requires a leap of faith that appears unjustified.[29] Dr. Pelcovits then multiplies the 50% Stern figure by 56% of all customers purportedly attracted to music so as to determine the "share of the customer base that can be attributed to sound recordings in the same sense" that Stern's *incremental* customers are attributed to Stern. Pelcovits WDT at 13. But this latter calculation has little to do with determining *incremental* subscriber revenue. For example, Dr. Wind's survey findings do not satisfactorily meet the needs of the theory espoused by Dr. Pelcovits because, as noted by Dr. Noll, "The survey methods for determining the importance of music to SDARS penetration are not designed to answer the pertinent question, which is the *incremental* value of music, holding constant the features of the service, including the quantity of music that is now

[29] This 50% estimate was originally based on analyst projections of 1.75 million incremental subscribers. A subsequent 50% estimate was based on the 2 million incremental subscribers that Dr. Pelcovits said Sirius contemplated Stern would generate by the end of 2007. Pelcovits Amended WDT at 6-8. In his amended estimates, using the original 1.75 million incremental subscribers reduces the Stern cost as a percent of incremental revenue to 49%. Dr. Pelcovits further offered estimates for 1, 2, 3 or 4 million subscribers (79%, 50%, 39% and 34% respectively) as well as an average percentage of 49% taking into account each of the four amounts of incremental subscribers. Pelcovits Amended WDT at 7-8. Incredulously, even though he offers no apparent reason for looking at one of these estimates (the 3 million incremental subscriber case) or for suggesting that it might reflect actual experience in some way, Dr. Pelcovits includes it in his "average" and describes the resulting average as "reasonable." Pelcovits Amended WDT at 8 n.20. To the contrary, Dr. Pelcovits' various alternative estimates simply underscore the lack of a solid foundation, in fact or in theory, for his estimates and, therefore, undermine their reasonableness.

available." Noll WRT at 69. (*See also* Noll WRT at 10-11). Thus, even assuming Dr. Wind's survey were without faults, that survey says little about *incremental* subscribers, but rather tries to assess the consumer preferences of all Sirius subscribers or the average Sirius subscriber. By comparing the incremental revenues attributable to Stern and the overall revenues arguably attributable to music programming in order to solve for the unknown price of the music input, Dr. Pelcovits effectively ignores the marginal or incremental nature of the concept he seeks to employ.[30] Even Dr. Pelcovits' estimate of the total revenues attributable to the music input is based on a single imperfect snapshot of consumer preferences provided by Dr. Wind[31] at one point in time, without any justification for the implied assumption that such preferences have remained or will remain stable across Sirius' subscribership over time or even over any limited relevant time period.

Third, and most importantly, inasmuch as Dr. Pelcovits offers the Stern analysis as a "benchmark," he assumes a degree of marketplace comparability that the evidence in this proceeding does not support. The sellers of the respective inputs are different.[32] There is a single purchaser of the "exclusive" Stern content from among the SDARS (i.e. Sirius), while both SDARS are buyers of the same music content. The way the inputs are

---

[30] Indeed, it is questionable as to whether the marginal analysis Dr. Pelcovits seeks to apply to the Stern content makes good sense given that the acquisition of Stern was a "lumpy" purchase that inhibits small incremental adjustments. Woodbury WRT at 41.

[31] Because nonmusic content is broken down into a number of non-additive sub-categories, while music content is not, Dr. Wind asks consumers to compare music not relative to nonmusic content, but rather to compare music to each of news, sports and talk and entertainment programming separately. These survey results therefore cannot be properly interpreted as if music as a generic category were being compared to nonmusic as a generic category.

[32] In addition, because Stern is a single seller in the market for his content, he arguably functions as a monopolist in the market for his service whereas the sellers of the music inputs are more numerous.

used in the ultimate consumer offering results in different revenue generating capabilities for the respective inputs. For example, the Stern content can generate revenue through increased subscriptions as well as through increased advertising, while the chief characteristic of the music input on the SDARS is that it is commercial-free. Then too, there are other benefits associated with specific nonmusic content like the Stern content, such as the right to associate the service with the content provider's brand, that makes those inputs differentiable from the music input in terms of the breadth of intellectual property rights provided or the nature of the input provided. SDARS RFF at ¶ 286. In other words, all "content" is not comparable, any more than all inputs in addition to that content are comparable just because they share the ultimate purpose of generating revenue for the SDARS.

Fourth, to the extent that Dr. Pelcovits treats advertising revenues as part of incremental revenues attributable to Howard Stern (Pelcovits Amended WDT at 6), his use of the result as a benchmark for pricing commercial-free content inappropriately assumes an undemonstrated incremental revenue impact for the music input from advertising. SoundExchange's argument that "to the extent that music grows the subscriber base, and those subscribers listen to non-music channels as well as music channels, the larger base of potential listeners helps attract advertisers" (*see* SX RFF at ¶ 464) mistakenly attempts to equate an actual, measurable direct or primary effect associated with the Stern content to a possible, though a largely unsupported and uncalculated indirect or secondary effect which SoundExchange attributes to music. There is no dispute that the Stern content, as is the case with other nonmusic content used by the SDARS, is specifically utilized in conjunction with advertising, while the music

content used by the SDARS is specifically touted to emphasize the commercial-free nature of the offering.

Finally, Dr. Pelcovits' estimates of subscribers drawn to Sirius by the Stern deal do not inspire great confidence. Other conflicting evidence concerning estimates of the additional subscribers likely to flow from the Stern deal have been identified in the record. SDARS RFF at ¶¶ 392-393.

For all these reasons, we find the proposed Stern content benchmark to be a poor starting point for the 801(b) analysis that must be undertaken in this proceeding.

ii. The Nonmusic Content Benchmark

Many of the shortcomings that apply to the Stern benchmark, similarly apply to Dr. Pelcovits' consideration of other nonmusic content deals as *benchmarks*. Here again, Dr. Pelcovits does not satisfy his theoretical claims that music programming and these other types of content are substitutes in the primary product offering of the SDARS. Most importantly, the key characteristic of a good benchmark–comparability–is not present. The sellers are different, the buyers are only the same in the aggregate and the nature of the inputs offered vary substantially.

Then too, Dr. Pelcovits abandons the economic rationale that he claimed served to undergird his Stern analysis: "Absent data for other content deals, I was unable to reliably perform similar analyses of other individual deals relating the amount paid to the content provider to the expected number of incremental subscribers." Pelcovits Amended WDT at 9. Undeterred, Dr. Pelcovits claims that it is sufficient to simply calculate the total expenditure of the SDARS on nonmusic content as a proportion of total SDARS revenues in order to determine the appropriate revenue-based rate to use as a benchmark for the

music input. We find Dr. Pelcovits' analysis and the resulting recommended "benchmark" of 18.6% particularly unpersuasive. Certainly, confidence in the reliability of the benchmark is hardly enhanced by the fact that it reflects two widely disparate estimates for each of the two SDARS.[33]

In short, we find Dr. Pelcovits' proposed rates based on nonmusic content to poorly meet the needs of a reliable benchmark. Even before subjecting it to any 801(b) analysis, SoundExchange admits this benchmark is significantly lower if the same analysis is applied to data projections for the years 2006 through 2012 instead of just actual data from 2006. SX RFF at ¶ 461. Even if the benchmark did not suffer from all the shortcomings identified hereinabove, such a large degree of sensitivity does not inspire confidence in using this proposed benchmark as a starting point for our analysis.

iii. Division of Surplus Analysis

In addition to his two proferred nonmusic content benchmarks, Dr. Pelcovits undertakes an additional analysis that purports to divide the SDARS "surplus" or residual revenues (revenues net of noncontent costs including capital costs) between the SDARS, music content providers and nonmusic content providers. We find that this analysis relies on unsupported assumptions about market behavior. For example, Dr. Pelcovits argues that all content costs must be part of his surplus pot because that is how negotiations take place "in the real world." Pelcovits WDT at 16. No evidence from this market was provided to support this assumption. Despite this assumption, Dr. Pelcovits omits musical works royalty costs from his surplus pot. Pelcovits WDT at 16 n.15. Thus his

[33] Looking at each of the SDARS individually, Dr. Pelcovits calculates that XM's nonmusic content providers were paid 16.9% of revenues in 2006 while Sirius' nonmusic content providers were paid 33.2% of revenues in 2006. Pelcovits Amended WDT at 10.

inclusion of nonmusic content costs into his surplus pot appears to be little more than a transparent attempt to enlarge the surplus that is potentially available for distribution to owners of sound recordings. Although Dr. Pelcovits later claims to amend his results by "excluding these royalties and then pay this same amount off the top out of the surplus assigned to music," this adjustment still treats the music publishers' costs as predetermined, rather than adding the publishers as the players to the game who also share in the surplus. Dr. Pelcovits offers no sound basis for distinguishing between his treatment of nonmusic content costs and musical works content costs or, for that matter, for treating other variable inputs as predetermined costs as well. As Dr. Noll points out, this disparate treatment of SDARS inputs may well bias the Shapley values in favor of the record labels. Noll WRT at 89.

Other assumptions underlying Dr. Pelcovits' analysis are also not solidly supported. For example, Dr. Pelcovits relies on Mr. Butson's revenue and cost estimates for XM and Sirius in 2012, despite the well-known fact that financial projections of the kind undertaken by Mr. Butson increase in uncertainty over the course of the period projected, with the last year in a six-year period of projections (in this case, 2012) being the least reliable. SDARS PFF at ¶ 960. Mr. Butson's projections in turn rest on a number of growth assumptions that either merely track past experience at best or are arbitrary at worst, leading us to question the degree to which such data is reliable for the purpose employed by Dr. Pelcovits. Different assumptions would provide different bottom-line numbers in Dr. Pelcovits' analysis.

