

**UNITED STATES COPYRIGHT ROYALTY JUDGES**

<b>In the Matter of</b>	)	
	)	
<b>Determination of Rates and Terms for</b>	)	<b>Docket No. 2011-1 CRB</b>
<b>Preexisting Subscription Services and</b>	)	<b>PSS/Satellite II</b>
<b>Satellite Digital Audio Radio Services</b>	)	
_____	)	

**TECHNICAL AMENDMENT TO FINAL DETERMINATION**

The Copyright Royalty Judges (“Judges”) issued a Final Determination in the captioned proceeding on February 14, 2013. The Librarian of Congress published the Final Determination on April 17, 2013, as required by 17 U.S.C. § 803(c)(6).<sup>1</sup> See 78 FR 23054. The Register of Copyrights (“Register”) may review any determination by the Judges for legal error in resolution of a material issue of substantive law under the Copyright Act (“Act”) found in title 17, United States Code. 17 U.S.C. § 802(f)(1)(D). If the Register finds such legal error, her decision identifying and correcting the error is published in the *Federal Register*, along with the Final Determination. Although the Register’s decision does not change the rates and terms set in the Final Determination, her opinion is binding on the Judges prospectively. Section 803(c)(4) of the Copyright Act authorizes the Judges to issue amendments to a written determination to correct any technical or clerical errors in the determination or to modify the terms, but not the rates, of royalty payments in response to unforeseen circumstances that would frustrate the proper implementation of such determination.

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<sup>1</sup> The Final Determination was not a unanimous decision. Judge William Roberts issued a dissenting opinion on the same date; his dissent was published with the Final Determination. See 78 FR 23075-96 (Apr. 17, 2013). References to the “Judges” in this Amendment are references to the Judges issuing the majority determination.

In the Final Determination, the Judges found that the current statutory rate of 7.5% of *Gross Revenues* for Pre-existing Subscription Services (“PSS”) was the appropriate rate upon which to consider whether a policy adjustment was warranted under the factors set forth in § 801(b) of the Copyright Act. In applying those factors as required by the statute, the Judges determined that, under the second of those factors (afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions) a 1 percent upward adjustment (phased in over the first two years of the rate period) from the current rate was warranted. The Register found that it was legal error for the Judges not to then apply (or reapply as the case may be) the § 801(b) factors with respect to those adjusted rates. *See* 78 FR 22913 (Apr. 17, 2013). After careful consideration, the Judges find that such a supplemental review of the application of the § 801(b) factors is technical in nature and is therefore amenable to correction pursuant to the Judges’ authority under § 803(c)(4) of the Copyright Act. In this Amendment, the Judges do not revisit any of the analysis in the Determination relating to the base rate; rather, they articulate the outcome of application of the § 801(b) factors to the prospective rates—an application cited by the Register of Copyrights as missing in the Determination.<sup>2</sup>

The Judges, therefore, issue this Technical Amendment to the Final Determination. The Amendment is confined to Section V.A.3.c.1. of the Final Determination. All other portions of the Final Determination, including the rates and terms, are unchanged. The amended text, which is highlighted, appears below.

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<sup>2</sup> The Judges believe their interpretation of § 803(c)(4) is not only consistent with the flexibility that Congress intended to grant the Judges to correct their own determinations, but also consistent with the Register of Copyright’s application of the term “technical amendment” in the copyright royalty context. *See* 61 FR 63715 (Dec. 2, 1996) (*in which the Library adopted a broad range of “non-substantive technical amendments” to address “identified problems” in the regulations governing CARP proceedings*).

## **1. Application of Section 801(b) Factors**

Based on the record evidence in this proceeding, the Judges have determined that the benchmark evidence submitted by Music Choice and SoundExchange has failed to provide the means for determining a reasonable rate for the PSS, other than, perhaps to indicate the extreme ends of the range of reasonable rates. The testimony and argument of Music Choice demonstrates nothing more than to show that a reasonable rate cannot be as low as the rates (*i.e.*, [ ] of Music Choice's revenues) paid by Music Choice to the three performing rights societies for the public performance of musical works. The benchmark testimony of SoundExchange is of even lesser value. The proposed rate of 15% for the PSS for the first year of the licensing period, deemed reasonable by Dr. Ford (at least in the beginning of the licensing period), stands as the upper bound of the range of reasonable rates. Within that range is the current 7.5% rate. On the record before us, the Judges are persuaded that the current rate is neither too high, too low, nor otherwise inappropriate, subject to consideration of the § 801(b) factors discussed below.<sup>3</sup>

