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Before the
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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT STATEMENT OF THE NATIONAL ASSOCIATION OF BROADCASTERS

Witness Testimony

Volume 2 of 3

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October 7, 2014

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WRITTEN DIRECT TESTIMONY OF
MICHAEL L. KATZ
(On behalf of the National Association of Broadcasters)

October 7, 2014

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I. INTRODUCTION AND OVERVIEW

1. The Copyright Royalty Judges ("Judges") have commenced a proceeding to determine reasonable rates and terms for public performances of sound recordings by means of eligible, nonsubscription transmissions, under Section 114 of the Copyright Act, and the making of an ephemeral recording in furtherance of making a permitted public performance of the sound recording, under Section 112 of the Copyright Act, for the period beginning on January 1, 2016, and ending on December 31, 2020.[1] The Judges are charged with establishing reasonable royalty rates to be paid by eligible, nonsubscription services.[2] In determining these royalty rates, "the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller."[3]

2. At the request of counsel for the National Association of Broadcasters ("NAB"), I have conducted an economic analysis of what rates meet the statutory standard as I understand that standard as an economist. I have also examined the implications of this standard for the validity of certain benchmarks that have previously been used or that are likely to be proposed in the present proceeding. Previous rate proceedings have consistently considered royalties for the public performance and ephemeral recording

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1 *Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)*, 79 FR 412 (January 3, 2014) (hereinafter, *Web IV Commencement*).

2 Copyright Act, 17 U.S.C. § 801.

3 Copyright Act, 17 U.S.C. §§ 112(e) and 114(f)(2)(B).

rights in combination because there is no sound basis for attributing an independent economic value to the latter.[4] I therefore consider the two rates together in my analysis that follows.

3. My central finding with respect to the validity of past benchmarks is that the statutory rates adopted in the second webcasting proceeding ("Web II") were based on a severely flawed benchmark analysis conducted by Dr. Pelcovits that led to rates well in excess of those that would have been negotiated by a willing buyer and willing seller in an appropriate market. Moreover, by strongly influencing the private parties' expectations regarding future statutory rates, the rates set in Web II created significant upward pressure on rates in the Webcaster Settlement Act ("WSA") agreements subsequently negotiated and, thus, rendered those agreements inappropriate benchmarks for what a willing buyer would have paid a willing seller in the absence of the statute. In short, there is a need to break with the past by taking a close look at new benchmarks that are meaningfully similar to the licenses at issue and that do not reflect undue licensor market power.

4. With respect to appropriate benchmarks for the current proceeding, my central findings are that: (a) an analysis of the economic relationship between record companies and terrestrial radio broadcasters establishes that the lower bound for reasonable royalties

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[4] *See, e.g.*, *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, Final Rule, 78 FR 23054 (hereinafter, *SDARS II Decision*) at 23055-56; *Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings,* Final Rule and Order, 79 FR 23102 (April 25, 2014) (hereinafter, *Web III Remand Decision*) at 23104-105; *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Final Rule, 72 FR 24084 (May 1, 2007) (hereinafter, *Web II Decision*) at 24101-102.

to be paid by webcasters that simulcast terrestrial radio broadcasts ("simulcasters") is near zero, and (b) an analysis of the statutory rate set in the most recent Satellite Digital Audio Radio Services proceeding ("SDARS II")[5] establishes that, when expressed as a percentage of a music-formatted radio station's simulcasting revenues, a royalty of 13 percent or higher would be unreasonably high. In fact, percentage royalties that were lower but near 13 percent (or per-performance royalties that were equivalent to a rate near 13 percent) of simulcasting revenue would also be unreasonably high. Given the data available to me at this point in the current proceeding, I am unable to reach a conclusion as to how much lower than 13 percent of applicable revenue the upper bound on reasonable rates for simulcasting is. I anticipate being able to reach such a conclusion after reviewing additional information that I expect will be introduced into the record by other parties or made available in discovery.