After estimating the available "surplus" in 2012, Dr. Pelcovits proceeds to use a Shapley model of a cooperative game to divide the "surplus" among the various inputs.

But a cooperative game solution to a bargaining problem assumes that an agreement between the parties is both possible and enforceable. Here there is no enforcement mechanism. 7/9/07 Tr. 303 (Pelcovits); Noll WRT at 83. Therefore, the outcomes of the model cannot be supported. At the same time, no reason is provided by Dr. Pelcovits as to why each participant in the game should not make its decisions independently to maximize their own profits. In other words, a non-cooperative game approach may have been more appropriate under the circumstances.

In short, questionable assumptions coupled with concerns over the reliability of the data used in the Pelcovits analysis cause us to regard the findings of the Pelcovits analysis as carrying little weight. For those reasons, the Judges find that the Pelcovits surplus analysis neither serves to provide a solid market rate estimate to serve as a starting point for the application of the 801(b) considerations nor to provide additional solid corroboration of SoundExchange's various benchmark analyses.

c. The Ordover Benchmarks

Although Dr. Ordover recognizes that no benchmark is perfect, he offers two categories of benchmarks for the Judges' consideration: (1) satellite TV deals with nonmusic content providers that yield two benchmarks, 40% of gross revenues based on overall content or 49.3% of gross revenues based on premium network programming, subject to certain adjustments which would reduce the effective rate for the SDARS to 18.5% or 23.5% of gross revenues (Ordover WDT at 40-41); and (2) a variety of agreements covering other distribution channels for digital music (e.g., interactive subscription services, cellular ringtones, etc.) that suggest a benchmark of 35% to 50% of revenues, subject to only an adjustment for the lower proportion of music content on the

SDARS that would result in a benchmark royalty rate of 19% to 28% or, if adjusted to account for other differences between the benchmark market and the target SDARS market, would yield a royalty rate of $2.51 to $3.09 per subscriber per month (Ordover WDT at 50-52) .

We find the first of these two categories of proferred benchmarks to be of little value. Even assuming that the SDARS have similar cost structures to satellite TV (also known as Direct Broadcast Satellite or DBS) operators, they offer very different consumer products, the inputs focused on in the analysis (nonmusic audiovisual content) differ substantially from the sound recording inputs at issue in this proceeding, and the buyers and sellers are different in the benchmark market as compared to the target market. The fact that these different enterprises may exhibit some similarities with respect to their capital structure and that both are subscription services offering entertainment in a broad sense is not sufficient to overcome all the aforementioned fundamental differences between the proposed benchmark market and the target market.

However, we find Dr. Ordover's second category of proferred 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. Ordover WDT at 47-48. But this difference is reasonably accounted for in Dr. Ordover's interactivity adjusted per subscriber rates. In order to make the benchmark interactive market more comparable to a non-interactive service like the SDARS, Dr. Ordover adjusts the benchmark by the differential value associated with the interactivity characteristic. Ordover WDT at 47-52. This adjustment by itself suggests a rate of $1.40 per subscriber per month (i.e. $7.50 per subscriber per month multiplied by an interactivity adjustment factor of .0015/.008). Using Dr. Ordover's assumption that the average monthly per subscriber price for satellite radio is $11.25, the interactivity adjusted benchmark of $1.40 per subscriber per month is the equivalent of 13% on a percentage of subscriber revenue basis.[34] While we agree with Dr. Ordover, that but for the lack of extensive data, these calculations might well be improved through a hedonic regression analysis, nevertheless we find that, based on the available data in the record, this interactivity adjusted benchmark is a reasonable estimate of a marketplace derived benchmark.[35]

---

[34] Because of the commercial-free character of music programming on the SDARS, subscription revenues attributable to music programming are the appropriate focus of this analysis.

[35] SoundExchange's argument that this interactivity adjustment needs to be adjusted further by differences in the intensity of use is not adequately supported by the record. Dr. Ordover admitted that the information he would have to rely on to make such an adjustment was "imparted to me by counsel" and that he "did not have a direct conversation with the people who delivered the information" and that he "did not file a calculation that would reflect that adjustment" (i.e. he

At the same time, we find that any rate derived from the higher digital distribution channel benchmarks offered in evidence lie outside the zone of reasonableness because they either: (1) fail to account for key differences that consumers value or (2) propose other adjustments not well supported by the evidence. For example, Dr. Ordover himself proposes an additional upward "immediacy" adjustment to the interactivity adjusted digital subscription rate calculated above that would raise it from $1.40 per subscriber per month to $2.51 per subscriber per month. Ordover WDT at 49-50. However, we find that the "immediacy" adjustment is not well founded in that it: (1) unrealistically treats all computers as stationary devices always necessitating a two-step accessibility process involving downloading music to a computer and uploading therefrom to a separate portable device in order to move the music listening experience to another physical location (i.e., widely available technology allows portable computers not only to be moved to other physical locations but also to access the internet wirelessly); and (2) appears to overstate the significance of the delay involved in listening to music because of the process of downloading to a computer and uploading therefrom to a separate portable device (i.e., the consumer may have previously downloaded the music that he may want to listen to at any point in time so that the download process does not

---

made no adjustment to his proposed rates based on this information regarding intensity of use). 8/27/07 Tr. 102:11-12; 108:7-109:18 (Ordover). Moreover, Mr. Eisenberg's testimony cited by SoundExchange to support higher intensity of usage ambiguously refers to "historical" data from an unknown period which may or may not coincide with the period analyzed by Dr. Ordover in making his initial interactivity adjustment. Eisenberg WDT at 19. At the same time, the SDARS' argument that Dr. Ordover's interactivity adjustment is fatally compromised by the absence of this additional intensity adjustment is equally without merit. The absence of the unsupported additional "intensity" adjustment does not negate the reasonableness of Dr. Ordover's interactivity adjustment based on the record of evidence before us. The SDARS' separate argument that Dr. Ordover's video-service interactivity adjustment needs to be adjusted to reflect a substantially higher value for interactivity, as shown by a few recent audio agreements

have to be repeated every time the consumer wants to listen to music). Moreover, Dr. Ordover admits that, in light of the trend of more recent agreements, it is possible that the basis for his "immediacy" adjustment has all but disappeared as indicated by a ratio approaching unity. 6/21/07 Tr. 186:20-187:8 (Ordover).

In sum, while some aspects of the Ordover analysis may not be persuasive, the Judges find that these critiques are not sufficient to undermine the basic thrust and conclusions of the Ordover analysis that the interactive subscription market is a benchmark with characteristics reasonably similar to the non-interactive SDARS, particularly after Dr. Ordover's reasonable adjustment for the difference in interactivity. As noted hereinabove, we equate the resulting benchmark offered by Dr. Ordover to be the equivalent of 13% stated as a percentage of revenue. We find that some of the additional relevant evidence from the marketplace for other types of digital music services corroborates Dr. Ordover's analysis by showing that, for many types of music services, a substantial portion of revenue is paid to sound recording copyright owners above the current SDARS rate, just as it would be pursuant to the 13% rate that would result from Dr. Ordover's interactivity adjusted interactive subscription market analysis. In other words, we find these additional voluntary agreements covering such digital services as clip licenses, permanent audio downloads, etc. of some general corroborative value. These data show that, in many cases, the price paid by buyers for the rights to utilize a sound recording in various ways is as much as or higher than the 13% rate suggested hereinabove. This shows that the prevailing rates in these other markets do not appear to undermine his analysis–some indication of general reasonableness. However,

---

covering interactive as well as noninteractive services, is not supported by a close reading of the relevant provisions of those agreements. SX PFF at ¶ 481-486.

because no effort is made to reconcile the many differences in product characteristics that may exist between these markets and the target SDARS market and adjust for such differences, these alternatives must be regarded as having only directional value and to lie outside the zone of reasonableness (i.e. a zone that excludes clearly noncomparable market situations). In other words, based on the record of this proceeding, the 13% rate identified hereinabove marks the upper boundary for a zone of reasonableness for potential marketplace benchmarks from which to identify a rate that satisfies any 801(b) policy considerations not adequately addressed in the market.

3. The Zone of Reasonableness And The 801(b) Policy Considerations

The marketplace evidence offered by the SDARS and SoundExchange supports the determination of the parameters of a zone of reasonableness. Based on the record of evidence in this proceeding we have determined that the 13% rate identified hereinabove marks the upper boundary for a zone of reasonableness for potential marketplace benchmarks. We have also determined that potential marketplace benchmarks cannot be less than or equal to the SDARS' musical works rates (i.e., 2.35% of gross revenues). However, the latter lower boundary for the zone of reasonableness is not the equivalent of the upper boundary in offering a specific benchmark defined by comparability. Therefore, based strictly on marketplace evidence, a rate close to the upper boundary is more strongly supported than one close to the lower boundary. We now turn to the 801(b) policy considerations to determine the extent to which those policy considerations weigh in the same direction or a different direction as the benchmark market evidence hereinbefore reviewed.