### **a. Maximize Availability of Creative Works**

To argue for an adjustment in its favor under the first § 801(b) factor, Music Choice touts that it is a music service that is available in over 54 million homes, with 40 million customers using the service every month. 8/16/12 Tr. 3878:3 (Del Beccaro); 6/11/12 Tr. 1462:5-11, 1486:19-1487:2 (Del Beccaro). According to Music Choice,

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<sup>3</sup> As discussed below, the Judges conclude that the second § 801(b) factor (afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions) warrants a 1 percent upward adjustment (to 8.5% phased in from 8.0% in 2013 to 8.5% for 2014 through 2017) from the current statutory rate of 7.5%. In her April 9, 2013, decision, the Register of Copyrights found that the Judges erred by not considering the 8.0% and 8.5% rates under the § 801(b) factors. After carefully reviewing the evidence, the Judges conclude that none of the § 801(b) factors warrants an adjustment, either upward or downward, from the 8.5% rate that the Judges selected for the PSS for 2014 through 2017, or for the 8.0% rate that the Judges selected for 2013.

channel offerings have increased through the years, and they are curated by experts in a variety of music genres. Del Beccaro Corrected WDT at 3, 24, PSS Trial Ex. 1. Music Choice also highlights recent developments in technology that enable Music Choice to display original on-screen content identifying pertinent information regarding the songs and artists being performed. *Id.* at 24, MC 23; Williams WDT at 12, PSS Trial Ex. 3; 6/11/12 Tr. 1461:14-1462: 1, 1491:2-12 (Del Beccaro). According to Music Choice, these elements, along with certain promotional efforts that Music Choice makes on behalf of artists, support a downward adjustment in the rates. In any event, an upward adjustment in the rates, argues Music Choice, would not affect the record companies' bottom-line because PSS royalties are not a material revenue source for record companies. *Music Choice PFF ¶¶ 409-417.*

SoundExchange submits that a market rate incorporates considerations under the first § 801(b) factor, citing the decision in *SDARS-I*, and that if PSS rates turn out to be too high and drive Music Choice from the market, presumably consumers will shift to alternative providers of digital music where higher royalty payments are more likely for record companies. Ford Second Corrected WDT at 19-21, SX Trial Ex. 79.

The current PSS rate is not a market rate, so market forces cannot be presumed to determine the maximum amount of product availability consistent with the efficient use of resources. *See SDARS-I*, 73 FR 4094. However, the testimony demonstrates that Music Choice has not, under the current rate, reduced its music offerings or contemplated exiting the business; in fact, it will be expanding its channel offerings in the near term. Del Becarro Corrected WDT at 3, 24, PSS Trial Ex. 1; *see also* 6/11/12 Tr. 1460:21-1461:1 (Del Beccaro). The Judges find no **credible** evidence in the record to suggest that

the output of music from record labels has been impacted negatively as a result of the current rate. The record shows no persuasive evidence that a higher PSS royalty rate would necessarily result in increased output of music by the record companies, nor that a lower rate would necessarily further stimulate Music Choice's current and planned offerings. In sum, the policy goal of maximizing creative works to the public is reasonably reflected in the current rate and, therefore, no adjustment is necessary.

Similarly, the Judges' conclusion with respect to the first § 801(b) factor is unchanged even when weighed against the modest increases to 8.0% for 2013 and to 8.5% for 2014 through 2017 that the Judges adopt for the upcoming rate period. Given the Judges' determination on other grounds to increase the rate by only one percentage point above the current statutory rate (phased in over the first two years of the rate period), the Judges find that that minimal increase will not adversely affect Music Choice's planned expansion nor will it provide a material incentive to artists and record companies sufficient to impact the availability of creative works to the public. In sum, the modest increase ordered by the Judges is in concert with the policy objective of maximizing the availability of creative works to the public. No adjustment, either upward or downward, is warranted by this factor.