5. Turning to specific findings, drawing on my training and experience as an economist, my review of the public record in related proceedings, and my analysis of the relevant industries, I find that:

- *From the perspective of economics, the willing-buyer/willing-seller standard is most appropriately interpreted as asking what would happen in an effectively competitive market in the absence of the statutory licensing regime.* Congress's decision to create a rate-determination process with a willing-buyer/willing-seller

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[5] *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services* (hereinafter, *SDARS II*). *SDARS II*, in turn, relied in significant part on the result in the first satellite radio case before the Judges, *Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services* (hereinafter, *SDARS I*).

standard can best be reconciled with economic principles and common sense by interpreting willing buyers as those who have meaningful choices among competing sellers, rather than facing a single, all-or-nothing offer from a monopolist or sellers with equivalent market power. This interpretation is fully consistent with the Librarian of Congress's statement in Web I that the willing-buyer/willing-seller standard calls for rates that would have been set in a "competitive marketplace"[6] and the Judges' statement that, although the standard does not require that there be perfect competition, it does require that benchmark agreements be reached in effectively competitive markets.[7]

- *Effectively competitive prices promote consumer welfare and economic efficiency.* From the perspective of economics, a standard requiring royalty rates to be set at the levels that would emerge from an effectively competitive market is a sound one. Economists and public policy makers have long recognized that competition delivers benefits to consumers in the form of lower, cost-based prices, greater innovation and variety, and/or improved product and service quality. Promoting efficiency through competition is widely recognized as the most effective means in most markets to promote overall consumer welfare. And, in particular, competitive prices are recognized as providing incentives to buyers and sellers

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6 *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Final Rule and Order, 67 FR 45240 (July 8, 2002) (hereinafter, *Web I Decision*), at 45244-45.

7 *Web III Remand Decision* at 23114, n. 37 and sources cited therein.

alike to behave in ways that maximize the total benefits society enjoys from available resources.

- *Competition pushes prices towards marginal costs.* A competitive supplier will find it profitable to engage in licensing as long as the license fees it expects to earn exceed the expected costs of issuing and administering the license. Hence, rivalry among competing licensors drives license fees toward the incremental costs of issuing the licenses. In the case of an idealized, perfectly competitive market, price would fall all the way to marginal cost. In less competitive markets (*e.g.*, workably competitive or effectively competitive markets), the prices will not fall all of the way to marginal cost, but they will strongly tend in that direction and will be near marginal cost.

- *Effectively competitive prices will reflect any other benefits that the buyer provides to the seller.* To the extent that a buyer provides benefits to a seller in addition to the price paid for the good or service, the competitive price will reflect those benefits. In particular, to the extent that a licensee provides valuable promotional benefits to the seller, a competitive seller will be willing to accept a lower—and, in some cases, even negative—price in recognition of the fact that those promotional benefits are a form of compensation to the seller. As I will discuss below, the evidence indicates that simulcasting generates significant promotional benefits, which indicates that in many instances the license fee for the simulcasting of a musical recording could be *negative*.

- *A market cannot be effectively competitive in the absence of buyer choice.* Competition arises *only* when buyers have the ability to substitute the offerings of one seller for those of another. It is this possibility of substitution that drives each seller to offer higher quality and lower prices in order to attract buyers to itself rather than its rivals. For this reason, a market with a single, monopoly seller cannot be effectively competitive: there are no alternative suppliers to which buyers can turn for substitutes. It is also the case that a market in which suppliers offer strongly complementary products cannot be effectively competitive. By definition, when the supplier of a complementary product lowers its price, that lower price benefits its rivals rather than places competitive pressure on them. Therefore, the sellers of complementary products do not compete with one another.

- *The rates set in Web II were substantially above the rates that would exist in an effectively competitive market.* The rates set in Web II were based on an analysis of the major record companies' licenses with certain subscription-based, interactive services; the analysis was conducted by Dr. Michael Pelcovits, an economic expert for SoundExchange. This analysis was critically flawed in several respects:

    - An interactive service requires licenses to all of the major record companies' catalogs in order to be commercially viable. Thus, licenses to the majors' catalogs are complements and, as described above, it is a well-established principle of economics that this fact implies that the record companies do *not* compete against one another in the sale of licenses to interactive service providers. Where licensors do not compete with one another, the license terms necessarily neither reflect competition nor constitute competitively priced benchmarks.

  - Interactive services are not sufficiently similar to the target services, and, therefore, the interactive services agreements used as the basis for Dr. Pelcovits's analysis are not appropriate benchmarks for establishing statutory rates for the target services. As described below, Dr. Pelcovits's analysis relied on license fees for subscription, interactive services as benchmarks for *non*interactive services that are predominantly *non*subscription. Dr. Pelcovits failed to correct for important differences between the business models of the two types of services, most notably that for nonsubscription, noninteractive services, advertising revenues per play are far lower than subscription fees per play. Dr. Pelcovits also based his analysis on a biased sample of contracts drawn from a nascent, rapidly changing industry. Although those may have been the only data available to him at the time, those data should not serve as a legacy basis for present or future statutory rates.