The relevant 801(b) factors meriting further consideration consist of the following four specific policy objectives: (A) to maximize the availability of creative works to the public; (B) to afford the copyright owner a fair return for his 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; and (D) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. 17 U.S.C. 114(f)(1)(B) and 17 U.S.C. 801(b)(1). Not surprisingly, both the SDARS and SoundExchange have a different view of how specific facts weigh in their favor on each of these policy objectives. We reject the notion, however, that Section 801(b)(1) is 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. Neither the Copyright Royalty Tribunal nor the Librarian of Congress adopted such an approach. *See* 46 FR 884 (January 5, 1981) (jukebox proceeding); 46 FR 10466 (February 3, 1981) (mechanical license proceeding); 63 FR 25394 (May 8, 1998) (PSS proceeding). Rather, the issue at hand is whether these policy objectives weigh in favor of divergence from the results indicated by the benchmark marketplace evidence. Therefore, we next evaluate the other evidence in the record offered with respect to the four policy considerations to determine if that evidence shows that the weight of marketplace evidence we have previously reviewed requires any adjustment.

a. <u>Maximizing the Availability of Creative Works to the Public</u>

While the SDARS and SoundExchange offer various arguments to suggest that they are each respectively the largest contributor toward the achievement of this policy objective, those arguments miss the mark. The ultimate question is whether it is necessary to adjust the result indicated by marketplace evidence in order to achieve this policy objective. 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." Ordover WDT at 11. An effective market assures absence of both below-market prices and supra-competitive 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.

The parties to this proceeding choose to emphasize only one or two aspects of these supply and demand dynamics because doing so appears to facially support a "win" for them on the availability factor. The SDARS, for example, choose to emphasize that they foster the availability of music: (1) by assuring that different types of music are more widely disseminated than they are in the terrestrial radio alternative and (2) by the promotional effect of their airplay. Therefore, their view is that the availability of works to the public is maximized if the rates are as low as possible. *See* SDARS PFF at ¶¶ 126-147; Woodbury Amended WDT at 43-44; Noll WRT at 41. On the other hand, SoundExchange focuses on the input suppliers' incentive to increase creative output, arguing that the recording industry requires higher revenues from alternative distribution

mechanisms to compensate for a drop in the physical sales of CDs generally and higher revenues from the SDARS specifically to compensate for the substitution of SDARS listening for physical CD sales. Therefore, its view is that the availability of works to the public can only be maximized through higher rates. *See* SX PFF at ¶¶ 781-93, ¶¶ 811-12, ¶¶ 669-710.

We find that the record does not support any adjustment from the result indicated by the previously reviewed marketplace evidence in order to achieve the policy objective of maximizing the availability of creative works. For example, the evidence presented by the SDARS and SoundExchange is insufficient to suggest a net substitution/promotion difference between the interactive subscription service benchmark and the SDARS marketplace. Because only the relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment, the absence of solid empirical evidence of such a difference obviates the need for such further adjustment.

Furthermore, even if the absolute levels of promotion/substitution in the SDARS market alone were somehow relevant, as the parties appear to suggest, we find that they presented no acceptable empirical basis for quantifying promotion/substitution for purposes of adjusting rates. For example, the SDARS assert that their service is promotional and imply that they should receive credit for this effect. But they present no persuasive evidence that would be useful for quantifying the magnitude of this asserted effect or for deriving a method for translating such magnitudes into a rate adjustment. The mere assertion that airplay is promotional without more is insufficient. Indeed, the quality of evidence presented by the services on this issue consisted largely of such

assertions (e.g., Woodbury Amended WDT at 44-46), a handful of consumer testimonial e-mails or anecdotes recounting subjective opinions. *See* SX PFF at ¶¶ 714, 717.

SoundExchange, in an effort to support and quantify its claimed substitution effect, offers the results of several consumer surveys. Dr. Pelcovits concludes that these surveys show that SDARS subscribers will reduce their purchases of CDs by 2.6 CDs per subscriber per year. *See* Pelcovits WRT at 31-33. But the Wind survey on which Dr. Pelcovits partially relies in reaching his conclusion was excluded by the Judges in their gatekeeping roles (applying Federal Rule of Evidence 702), because of data shortcomings and questions about the reliability of the methods employed by Dr. Wind in that survey. 8/29/07 Tr. 114:2-115:2. Dr. Pelcovits' partial reliance on the marketing survey research offered by Mr. Mantis is similarly misplaced because the weight of the survey's results are questionable in light of: (1) the lack of a control group where the purpose of the survey is to establish causality; (2) the potential bias introduced by the leading character of important questions in the survey; (3) an inability to specifically attribute all of the claimed substitution effect to the SDARS music programming as opposed to the SDARS nonmusic programming; and (4) the lack of time period specificity in asking about consumer behaviors. SDARS PFF at ¶¶ 247-257, 258-261, 263. Dr. Pelcovits' reliance on the National Association of Recording Merchants ("NARM") survey does not aid his calculation of the magnitude of the substitution effect because, even construing the evidence in a light most favorable to SoundExchange, it indicates the percentage of satellite radio subscribers who purchased no music in the last

year. That is, the NARM study may suggest a substitution effect but does not attempt to quantify it.[36]

Thus, on the evidence before us we find the net impact of the claimed substitution and promotion effect of the SDARS on CD sales is indeterminate. More importantly, we find that little if any of this evidence sheds light on the question of whether the net substitution/promotion effect of the SDARS is different from the net substitution/promotion effect of the interactive subscription service benchmark.

Finding no conclusive quantifiable evidence of such a substitution/promotion difference between the benchmark market and the target market and, further, finding no quantifiable difference suggested by the parties with respect to the remaining evidence submitted on the first policy factor discussed hereinabove, we conclude that, in the instant case, the policy goal of maximizing the availability of creative works to the public is reflected in the market solution embodied in the benchmark market rates. An effective market would have taken into account substitution concerns and promotion effects in determining the maximum amount of product availability consistent with the efficient use of resources.

b. Fair Return to Copyright Owner and Fair Income to Copyright User

Here, too, the SDARS and SoundExchange offer various arguments to suggest that they should each be the largest beneficiary of this policy objective and, again, those arguments miss the mark. The ultimate question is whether it is necessary to adjust the

[36] SoundExchange also argues that the SDARS' own listening research suggests a substitution effect. Again, even construing the evidence in a light most favorable to SoundExchange, the SDARS' internal research merely provides general evidence of a substitution effect rather than a specific quantifiable magnitude.

result indicated by marketplace evidence in order to achieve this policy objective and, if so, is there sufficient evidence available to do so.

We find that the evidence in the record supports no such adjustment. The SDARS have not shown that their income under existing economic conditions is unfairly constrained by adoption of a rate informed by the marketplace evidence we have previously reviewed. Nor has SoundExchange shown that the copyright owners will fail to receive a fair return for their creative work because of the adoption of a rate informed by the marketplace evidence we have previously reviewed.

The SDARS argue that a fair income to the copyright user is one which is sufficient to generate a competitive risk-adjusted return on past and future investments. *See* SDARS PFF at ¶ 179. But the SDARS conveniently ignore the highly leveraged structure of their enterprises and imply that such a return should occur within the license term and, further, that such a return should be at least one that consists of net income in the form of profits. *See* SDARS PFF at ¶¶ 178, 186. Affording copyright users a fair income is not the same thing as guaranteeing them a profit in excess of the fair expectations[37] of a highly leveraged enterprise. Nor is a fair income one which allows the SDARS to utilize its other resources inefficiently. In both these senses, a fair income is more consistent with reasonable market outcomes. Therefore, in the absence of any substantial evidence in the record to the contrary, we find that it is not necessary to adjust the benchmark rate hereinbefore indicated by marketplace evidence in order to achieve

[37] The SDARS readily admit that any projections, particularly in this relatively new industry, are subject to substantial uncertainty especially towards the latter part of the license period. Frear WRT at ¶¶ 13-14. Therefore, the fair earnings expectations of a highly leveraged enterprise must reasonably carry a somewhat wider ambit than various projections offered into evidence by the contending parties.

the policy objective of affording copyright users a fair income. For example, there is no substantial evidence of the exercise of unfair market power in the setting of prices in the benchmark marketplace.

This is not to say that SDARS' concerns with respect to meeting their cash flow and income goals sooner rather than later should not be considered in this proceeding, but rather we find that they are more properly raised when the SDARS more directly address the timing issue and its impact in the context of the fourth policy objective articulated in the statute (i.e., minimizing any disruptive impact on the structure of the industries involved).

With respect to the second policy objective, SoundExchange primarily points to the voluntary agreements negotiated with other digital services in the market for sound recordings as representing a fair return for copyright owners. However, SoundExchange suggests that if the application of the four policy objectives produces a below-market rate, then a fair return would not be achieved because that below-market rate would result in the record industry not earning sufficient royalties to compensate for the substitution effect the SDARS have on revenues from the sales of other forms of music. *See* SX PFF at ¶ 834. Because we have previously addressed SoundExchange's market-based evidence, *supra* at Section IV.C.2.b.-c., we need not address the specifics of that evidence again here. Similarly, we have previously addressed SoundExchange's evidence with respect to substitution of the SDARS for CD sales, *supra* at Section IV.C.3.a., where we found the net impact of the claimed substitution and promotion effect of the SDARS on CD sales was indeterminate. We further note that additional SoundExchange claims regarding a broader view of substitution (i.e. an SDARS substitutional effect on the sales

of music in forms other than CDs) are neither adequately supported nor quantified in the record. In short, based on the evidence before us, we find that it is not necessary to adjust the benchmark previously indicated by marketplace evidence in order to achieve the policy objective of affording copyright owners a fair return.

c. 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

The SDARS, in effect, argue that the third 801(b) policy objective requires a discounted market rate in consideration of their: (1) creative contributions to developing and airing nonmusic programming, (2) creative contributions to music channels, (3) contributions in the form of the design and development of new technology, (4) substantial capital investments and operating costs, (5) contribution towards meeting various risks associated with making their product available to the public, and (6) contribution to opening new markets for creative expression and media for their communication. Not surprisingly, SoundExchange argues that record companies and artists make equally important contributions to the achievement of this third policy objective when these various sub-factors are considered as a whole and, further, that these various sub-factors are adequately considered and valued in market transactions. We find that, considering the record of relevant evidence as a whole, the various sub-factors identified in this policy objective may weigh in favor of a discount from the market rate because of the SDARS' demonstrated need to continue to make substantial new investments to support the satellite technology necessary to continue to provide this specific service during the relevant license period. However, inasmuch as we find this

issue is intimately intertwined with evidence impacting our consideration of the fourth 801(b) policy objective (i.e., minimizing any disruptive impact on the structure of the industries involved), we will treat the effect of this particular matter as part of our consideration of the fourth policy objective. *See infra* at Section IV.C.3.d.