**b. Afford Fair Return/Fair Income Under Existing Market Conditions**

Music Choice submits that the Judges need not worry about the impact of a low royalty rate on the fair return to record companies and artists for use of their works because royalties from the PSS market are so small as to be virtually inconsequential to companies whose principal business is the sale of CDs and digital downloads. *Music Choice PFF ¶¶ 420-430*. With respect to Music Choice's ability to earn a fair income,

however, Music Choice argues that it is not profitable under the current 7.5% rate. Mr. Del Beccaro testified that its average revenue per customer for its residential audio business has been on the decline since the early 1990's, down from \$1.00 per customer/per month to [ ] per customer/per month currently. Del Beccaro Corrected WDT at 40, PSS Trial Ex. 1. He further testified that after 15 years of paying a PSS statutory rate between 6.5% and 7.5% Music Choice has not become profitable on a cumulative basis and is not projected to become so within the foreseeable future. *Id.* at 42. Music Choice represents that it has a cumulative loss at the end of 2011 of [ ], projected to grow to [ ] in 2012 and continue to increase throughout the 2013-17 license period. Del Beccaro Corrected WRT at MC 69 at 1 and MC 70 at 1, PSS Trial Ex. 21. These losses lead Music Choice to conclude that it has not generated a reasonable return on capital under the existing rates. *Music Choice PFF ¶¶ 442-43.*

Music Choice's claims of unprofitability under the existing PSS rate come from the oblique presentation of its financial data and a combining of revenues and expenses from other aspects of its business. The appropriate business to analyze for purposes of this proceeding is the residential audio service offered by Music Choice, the subject of the § 114 license. Music Choice, however, reports costs and revenues for its residential audio business with those of its commercial business, which is not subject to the statutory license. This aggregation of the data, which Music Choice acknowledges cannot be disaggregated, *see* 6/11/12 Tr. 1572:3-1576:2 (Del Beccaro), masks the financial performance of the PSS business. As a consolidated business, Music Choice has had significantly positive operating income between 2007 and 2011 and made profit distributions to its partners since 2009. Ford Amended/Corrected WRT at SX Ex. 362-

RR, p. 3 (PSS\_002739), SX Trial Ex. 244; SX Trial Ex. 64 at 3 (PSS\_002715); SX Trial Ex. 233 at 3 (PSS\_366020). Dr. Crawford's effort to extract costs and revenues from this data for the PSS service alone for use in his surplus analysis cannot be credited because of his lack of familiarity with the data's source. 6/13/12 Tr. 1890:15-1891:10 (Crawford).<sup>4</sup> The Judges find no persuasive evidence to suggest that Music Choice has not operated successfully and received a fair income under the existing statutory rate, nor any to suggest that Music Choice would not continue to do so under a rate that was modestly above the current rate (*i.e.*, the 8.0% (2013) and 8.5% (2014-2017) rates that the Judges adopt for the upcoming rate period).<sup>5</sup>

With respect to fair return to the copyright owner, the Judges' examination is whether the existing statutory rate has produced a fair return with respect to the usage of sound recordings. During the current licensing period, Music Choice provided 46 channels of music programming. Music Choice plans to expand the number of music channels it provides dramatically in the coming licensing term, however, up to 300 channels by the first quarter of 2013. Del Beccaro Corrected WDT at 3-4, PSS Trial Ex. 1; 6/11/12 Tr. 1490:8-16 (Del Beccaro). This expansion will result in a substantial increase in the number of plays of music by Music Choice, even if the ultimate listenership intensity of its licensees' subscribers cannot be measured. Music Choice provided no evidence, however, to suggest that the planned expansion in usage would result in increased revenues to which the statutory royalty rate is to be applied. Indeed,

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<sup>4</sup> Much was made in the hearing and in closing arguments regarding Dr. Crawford's supposed use of audited financial data and Dr. Ford's use of unaudited financial data in an effort to examine costs and revenues of the PSS service vis-à-vis Music Choice's other non-PSS services. The Judges see no superiority to either data set as presented in this proceeding.

<sup>5</sup> It is improbable that Music Choice would continue to operate for over 15 years with the considerable losses that it claims. It is equally improbable that Music Choice would elect to incur the additional costs of adding more music channels unless it anticipated some additional revenue from the expanded service.

Music Choice has declared itself to be in a mature market with no expectation of increasing profits. 8/16/12 Tr. 3855:17-3856:7 (Del Beccaro).