We come to this conclusion in a straightforward manner from the evidence offered regarding the third policy consideration. The SDARS' attempt to obtain credit for creative contributions largely centers on: (1) enhancements to the channels described as music channels and (2) their acquisition of nonmusic programming as part of their product offering. The SDARS' reliance on the Librarian's decision in the *1998 PSS Rate Determination* at 63 FR 25405 which stated that the "product made available" is the "entire digital music service" of which sound recordings are an element is misplaced where the SDARS seek to gain credit towards a discounted royalty rate for music by pointing to their creative addition of nonmusic programming to the digital music offering. The Librarian was clearly considering a music-only service in the *1998 PSS Rate Determination* and nowhere in that decision suggests that such nonmusic content considerations are relevant. SX PCL at ¶¶ 84-85. While the SDARS' creative contributions to music channels may be relevant, it is certainly subsidiary to and dependent 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.[38] Herscovici

[38] Dr. Woodbury suggests that the creative contributions of the record companies and artists are not relevant because they were not made specifically for this product offering–that is, they involved no "incremental effort to create new music." Woodbury Amended WDT at 48. There is no factual basis to support the Woodbury assertion. Moreover, the owners of sound recordings clearly receive recognition for their creative contribution in the form of compensation from all of the other digital music services discussed in this proceeding even though those sound recordings were not shown to be created exclusively for those services. In other words, the Woodbury analysis is flawed because it would preclude intellectual property owners from ever being

WRT at 23-24. However, our inquiry does not end here. We find that, notwithstanding this imbalance in relative creative contributions, there is nothing that distinguishes this result from the benchmark marketplace that requires an adjustment in order to achieve the third policy objective.

With respect to technological contributions, capital investment, cost, risk and the opening of new markets, the SDARS' claims are overstated regarding their relative contributions to the relevant product made available to the public. For example, the SDARS' claimed technological contributions take credit for not only their own efforts but also for the substantial technological contributions of others. Elbert WRT at 20-40. At the same time, capital investment expense, other costs, and risk incurred by copyright owners are dismissed by the SDARS because they are not "incremental" with respect to satellite radio (Woodbury Amended WDT at 50); but this ignores the fact that 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." Ordover WRT at 14. Thus, contrary to the overstated claims of the SDARS, with respect to most such investments, costs and risks, there is little to distinguish their relative contribution in this market from those of other digital music distributors in their markets.[39, 40] Moreover, over time, the relative position of the

---

compensated for their creative efforts in this market or other similar digital markets and thereby eliminates their incentive to create and supply the very music upon which the future of this service depends as currently structured.

[39] Moreover, there is no substantial evidence to indicate that the relative capital investment, cost and risk contributions made by the SDARS as shown by the record of evidence in this proceeding were made (or are continuing to be made) to secure revenue streams limited to the license period

SDARS may have improved compared to the relative position of the record companies. Herscovici WRT at 24-25, 29.

However, the primary type of expenditure incurred by the SDARS that does distinguish them from other digital distributors of music is their expenditure for satellite technology. This 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. Then, too, such technology may have a recoverable asset value even if the SDARS that made the investment ceases to operate. Herscovici WRT at 28. Nevertheless, nothing in the record of evidence before us indicates that the SDARS can continue to make their current product available to the public in the license period at issue in this proceeding without making new expenditures related to their satellite technology. Clearly, new satellite investment, unlike other costs, cannot be postponed without a serious threat of disruption to the service the SDARS provide. Although this may weigh in favor of a discount from the market rate, we find this issue is intimately intertwined with evidence impacting our consideration of the fourth 801(b) policy objective (i.e., minimizing any disruptive impact on the structure of the industries involved). Consequently, we will treat the potential disruptive effect of postponing investment in new satellite technology as part of our consideration of the fourth policy objective below. *See infra* at Section IV.C.3.d.

---

at issue in this proceeding. The same, of course, is true for similar contributions made by the record companies.

[40] There is also little to distinguish the SDARS' relative contribution to opening new markets from those of other digital music distributors in their markets at present. SX RFF at ¶¶ 104-105.

d. Minimizing Any Disruptive Impact on the Structure of the Industries Involved and on Generally Prevailing Industry Practices

Despite predictions of impending doom for satellite radio if excessively high rates are set in this proceeding or similar dire predictions for the record companies if exceedingly low rates are set in this proceeding, the rate set here is just one component that will impact the future of both industries. It can be disruptive, however, if it directly produces an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either the SDARS or the copyright owners 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.

Economic experts for both sides agree that a royalty rate that would cause the SDARS to cease operating or dramatically change the nature of its product would clearly be disruptive. Ordover WDT at 33-34; Herscovici WRT at 31,40; 8/16/07 Tr. 70:10-72:13, 73:21-76:7 (Noll). In order to minimize the adverse impact of the rate applicable to the license here, we find it appropriate to adopt a rate from the zone of reasonableness for potential marketplace benchmarks that is lower than the upper boundary most strongly indicated by marketplace data. We do so in order to satisfy 801(b) policy considerations related to the minimization of disruption that are not adequately addressed by the benchmark market data alone. The Judges further find that over the period of time marked by the license period, the potential for disruption will diminish, allowing for some reasonable escalation of the initial rate we set herein.

Although much evidence of the respective financial conditions of the SDARS and the record companies was presented in this proceeding, we conclude that many of the claimed examples of "disruption" are overstated. As Dr. Herscovici points out "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. Herscovici WRT at 31. However, we are persuaded by the evidence before us that there are two circumstances faced by the SDARS that merit the adoption of a rate below the upper boundary of the zone of reasonable market rates we have identified hereinbefore (i.e., 13%).

First, given that the current rates paid by the SDARS for these inputs are in the range of 2.0% to 2.5% of revenues, an immediate increase to the upper boundary of the zone of reasonableness (i.e., 13%) would be disruptive inasmuch as the SDARS have not yet attained a sufficient subscriber base nor generated sufficient revenues to reach consistent Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") profitability or positive free cash flow. For example, EBITDA profitability for Sirius is estimated by Mr. Karmazin to be consistent with revenues generated from between 10 million and 11 million subscribers. 6/7/07 Tr. 35 (Karmazin). Increasing the current royalty rates to 13% will increase costs and raise the necessary critical mass of subscribers sufficient to generate revenues that can yield EBITDA profitability or even positive free cash flow. In order not to significantly delay the attainment and amounts of EBITDA profitability and positive free cash flow, some rate within the zone of reasonableness that is less than 13% is warranted. Even SoundExchange's own proposal recognizes that immediate movement to a substantially higher market rate is potentially

disruptive and seeks to minimize the possibility by requesting an initial rate of 8% that increases as subscribership increases for each of the SDARS. Moreover, while SoundExchange maintains that the proper market-based rate is 23% and it is merely proposing a phase-in of that rate, it also recognizes that various year-end 2011 consensus subscriber projections in the neighborhood of 15–16 million for each of the SDARS (*See* SX PFF at ¶¶ 1094, 1096) would only take the SDARS to a rate of 17% by the beginning of the last year of the license term (2012). *See* SoundExchange Third Amended Rate Proposal (August 6, 2007) at 1-8 and closing argument of SoundExchange's counsel, 10/17/07 Tr. 142 (Handzo). In short, even SoundExchange has made a market-based proposal that, barring exceptional events,[41] is adjusted to minimize disruption for the SDARS by not only delaying the application of that market-based rate but effectively discounting it throughout the relevant period of the license.

Second, as noted, *supra* at Section IV.C.3.c., we are persuaded that still another factor that requires attention is any undue constraint on the SDARS' ability to successfully undertake satellite investments planned for the license period. A failure to complete these investments as scheduled clearly raises the potential for disruption of the current consumer service.

For all these reasons, the Judges find it appropriate to adopt a rate from the zone of reasonableness for potential marketplace benchmarks that is lower than the upper boundary most strongly indicated by marketplace data. Based on the record before us,

[41] SoundExchange argues that the proposed merger between Sirius and XM should be factored into the rate determination. But this would require us to estimate the likelihood that the merger would successfully occur, forecast the precise date when the merged entity would become a single operation, and project the likelihood, magnitude and timing of any synergistic benefits of the merger in terms of cost savings. We find on the record before us that we have been presented with insufficient evidence on these issues.

including, among other things, Mr. Butson's sensitivity analysis and testimony from the respective CFOs of the SDARS, Mr. Frear and Mr. Vendetti, a reasonable starting point for this license is a royalty rate of 6% of gross revenues as we have previously defined such revenue. *See* Butson WRT at Appendix A, B and E (suggesting that inasmuch as a 4% average rate over the period will not cause the SDARS' EBITDA profitability and positive free cash flow to be substantially impacted relative to current consensus analyst expectations and, by comparison, that a near 8% average rate over the period significantly delays the attainment and amounts of EBITDA profitability and positive free cash flow for the SDARS, then an average rate somewhat less than 8% and structured to begin as high as 6% will have an impact not likely to threaten disruption); 6/6/07 Tr. 37:16-38:16 (Vendetti) (indicating that a 4% immediate rate necessitates no change in plans as contrasted to an 8% immediate rate that "particularly impacts the amount of cash the company has to run its operation" and therefore an 8% immediate rate adversely impacts the company "very much" in the short-term whereas a 6% rate has lesser impact than an 8% rate); 6/12/07 Tr. 172:1-10 (Frear) and 8/15/07 Tr. 103:15-104:12 (Frear) (sound recording royalties already budgeted in 2007 at a figure north of 4% or at 4.2%); *see also* closing argument of XM's counsel, Mr. Bruce Rich, at 10/17/07 Tr. 234:19-237:14 (indicating that an immediate rate higher than 6% is likely to give rise to planning concerns and that SDARS do not have "absolute vision that 4-1/2 percent wouldn't work or 5% wouldn't work"). We further find that over the passage of time the potential for disruption from the imposition of the 6% rate gradually diminishes as indicated by various forecasts showing consistent subscriber and revenue growth (*See* SX PFF at ¶¶ 1094,1096), thereby allowing a reasonable escalation of the initial rate by the

addition of 0.5% annually beginning with the start of the 2009 calendar year to the previous years' royalty rate.

In short, the Judges find that the percentage of gross revenues rate applicable to each year of the license for the SDARS is as follows: 6.0% for 2007, 6.0% for 2008, 6.5% for 2009, 7.0% for 2010, 7.5% for 2011, and 8.0% for 2012. We find no basis for making further adjustments to this revenue rate to reflect inflation.[42]

D. THE SECTION 112 ROYALTY RATES AND MINIMUM FEES

1. Background

Section 112(e) of the Copyright Act directs the Judges to establish rates and terms for the making of ephemeral copies of digital recordings. We are tasked with setting rates and terms that "most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller," as well as establish " a minimum fee for each type of service offered by transmitting organizations." 17 U.S.C. 112(e)(4).

2. Proposals of the Parties

SoundExchange proposes combining the Section 112 and 114 rates over the license period by allocating 8.8% of the combined fee owed by the SDARS towards the Section 112 charge. SoundExchange Third Amended Rate Proposal (August 6, 2007) at 4. The SDARS also appear to believe that the fee for the Section 112 license should be combined with that for Section 114, but their fee proposal recognizes no separate value for the Section 112 license. They argue that ephemeral copies have no economic value

[42] We do *not* find that the benchmark supports an additional Consumer Price Index adjustment to the percent of revenue rate. No showing has been made to indicate that gross revenues, as hereinbefore defined, will not maintain their real value over time–indeed, the services have increased their prices during the prior licensing periods. Moreover, no evidence has been submitted by SoundExchange, the proponent of such an adjustment, to support this additional adjustment by what is, at this point in time, an indeterminate amount.

separate from the value of the performances they effectuate, citing the Copyright Office's 2001 *DMCA Section 104 Report* in support. SDARS PFF at ¶¶ 898-899, 902; SDARS RFF at ¶ 504.

3. The Record Evidence

While the record in *Webcaster II* regarding the Section 112 license was exceedingly slim, it is virtually nonexistent in this proceeding. No party presented any evidence as to the independent value arising from the Section 112 license. SDARS PFF at ¶ 903.

4. Conclusion

Of the thousands of pages of testimony and exhibits submitted by the parties in this proceeding, virtually none of them are devoted to any discussion of the Section 112 license and ephemeral copies. It is therefore evident that the parties consider the Section 112 license to be of little value at this point in time. Nevertheless, SoundExchange asks the Copyright Royalty Judges to bless the fiction that whatever the royalty fee for the Section 114 license may be, 8.8% of that fee constitutes the value of the Section 112 license. We decline to accept SoundExchange's invitation for the same two reasons we declined to do so in *Webcaster II*.

First, the Section 112 license requires us to determine the rate or rates that would have been negotiated between a willing buyer and a willing seller, not the value that copyright owners and performers or the SDARS would have attached to ephemeral copies. SoundExchange's valuation of 8.8% is not a rate. The SDARS will not be paying 8.8% more in total royalty fees because of this valuation, nor will they be subtracting 8.8% from their charge if they choose not to avail themselves of the Section 112 license. Rather, SoundExchange's 8.8% valuation is nothing more than an effort to preserve a belief that the Section 112 license has *some* value by perpetuating the number adopted in the first webcasting proceeding. *Determination of Reasonable Rates*

and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings (Final Rule), 67 FR 45240 (July 8, 2002) (codified at 37 CFR part 261) ("*Webcaster I*").

Second, the paucity of the record prevents us from determining that 8.8% of the Section 114 royalties is either the value or the rate for the Section 112 license. SoundExchange's mere assertion that its 8.8% proposal reflects an agreement between record companies and artists on the rate applicable to Section 112 does not overcome the absence of evidence in the record with respect to this license. SoundExchange did not present any testimony or evidence from copyright owners or performers on this point.

We are left with a record that demonstrates that the license is merely an add-on to the securing of the performance rights granted by the Section 114 license. SoundExchange's proposal to include the Section 112 license within the rates set for the Section 114 license reflects this reality and we accept it as we did in *Webcaster II*. However, just as we did in *Webcaster II*, we decline, for the reasons stated above, to ascribe any particular percentage of the Section 114 royalty as representative of the value of the Section 112 license. *See Webcaster II*, 72 FR 24101-2.

V. TERMS

Having determined the rates to be paid by the SDARS for their activities under Sections 114 and 112 of the Copyright Act, the Judges now turn to the terms necessary to effectuate payment and distribution. As we stated in *Webcaster II*, we are obligated to "adopt royalty payment and distribution terms that are practical and efficient." 72 FR 24102. SoundExchange and the SDARS each submitted proposals of the terms they believe fulfill this obligation. SoundExchange based its proposal largely on terms the Judges adopted in *Webcaster II.* SX PFF at ¶ 1466. The terms proposed by the SDARS differ in certain respects from the *Webcaster II* terms.

In considering the parties' proposals and adopting royalty 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. This is not to say that the Judges will never vary terms across the licenses, but the burden is upon the parties to demonstrate the need for and the benefits of variance. As discussed below, the parties, for the most part, have not met this burden.

A. COLLECTIVE

SoundExchange requests to be named the sole collective for the collection and distribution of royalties paid by the SDARS under the Section 112 and 114 licenses for the license period 2007-2012. SX PFF at ¶ 1505; Kessler WDT at 15-17. The SDARS do not oppose SoundExchange's request. SDARS RFF at ¶ 506 n.51.

We have determined previously that designation of a single Collective "represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses." *Webcaster II*, 72 FR 24104. No party submitted evidence that would compel us to alter that determination here. Indeed, no party requested the designation of multiple collectives, and SoundExchange was the only party requesting to be selected as a collective.[43]

SoundExchange has a track record of serving as a Collective for the collection and processing of royalty payments made under Sections 112 and 114, having done so since the inception of the statutory licenses. That coupled with the absence of any opposition or record evidence to suggest that SoundExchange should not serve in that

---

[43] Although Royalty Logic Inc. filed a petition to participate, it withdrew from the proceeding before the oral presentation of witnesses. *See, supra,* at 3.

capacity here leads us to determine that SoundExchange will serve as the Collective for the 2007-2012 license period.

We now turn to those terms which are in dispute.

B. DISPUTED TERMS

1. Late Fees

a. Late Royalty Payments

SoundExchange requests that the Judges establish a fee for late royalty payments equal to 1.5% of the total royalty owed by the SDARS for that period. SX PFF at ¶¶ 1482, 1488, 1489; Kessler WRT at 2-4; 8/29/07 Tr. 19:15-20:5 (Kessler). The proposed fee of 1.5% is the fee that is currently paid by PSS for the license period 2002-2007 and was the fee imposed by the Judges in the recently concluded webcasting proceeding. *See* SX PFF at ¶¶ 1480-82; 8/29/07 Tr. 19:15-20:5 (Kessler).

SoundExchange argues that imposition of a "significant" late fee is necessary in order to compel licensees to make timely royalty payments. SX PFF at ¶ 1486; 6/19/07 Tr. 44:3-10 (Kessler). SoundExchange represents that many licensees are late with their payments, with such delinquency ranging from a few days to a few months. SX PFF at ¶ 1483. Ms. Kessler asserts that late fees are the only remedy available to SoundExchange to thwart late payments, absent filing an infringement suit. Kessler WRT at 3; 6/19/07 Tr. 44:3-10 (Kessler). Moreover, SoundExchange submits that a 1.5% late fee is not burdensome to the SDARS provided they submit their royalty payments in a timely manner. SX PFF at ¶ 1483; SX RFF at ¶ 522.

In support of its proposed fee, SoundExchange cites three marketplace agreements between record companies and digital music services that impose a late fee of

1.5%. SDARS Ex. 86 at SE-REB0025070 (sec. 7.2); SDARS Ex. 88 at SE-REB 0025912 (sec. 6.04(d)); SX Ex. 105 DR at Ex. A, sec. 5(b).

While the SDARS do not oppose the imposition of a fee for untimely royalty payments, they counter that a fee of 0.5% of the total royalty owed for the period is more reasonable and is supported by the record in this proceeding. SDARS PFF at ¶ 1311. The SDARS argue that SoundExchange's primary support for its 1.5% fee is that the Judges adopted that fee in *Webcaster II* and relies on the agreements offered in that proceeding here. *See* SDARS PFF at ¶ 1315; SDARS RFF at ¶¶ 507-09. The SDARS contend that SoundExchange has presented no other agreements in this proceeding to support its proposal. SDARS PFF at ¶ 1314. The SDARS further contend that, unlike the record in *Webcaster II*, which established that SoundExchange was faced "with virtually hundreds of different webcasters, including some with an established poor or unknown payment history," the SDARS are defined entities with a history of making payments in a timely manner the majority of the time–a point conceded by SoundExchange. SDARS PFF at ¶ 1315; 6/19/07 Tr. 94:14-95:5 (Kessler)("XM and Sirius are typically timely with their payments."). The SDARS assert, therefore, that they need no motivation to pay timely. SDARS PFF at ¶ 1315.