Music Choice presented no evidence to suggest that copyright owners would be compensated for the increased usage of their works. Dramatically expanded usage without a corresponding expectation of increased compensation suggests an upward adjustment to the existing statutory rate is warranted. Measurement of the adjustment is not without difficulty because any downstream increases in listenership of subscribers as a result of additional music offerings by Music Choice cannot be readily predicted. It is possible that listenership overall may remain constant despite the availability of several additional music channels. It is more likely, however, that Music Choice would not make the expansion, and incur the additional expense of doing so, without reasonable expectation that subscribers or advertisers would be more attracted to the expanded offerings, although the Judges have no evidence to suggest that the net increase in listenership (or advertising revenue) would be anything more than modest.

SoundExchange refers to prior rate decisions and the application of the fair return/fair income factor by the Judges and their predecessors. SoundExchange asserts that the Judges are looking for a fair return/fair income result that is consistent with reasonable market incomes. *SX PFF* at ¶ 491, *citing SDARS-I*, 73 *F.R.* 4080, 4095 (Jan. 24, 2008). Referring to testimony by Messrs. Ciongoli and Van Arman, SoundExchange emphasizes how vital statutory royalty income is to copyright owners—both the record labels and the artists, whose share SoundExchange distributes directly. *See* 6/13/12 Tr. 2138:5-2142:9 (Ciongoli), Van Arman *WDT* at 4, *SX Trial Ex. 77*. Although the income from any one statutory license may not be great, SoundExchange cites the aggregate

value of income from all of the statutory licenses as vital to the industry. With respect to fair income to the rights user, SoundExchange points to the profit on the consolidated financial statements of Music Choice over the past five years, 2007-2011.

The balance of fair return and fair income appears to have been maintained at the current PSS rates. This factor does not argue in favor of drastic cuts or increases in the current rate. Music Choice's planned increase in usage, however, argues in favor of an increase in the rates going forward to fairly compensate the licensors for the additional performances.

The Judges determine, therefore, that a 1% upward adjustment of the benchmark (from 7.5% to 8.5% of *Gross Revenues*), phased in during the early part of the licensing period, is appropriate to serve the policy of fair return/fair income. **Because the increase is modest and phased in over the first two years of the rate period, the Judges do not believe that the adjusted rates will negatively impact Music Choice's ability to earn a fair income.**

**c. Weigh the Relative Roles of Copyright Owners and Copyright Users**

This policy factor requires that the rates the Judges adopt reflect the relative roles of the copyright owners and copyright users in the product made available with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of markets for creative expression and media for their communication. Music Choice argues that its creative and technological contributions, and capital investments, outweigh those of the record companies. First, Music Choice touts the graphic and informational improvements made to its on-screen channels, noting that what were once blank screens now display significant artist and music information.

According to Music Choice, costs for these improvements have exceeded [ ]. Del Beccaro Corrected WDT at 31-32, PSS Trial Ex. 1. Second, Music Choice offers increases in programming, staff size and facilities, along with enhancements to product development and infrastructure. Music Choice estimates that costs for these improvements have exceeded [ ]. *Id.* Regarding costs and risks, Music Choice points to its lack of profitability and the exit of other PSS from the market as evidence of its continued risk and limited opportunity for profit. *Music Choice PFF ¶¶ 512-520.* Finally, with respect to opening new markets, Music Choice touts the PSS market itself for which it remains the standard-bearer in disseminating music to the public through cable television. *Id.* at ¶ 523.

SoundExchange offers little more on the third § 801(b) factor beyond Dr. Ford's contention that he saw no evidence to support that Music Choice makes contributions to creativity or availability of music that are beyond those of the music services he included in his benchmarks, and therefore, according to Dr. Ford, the third factor is accounted for in the market. Ford Second Corrected WDT at 21, SX Trial Ex. 79; 6/18/12 Tr. 2849:10-16 (Ford).

In considering the third factor, the Judges' task is not to determine who individually bears the greater risk, incurs the higher cost or makes a greater contribution in the PSS market, and then make individual up or down adjustments to the selected rate based upon some unspecified quantification. Rather, the consideration is whether these elements, taken as a whole, require adjustment to the Judges' selected benchmark rate of 7.5% (or to the modestly increased rates of 8.0% and 8.5% that the Judges found warranted under the second § 801 factor discussed above). Upon careful weighing of the

evidence, the Judges determine that no adjustment is necessary under the current statutory rate or under the modestly increased rates that the Judges have selected for the upcoming rate period.