The SDARS also cite the testimony of Mr. Frear who testified that most of Sirius' "commercial agreements have no late payment charges at all. If there are late payment charges, they tend to be in the half of one percent to one percent per month range." 6/12/07 Tr. 24:4-8 (Frear). They state that Mr. Frear's testimony is supported by numerous SDARS agreements as well as record company agreements and amendments with digital music services in the record which contain either no late fee provision or

impose a late fee of 1%. SDARS PFF at ¶ 1312, citing SIR Exs. 43, 52-53; SDARS Ex. 85 at SE-REB 0027789; SDARS Ex. 87 at SE-REB 0028157; SX Ex. 104 DR at 23; SX Ex. 256 RR.at SE 0000626; SX Ex. 257 RR at SE 000148; SE Ex. 258 RR at SE 0005331-32; SX Ex. 253 RR; SX Ex. 254 RR. The SDARS claim that SoundExchange's proposal of a 1.5% late fee is "the rare and extreme upper bound of marketplace fees, [whereas] the norm is no late fee at all," thus making the SDARS' proposal of 0.5% "far more consistent with the record evidence . . . particularly in light of [their] established record of timeliness." SDARS RFF at ¶ 510.

In determining an appropriate late fee, a balance must be struck between providing an effective incentive to the licensee to make payments timely on the one hand and not making the fee so high that it is punitive on the other hand. As we did in *Webcaster II*, the Judges conclude that a fee of 1.5% for untimely payments strikes the proper balance. Even though the SDARS typically submit their payments in a timely manner (SDARS PFF at ¶ 1309; 6/19/07 Tr. 94:14-95:5 (Kessler)), the SDARS' payment history is not dispositive. We are not persuaded that a late fee of 0.5% per month provides a sufficient incentive. While the content agreements and record company agreements cited by the SDARS do not contain a late fee provision, these agreements do contain provisions allowing for the termination of the agreement in the event of a breach of the agreement such as failure to make payments timely. SIR Ex. 43, sec. 12.4(a); SDARS Ex. 85 at SE-REB 0027790 (sec. 8(b)); SDARS Ex. 86 at SE-REB 0025071 (sec. 12); SDARS Ex. 87 at SE-REB 0028160 (sec. 10(b)); SDARS Ex. 88 at SE-REB 0025917 (sec. 10.01); SX Ex. 104 DR at 34 (sec. 12). Copyright owners and performers have no such recourse under a statutory license. They cannot terminate, short of a

finding of infringement by a federal court, access to their works under the license. *See Webcaster II*, 72 FR 24107. We find that a late fee of 1.5%, as found in several of the agreements in the record, provides a proper incentive to the SDARS to maintain such timeliness and is not unduly harsh. SDARS Ex. 86 at SE-REB 0025070 (sec. 7.2); SDARS Ex. 88 at SE-REB 0025912 (sec. 6.04(d)); SX Ex. 105 DR at A-7 (sec. 5(b)); SX Ex. 107 DR at 9 (sec. 6(c)). The 1.5% late fee we adopt today is consistent with the late fees applicable to webcasters and PSS.

<u>b. Statements of Account and Reports of Use</u>

SoundExchange proposes that a late fee of 1.5% also be assessed for untimely statements of account and reports of use. SX PFF at ¶¶ 1488-89; Kessler WRT at 3; 6/19/07 Tr. 44:15-17 (Kessler). SoundExchange justifies its request by asserting that untimely submission of these documents hamper its ability to promptly distribute royalties. SX PFF at ¶ 1488; Kessler WRT at 4. SoundExchange goes on that such late fees would provide licensees with a financial incentive to submit their statements and reports in a timely fashion. SX PFF at ¶ 1488; 6/19/07 Tr. 44:15-45:6 (Kessler).

The SDARS oppose SoundExchange's proposal. They assert that SoundExchange has provided no record evidence to support assessment of late fees to these submissions. SDARS PFF at ¶ 1319. Rather, the SDARS continue, the record establishes the opposite. Specifically, the SDARS point to several agreements between record labels and digital music distribution services which assess no late fee for anything other than a late payment. SDARS Ex. 85 at SE-REB 0027789; SDARS Ex. 86 at SE-REB 0025070; SDARS Ex. 87 at SE-REB 0028157; SDARS Ex. 88 at SE-REB 0025912; SX Ex. 104 DR at 23; SX Ex. 105 DR at A-6 of 7/1/04 agreement; SX Ex. 107

DR at 9; SX Ex. 256 RR at SE 0000626; SX Ex. 257 RR at SE 000148. In light of these agreements, they conclude that SoundExchange's proposal is unreasonable. SDARS RFF at ¶ 511.

In *Webcaster II*, the Judges determined "that timely submission of a statement of account is critical to the quick and efficient distribution of royalties." 72 FR 24107. Given its importance to the distribution process, we imposed a late fee of 1.5% of the total royalty owed for that month for its untimely submission. 72 FR 24108. That reasoning applies with equal force here. Consequently, we adopt the same 1.5% per month late fee for untimely statements of account that was adopted in *Webcaster II* and proposed by SoundExchange here. We defer any decision, however, to apply a late fee to the reports of use in light of our determination that issues relating to reports of use are best addressed in the context of a rulemaking proceeding. *See infra* at Section VI.

As we found in *Webcaster II*, "inconsequential good-faith omissions or errors" in the statement of account "should not warrant imposition of the late fee." 72 FR 24108.

In applying a late fee to both royalty payments and statements of account, we reject SoundExchange's request to have the late fee accrue separately for these items regardless of whether they are submitted simultaneously, as proposed by SoundExchange, or separately. Since we are requiring the simultaneous submission of payments and statements of account, we agree with the SDARS that SoundExchange has not demonstrated the need for such an onerous provision in that instance. Therefore, when a royalty payment and statement of account are submitted together in accordance with the regulations but are late, the offending SDAR will pay a late fee of 1.5% that covers both the payment and the statement. Conversely, if the payment and the statement

are submitted separately and both are late, then the SDAR will pay a 1.5% late fee for the late payment and an additional 1.5% late fee for the untimely statement.

Finally, we reject the SDARS' proposal to require receipt of written notice of a late submission before the accrual of the late fee begins. *See* Second Amended Proposal of Rates and Terms of Sirius Satellite Inc. and XM Satellite Radio Inc. (October 1, 2007) at § 3.__.3(c). The responsibility of timely submitting royalty payments and statements of account rests with the statutory licensee. We do not find such responsibility to be unduly burdensome. Therefore, we see no justification for providing the SDARS with any grace period before the commencement of the accrual period.

2. Confidentiality

The parties are at loggerheads over whether copyright owners and performers should have access to the information contained in the statements of account. SoundExchange seeks adoption of the same confidentiality provisions adopted in *Webcaster II*. SX PFF at ¶ 1491; *see also* 37 CFR 380.5. There, copyright owners and performers and their agents (as well as attorneys, consultants, and authorized agents in future proceedings) are allowed to review confidential information in or pertaining to statements of account, subject to appropriate confidentiality agreements. SX PFF at ¶ 1491. SoundExchange submits that such access assists copyright owners and performers in making informed decisions regarding licensees' compliance with their statutory obligations and in making audit and enforcement decisions. *Id*. SoundExchange contends that in its experience more restrictive confidentiality provisions, such as those adopted in *Webcaster I*, lead to "significant operational and other problems" which make "it difficult for SoundExchange to complete its work" and

result in unfairness to copyright owners and performers, the ultimate beneficiaries of the royalties. SX PFF at ¶¶ 1492-8.

In opposing SoundExchange's proposal, the SDARS characterize SoundExchange's proposal as flawed because it "assumes that the services at issue are not complying with their obligations or making accurate payments." SDARS PFF at ¶ 1327. The SDARS point out that unlike the webcasters in *Webcaster II*, they "largely have been compliant with all of their obligations." *Id.* They conclude that "[w]here there is no basis for the premise underlying SoundExchange's confidentiality proposal, there can be no justification for adopting" it. *Id.*

We find that the SDARS' argument misses the mark and adopt the confidentiality provisions proposed by SoundExchange. We previously have made clear that we will not impose confidentiality restrictions without a showing by the licensee–the SDARS here–of how disclosure of the information in the statements of account would be, or likely would be, harmful; in other words, a showing that such information is confidential. *See* 72 FR 24108. The SDARS made no such showing here; indeed, they put forth no evidence in support of their proposal to deny copyright owners and performers access to the statements of account. The SDARS' history of being "largely compliant" in its statutory obligations, while commendable, provides no justification for adversely impacting copyright owners' and performers' substantive rights under the Section 112 and 114 licenses. *See*, *id*. There is no support in the statute for excluding copyright owners and performers from having access to the information necessary to pursue an infringement suit, especially when copyright owners have full and complete access to the statements of account filed under the cable, satellite and DART licenses. 72 FR 24108 & n.77.

As in *Webcaster II*, the general public will not have access to the statements of account. Therefore, access is limited to copyright owners and performers, and their agents and representatives identified in the regulations, whose works were used by the SDARS under the Section 112 and 114 licenses. *See*, 72 FR 24109.

3. Audits and Verification of Payments

The SDARS strenuously object to SoundExchange's proposal that the SDARS be required to "use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the [royalty verification] audit." SDARS PFF at ¶ 1335. The SDARS argue that such a term is "unheard of in marketplace contracts between record labels and digital distribution services." SDARS PFF at ¶ 1336, citing SDARS Exs. 85-89; SIR Exs. 43, 52-53; SX Exs. 104-05, 107 DR; SX Exs. 253-54, 256-258 RR. The SDARS add that such a term would interfere with their private contractual relationships with third parties. SDARS PFF at ¶ 1336.

SoundExchange counters that its proposal only requires the SDARS to use "commercially reasonable efforts" to obtain these records, and the SDARS have offered no reason why they cannot make such an effort "to enable those audits to be as thorough and accurate as possible." SX RFF at ¶ 535.

Audits serve a critical function in the context of a statutory license where a copyright owner cannot easily terminate access to its works. Therefore, it is important that there be a high level of confidence in the results of such audits. It is equally important that the audit be as thorough and accurate as possible. Achievement of this goal requires a balancing of the benefits to SoundExchange of having at its disposal all

pertinent records (or access thereto) against the burdens placed upon the SDARS in providing such records or access. We find that the balance weighs in favor of SoundExchange. Therefore, we are requiring the SDARS to use commercially reasonable efforts to obtain or provide access to records maintained by third parties that are relevant to the verification process. Imposition of this requirement is consistent with the terms we adopted in *Webcaster II*. *See*, 37 CFR 380.6(d).

VI. NOTICE AND RECORDKEEPING

Section 803(c)(3) of the Copyright Act grants the Copyright Royalty Judges the authority to adopt terms regarding notice and recordkeeping which would supercede those set forth in 37 CFR Part 370. Our exercise of this authority, however, is discretionary. 17 U.S.C. 803(c)(3) ("[T]he Copyright Royalty Judges *may* specify notice and recordkeeping requirements of users of the copyrights at issue that apply in lieu of those that would otherwise apply under regulations.") (emphasis added). As with our consideration of terms, the Judges will adopt new or amended notice and/or recordkeeping requirements only where the parties sufficiently demonstrate the need for and the benefits of variances with existing regulations. The parties have once again failed to satisfy their burden.

The parties each have submitted recordkeeping proposals which go beyond the current interim notice and recordkeeping regulations set forth in 37 CFR Part 370. *See* SoundExchange Third Amended Rate Proposal (August 6, 2007) at 9; Second Amended Proposal of Rates and Terms of Sirius Satellite Radio Inc. and XM Satellite Radio Inc. (October 1, 2007) at § 3__.6. The proposals include provisions covering the frequency of service of the reports of use, the additional information to be reported regarding each

sound recording, the time period for retention of the reports of use by the SDARS, signature requirements, format and delivery requirements, confidentiality of the reports, and census reporting. While the parties agree on certain of the proposed provisions, they disagree on others.

The parties' proposals, with one exception discussed below, all suffer the same deficiency: they are nothing more than bare proposals unsupported by record evidence. The need for the changes and the benefits to be obtained from them are backed by nothing more than argument of counsel in their closing briefs. Without more, the Judges decline to exercise their discretion to amend the notice and recordkeeping regulations.

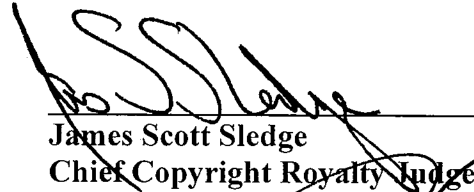
The one proposal that is offered with some record testimony is SoundExchange's request that the recordkeeping regulations be amended to require census reporting. Kessler WDT at 17-18; 8/29/07 Tr. 23:19-25:11 (Kessler); SX PFF at ¶ 1469. SoundExchange relies on the testimony it presented in *Webcaster II* for support of all of its proposed terms, including those relating to reports of use. Kessler WDT at 2; 6/19/07 Tr. 39:16-40:2, 47:8-19 (Kessler). The SDARS do not object to census reporting in general but disagree with SoundExchange that they should be required to report all sound recordings, noting that SoundExchange's proposal does not include the "pragmatic exceptions" found in the current recordkeeping regulations. SDARS PFF at ¶¶ 1329-30. Such "exceptions" require no reporting of sound recordings that are not under federal copyright protection or whose term has expired, that have been directly licensed by the Service or that amount to an incidental performance as defined in the regulations. 37 CFR 370.3(b)(8)(i)-(iii); SDARS PFF at ¶ 1329.

When the interim notice and recordkeeping rules were promulgated, we made clear our intention to "monitor the operation of these regulations . . . and [to] request public comment in the future as to the need for amendment or improvement prior to adopting final regulations." *Notice and Recordkeeping for Use of Sound Recordings Under Statutory License (Interim Final Rule),* 71 FR 59010, 59011 (October 6, 2006) (codified at 37 CFR Part 370). In *Webcaster II*, we declined to address notice and recordkeeping as part of that rate setting proceeding, explaining that "because our recordkeeping regulations are interim and not final, there is ample opportunity to again address" issues such as the Services' recordkeeping costs and SoundExchange's request for census reporting in the more appropriate context of a future rulemaking proceeding. 72 FR 24110. Moreover, we found "there was no persuasive testimony compelling an adjustment of the current recordkeeping regulations." *Id*. SoundExchange has failed to present any persuasive evidence in this proceeding to challenge our conclusion in *Webcaster II*, and we therefore do not see any reason to now adopt its proposed census reporting requirement, particularly where the parties cannot agree as to what information constitutes census reporting.

VII. DETERMINATION AND ORDER

Having fully considered the record, the Copyright Royalty Judges make the above Findings of Fact based on the record. Relying upon these Findings of Fact, the Copyright Royalty Judges unanimously adopt every portion of this Determination of the Rates and Terms of the Statutory Licenses for the digital transmission of sound recordings, pursuant to 17 U.S.C. 114, and for the making of ephemeral phonorecords, pursuant to 17 U.S.C. 112(e).

SO ORDERED.



James Scott Sledge
Chief Copyright Royalty Judge

William J. Roberts, Jr.
Copyright Royalty Judge

Stanley C. Wisniewski
Copyright Royalty Judge

DATED: December 3, 2007

PART 382–RATES AND TERMS FOR DIGITAL TRANSMISSIONS OF SOUND RECORDINGS AND THE REPRODUCTION OF EPHEMERAL RECORDINGS BY PREEXISTING SUBSCRIPTION SERVICES AND PREEXISTING SATELLITE DIGITAL AUDIO RADIO SERVICES[1]

Subpart B – Preexisting Satellite Digital Audio Radio Services

Sec.

382.10 General.

382.11 Definitions.

382.12 Royalty fees for public performance of sound recordings and the making of ephemeral recordings.

382.13 Terms for making payment of royalty fees and statements of account.

382.14 Confidential information.

382.15 Verification of royalty payments.

382.16 Verification of royalty distributions.

382.17 Unclaimed funds.

Authority: 17 U.S.C. 112(e), 114(f), 804(b)(3).

§ 382.10 General.

(a) *Scope*. This subpart establishes rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions by Licensees in accordance with the provisions of 17 U.S.C. 114, and the making of Ephemeral Recordings by Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period from January 1, 2007, through December 31, 2012.

---

[1] This Part also will contain the rates and terms for the preexisting subscription services,

(b) *Legal compliance*. Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112 and 114 shall comply with the requirements of those sections, the rates and terms of this subpart, and any other applicable regulations.

(c) *Relationship to voluntary agreements*. Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms of this subpart to transmission within the scope of such agreements.

§ 382.11 Definitions.

For purposes of this subpart, the following definitions shall apply:

Collective is the collection and distribution organization that is designated by the Copyright Royalty Judges. For the 2007-2012 license period, the Collective is SoundExchange, Inc.

Copyright Owners are sound recording copyright owners who are entitled to royalty payments made under this subpart pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114(f).

Ephemeral Recording is a phonorecord created for the purpose of facilitating a transmission of a public performance of a sound recording under a statutory license in accordance with 17 U.S.C. 114(f) and subject to the limitations specified in 17 U.S.C. 112(e).

GAAP shall mean generally accepted accounting principles in effect from time to time in the United States.

---

which will appear in Subpart A.

Gross Revenues. (1) Gross Revenues shall mean revenue recognized by the Licensee in accordance with GAAP from the operation of an SDARS, and shall be comprised of the following:

(i) Subscription revenue recognized by Licensee directly from residential U.S. subscribers for Licensee's SDARS; and

(ii) Licensee's advertising revenues, or other monies received from sponsors, if any, attributable to advertising on channels other than those that use only incidental performances of sound recordings, less advertising agency and sales commissions.

(2) Gross Revenues shall include such payments as set forth in paragraphs (1)(i) and (ii) of the definition of "Gross Revenues" to which Licensee is entitled but which are paid to a parent, wholly-owned subsidiary or division of Licensee.

(3) Gross Revenues shall exclude:

(i) Monies or other consideration attributable to the sale and/or license of equipment and/or other technology, including but not limited to bandwidth, sales of devices that receive the Licensee's SDARS and any taxes, shipping and handling fees therefor;

(ii) Royalties paid to Licensee for intellectual property rights;

(iii) Monies or other consideration received by Licensee from the sale of phonorecords and digital phonorecord deliveries;

(iv) Sales and use taxes, shipping and handling, credit card, invoice, and fulfillment service fees;

(v) Bad debt expense, and

(vi) Revenues recognized by Licensee for the provision of

(A) Current and future data services (e.g., weather, traffic, destination information, messaging, sports scores, stock ticker information, extended program associated data, video and photographic images, and such other telematics and/or data services as may exist from time to time);

(B) Channels, programming, products and/or other services offered for a separate charge where such channels use only incidental performances of sound recordings;

(C) Channels, programming, products and/or other services provided outside of the United States; and

(D) Channels, programming, products and/or other services for which the performance of sound recordings and/or the making of ephemeral recordings is exempt from any license requirement or is separately licensed, including by a statutory license and, for the avoidance of doubt, webcasting, audio services bundled with television programming, interactive services, and transmissions to business establishments.