Music Choice's investments in programming offerings, staff, and facilities, and other related products and services are no doubt impressive, but they have been accomplished under the current rate. As discussed above, Music Choice has already begun to expand its channel offerings and has allocated greater financial resources to its residential audio business. All of these undertakings, plus the investments made and costs incurred to date have been made under the existing rate, and the Judges have no persuasive evidence to suggest that these contributions have not been accounted for in the current rate. Moreover, the Judges find no evidence to suggest that the modest increase to 8.5% (phased in over the first two years of the rate period) that the Judges adopt will negatively impact Music Choice's continued operations in a material way.

On the other side of the ledger, SoundExchange has not offered any persuasive evidence that the existing rate has prevented the music industry from making significant contributions to or investments in the PSS market or that those contributions are not already accounted for in the current rate. The modest increases that the Judges adopt would make any such argument even less persuasive. Therefore, no adjustment, either upward or downward, from the 8.0% and 8.5% rates that the Judges adopt is warranted under this factor.

#### **d. Minimize Disruptive Impact**

Of the four § 801(b) factors, the parties devoted most of their attention to the last one: minimizing disruption on the structure of the industries and on generally prevailing

industry practices. This is perhaps not surprising, given the role this factor played in *SDARS-I* in adjusting the benchmark rates upon which the Judges relied to set the royalty fees. *See SDARS-I*, 73 FR at 4097-98. The Judges' analysis of the disruption factor is confined to the current statutory rate of 7.5% and to the phased-in rate of 8.5% (including the 8.0% rate for the first year of the rate period) that the Judges found warranted under the second § 801(b) factor, discussed above.

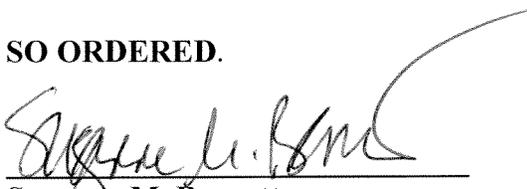
SoundExchange argues that the current rate is disruptive to the music industry. Dr. Ford testified that “the current practice of applying an exceedingly low rate to deflated revenues is disruptive of industry structure, especially where there are identical services already paying a higher rate.” Ford Second Corrected WDT at 23, SX Trial Ex. 79. This results, according to Dr. Ford, in a tilting of the competitive field for music services in favor of Music Choice, thereby disrupting the natural evolution of the music delivery industry. Dr. Ford, however, concedes that the PSS market has unique and distinctive features that distinguish it from other types of music services, thereby substantially reducing the likelihood that the PSS and other music services would be viewed as substitutes for one another. Further, Dr. Ford failed to present any empirical evidence demonstrating a likelihood of migration of customers from music services paying higher royalty fees to the PSS as a result of his perceived royalty imbalance. Dr. Ford's conclusion that the current rate paid by the PSS for the § 114 license has caused a disruption to the music industry (or would likely do so in the upcoming license period) is mere conjecture.

Music Choice also contends that the current rate is disruptive. The Judges find its argument weak and unsubstantiated. The test for determining disruption to an industry,

announced by the Judges in *SDARS-I*, is whether the selected rate directly produces an adverse impact that is substantial, immediate, and irreversible in the short-run. *SDARS-I*, 73 FR at 4097. The current rate has been in place for some time and, despite Music Choice's protestations that it has never been profitable, it continues to operate *and* continues to increase its expenditures by expanding and enhancing its services in the face of the supposedly disruptive current royalty rate. Music Choice's argument that DMX's bankruptcy and Muzak's decision to limit its participation in the PSS market are evidence of the onerous burden of the current rate are without support. Music Choice has failed to put forward any evidence demonstrating a causal relationship between the actions of those services and the current PSS royalty rate. In sum, the Judges are not persuaded by the record testimony or the arguments of the parties that the current PSS rate is disruptive to a degree that would warrant an adjustment, either up or down.

The modest, phased-in increase to 8.5% that the Judges adopt does nothing to change this conclusion. Neither SoundExchange nor Music Choice presented any credible evidence to suggest that the adjusted rates of 8.0% and 8.5% that the Judges adopt would directly produce an adverse impact that is substantial, immediate, and irreversible in the short-run. Therefore, the Judges find that no adjustment to the adopted rates is warranted under the fourth § 801(b) factor.

**SO ORDERED.**

  
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**Suzanne M. Barnett**  
**Chief Copyright Royalty Judge**

  
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**Richard C. Strasser**  
**Copyright Royalty Judge**

**DATED: April 30, 2013**