Licensee is a person that has obtained a statutory license under 17 U.S.C. 114, and the implementing regulations, to make transmissions over a preexisting satellite digital audio radio service, and has obtained a statutory license under 17 U.S.C. 112(e), and the implementing regulations, to make Ephemeral Recordings for use in facilitating such transmissions.

Performers means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C), and the parties identified in 17 U.S.C. 114(g)(2)(D).

Qualified Auditor is a Certified Public Accountant.

Residential means, with respect to a service, a service that may be licensed under the provisions of 17 U.S.C. 114(d)(2)(B); and, with respect to subscribers, subscribers to such a service.

SDARS means the preexisting satellite digital audio radio services as defined in 17 U.S.C. 114(j)(10).

Term means the period commencing January 1, 2007, and continuing through December 31, 2012.

§ 382.12 Royalty fees for the public performance of sound recordings and the making of ephemeral recordings.

The monthly royalty fee to be paid by a Licensee for the public performance of sound recordings pursuant to 17 U.S.C. 114(d)(2) and the making of any number of ephemeral phonorecords to facilitate such performances pursuant to 17 U.S.C. 112(e) shall be the percentage of monthly Gross Revenues resulting from Residential services in the United States as follows: for 2007 and 2008, 6.0%; for 2009, 6.5%; for 2010, 7.0%; for 2011, 7.5%; and for 2012, 8.0%.

§ 382.13 Terms for making payment of royalty fees and statements of account.

(a) *Payment to the Collective*. A Licensee shall make the royalty payments due under § 382.12 to the Collective.

(b) *Designation of the Collective*. (1) Until such time as a new designation is made, SoundExchange, Inc., is designated as the Collective to receive statements of account and royalty payments from Licensees due under § 382.12 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114.

(2) If SoundExchange, Inc. should dissolve or cease to be governed by a board consisting of equal numbers of representatives of Copyright Owners and Performers, then it shall be replaced by a successor Collective upon the fulfillment of the requirements set forth in paragraph (b)(2)(i) of this section.

(i) By a majority vote of the nine Copyright Owner representatives and the nine Performer representatives on the SoundExchange board as of the last day preceding the condition precedent in paragraph (b)(2) of this section, such representatives shall file a petition with the Copyright Royalty Judges designating a successor to collect and distribute royalty payments to Copyright Owners and Performers entitled to receive royalties under 17 U.S.C. 112(e) or 114 that have themselves authorized the Collective.

(ii) The Copyright Royalty Judges shall publish in the **Federal Register** within 30 days of receipt of a petition filed under paragraph (b)(2)(i) of this section an order designating the Collective named in such petition.

(c) *Monthly payments*. A Licensee shall make any payments due under § 382.12 on a monthly basis on or before the 45th day after the end of each month for that month, except that payments due under § 382.12 for the period beginning January 1, 2007, through the last day of the month in which the Copyright Royalty Judges issue their final determination adopting these rates and terms shall be due 45 days after the end of such period. All payments shall be rounded to the nearest cent.

(d) *Late payments and statements of account*. A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment and/or statement of account received by the Collective after the due date. Late fees shall accrue from the due date until payment is received by the Collective.

(e) *Statements of account.* Any payment due under § 382.12 shall be accompanied by a corresponding statement of account. A statement of account shall contain the following information:

(1) Such information as is necessary to calculate the accompanying royalty payments;

(2) The name, address, business title, telephone number, facsimile number (if any), electronic mail address and other contact information of the person to be contacted for information or questions concerning the content of the statement of account;

(3) The handwritten signature of a duly authorized officer or representative of the Licensee;

(4) The printed or typewritten name of the person signing the statement of account;

(5) The date of signature;

(6) The title or official position held in relation to the Licensee by the person signing the statement of account;

(7) A certification of the capacity of the person signing; and

(8) A statement to the following effect:

> I, the undersigned officer or representative of the Licensee, have examined this statement of account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence.

(f) *Distribution of royalties*. (1) The Collective shall promptly distribute royalties received from Licensees to Copyright Owners and Performers, or their designated agents, that are entitled to such royalties. The Collective shall only be responsible for making distributions to those Copyright Owners, Performers, or their designated agents who

provide the Collective with such information as is necessary to identify the correct recipient. The Collective shall distribute royalties on a basis that values all performances by a Licensee equally based upon the information provided under the reports of use requirements for Licensees contained in § 370.3 of this chapter.

(2) If the Collective is unable to locate a Copyright Owner or Performer entitled to a distribution of royalties under paragraph (f)(1) of this section within 3 years from the date of payment by a Licensee, such royalties shall be handled in accordance with § 382.17.

(g) *Retention of records.* Books and records of a Licensee and of the Collective relating to payments of and distributions of royalties shall be kept for a period of not less than the prior 3 calendar years.

§ 382.14 Confidential information.

(a) *Definition.* For purposes of this subpart, "Confidential Information" shall include the statements of account and any information contained therein, including the amount of royalty payments, and any information pertaining to the statements of account reasonably designated as confidential by the Licensee submitting the statement.

(b) *Exclusion*. Confidential Information shall not include documents or information that at the time of delivery to the Collective are public knowledge. The party claiming the benefit of this provision shall have the burden of proving that the disclosed information was public knowledge.

(c) *Use of Confidential Information*. In no event shall the Collective use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(d) *Disclosure of Confidential Information.* Access to Confidential Information shall be limited to:

(1) Those employees, agents, attorneys, consultants and independent contractors of the Collective, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related thereto, for the purpose of performing such duties during the ordinary course of their work and who require access to the Confidential Information;

(2) An independent and Qualified Auditor, subject to an appropriate confidentiality agreement, who is authorized to act on behalf of the Collective with respect to verification of a Licensee's statement of account pursuant to § 382.15 or on behalf of a Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to § 382.16;

(3) Copyright Owners and Performers, including their designated agents, whose works have been used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114(f) by the Licensee whose Confidential Information is being supplied, subject to an appropriate confidentiality agreement, and including those employees, agents, attorneys, consultants and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate confidentiality agreement, for the purpose of performing their duties during the ordinary course of their work and who require access to the Confidential Information; and

(4) In connection with future proceedings under 17 U.S.C. 112(e) and 114(f) before the Copyright Royalty Judges, and under an appropriate protective order,

attorneys, consultants and other authorized agents of the parties to the proceedings or the courts.

(e) *Safeguarding of Confidential Information*. The Collective and any person identified in paragraph (d) of this section shall implement procedures to safeguard against unauthorized access to or dissemination of any Confidential Information using a reasonable standard of care, but no less than the same degree of security used to protect Confidential Information or similarly sensitive information belonging to the Collective or person.

§ 382.15 Verification of royalty payments.

(a) *General*. This section prescribes procedures by which the Collective may verify the royalty payments made by a Licensee.

(b) *Frequency of verification*. The Collective may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit*. The Collective must file with the Copyright Royalty Judges a notice of intent to audit a particular Licensee, which shall, within 30 days of the filing of the notice, publish in the **Federal Register** a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Licensee to be audited. Any such audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all parties.

(d) *Acquisition and retention of report*. The Licensee shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records

maintained by third parties for the purpose of the audit. The Collective shall retain the report of the verification for a period of not less than 3 years.

(e) *Acceptable verification procedure*. An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(f) *Consultation*. Before rendering a written report to the Collective, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Licensee being audited in order to remedy any factual errors and clarify any issues relating to the audit; Provided that an appropriate agent or employee of the Licensee reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(g) *Costs of the verification procedure*. The Collective shall pay the cost of the verification procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Licensee shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

§ 382.16 Verification of royalty distributions.

(a) *General*. This section prescribes procedures by which any Copyright Owner or Performer may verify the royalty distributions made by the Collective; Provided, however, that nothing contained in this section shall apply to situations where a

Copyright Owner or Performer and the Collective have agreed as to proper verification methods.

(b) *Frequency of verification*. A Copyright Owner or Performer may conduct a single audit of the Collective upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit*. A Copyright Owner and Performer must file with the Copyright Royalty Judges a notice of intent to audit the Collective, which shall, within 30 days of the filing of the notice, publish in the **Federal Register** a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Collective. Any audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all Copyright Owners and Performers.

(d) *Acquisition and retention of report*. The Collective shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. The Copyright Owner or Performer requesting the verification procedure shall retain the report of the verification for a period of not less than 3 years.

(e) *Acceptable verification procedure*. An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(f) *Consultation*. Before rendering a written report to a Copyright Owner or Performer, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Collective in order to remedy any factual errors and clarify any issues relating to the audit; Provided that the appropriate agent or employee of the Collective reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(g) *Costs of the verification procedure*. The Copyright Owner or Performer requesting the verification procedure shall pay the cost of the procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Collective shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

§ 382.17 Unclaimed funds.

If the Collective is unable to identify or locate a Copyright Owner or Performer who is entitled to receive a royalty distribution under this subpart, the Collective shall retain the required payment in a segregated trust account for a period of 3 years from the date of distribution. No claim to such distribution shall be valid after the expiration of the 3-year period. After expiration of this period, the Collective may apply the unclaimed funds to offset any costs deductible under 17 U.S.C. 114(g)(3). The foregoing shall apply notwithstanding the common law or statutes of any State.