- *The license fees negotiated in the NAB/SoundExchange WSA Agreement are not a valid benchmark.* The statutory rates set in Web II, which were far above effectively competitive levels, strongly influenced the rates reached in the WSA agreement between the NAB and SoundExchange. The Web II rates established the parties' expectations and eliminated the incentive of the NAB to rely on a possible return to the Copyright Royalty Board ("CRB") to set rates for 2011 through 2015. In addition to the effects of Web II on the WSA negotiations, the NAB faced a monopoly seller in SoundExchange. Accordingly, the NAB/SoundExchange WSA Agreement cannot be considered to reflect rates that would be agreed to in an effectively competitive market. In addition to distorting the overall level of royalties in the agreement, the Web II decision distorted the rate structure. Specifically, the licensees under the NAB/SoundExchange WSA agreement paid for short-term relief from the overly high Web II rates by agreeing to higher future rates in return for lower current rates during a period of overlap with the Web II rates. Hence, the rates in later years of the NAB/SoundExchange agreement were even higher relative to an effectively competitive rate than was the average rate, which itself was above any effectively competitive level.

- *An analysis based on record company behavior demonstrates that the lower bound of the zone of reasonableness for statutory license fees for simulcasting is near zero.* Because of the promotional value associated with simulcasts, an effectively competitive license fee for simulcasting could well be negative for many recordings and simulcasters. Taking into account the heterogeneity in promotional value and the possibility of strategic behavior by potential licensees, I find that a negative statutory license fee would be unreasonable, but that the lower bound of the zone of reasonableness for a statutory rate for web simulcasting is near zero.

- *Analysis of the findings in SDARS II demonstrates that statutory license fees equivalent to 13 percent or more of a music-formatted simulcaster's revenues from simulcasting would be unreasonable and the upper bound on reasonable rates is lower*. Given the information currently available to me, I cannot determine the precise upper bound for a reasonable simulcasting license fee. I can say, however, that the upper bound is no higher than the rate in SDARS II before the Judges applied the Section-801(b) adjustments. Empirical evidence indicates that copyrighted music is no more important to music-formatted simulcasters than to Sirius XM. Moreover, the SDARS II rate reflects the SDARS I analysis, which resulted in a rate higher than that which would be reached in an effectively competitive market. Therefore, a royalty rate of 13 percent or higher of the simulcast revenues of music-formatted radio stations would be unreasonably high, as would be rates lower than, but near 13 percent.[8]

6. The remainder of this statement explains these conclusions in greater depth and provides details of the facts and analysis that led me to reach them.

II. QUALIFICATIONS

7. I hold the Sarin Chair in Strategy and Leadership at the University of California at Berkeley. I hold a joint appointment in the Haas School of Business Administration and in the Department of Economics. I have also served on the faculty of the Department of

[8] As noted above, based on available data, I am unable to reach a conclusion as to how much lower than 13 percent of directly applicable revenue a rate would have to be in order to be reasonable, but I anticipate being able to reach such a conclusion after reviewing additional information that I expect will be introduced into the record by other parties or produced in discovery.

Economics at Princeton University and the Stern School of Business at New York University. I received my A.B. from Harvard University *summa cum laude* and my doctorate from Oxford University. Both degrees are in Economics.

8. I specialize in the economics of industrial organization, which includes the study of competition and pricing, as well as antitrust and regulatory policies. I regularly teach courses on microeconomics and business strategy. I am the co-author of a microeconomics textbook, and I have published numerous articles in academic journals and books. I have written academic articles on issues regarding the economic analysis of intellectual property law, the relationship between intellectual property law and antitrust policy, the economics of intellectual property licensing, and the economics of network industries and two-sided platforms. My curriculum vitae, which is attached to this testimony, lists all publications that I have authored or co-authored, with the exception of a few letters to the editor published in newspapers. I am a co-editor of the *Journal of Economics and Management Strategy* and serve on the editorial boards of *Information Economics and Policy* and the *Journal of Industrial Economics*.

9. In addition to my academic experience, I have consulted on the application of economic analysis to public policy. I have served as a consultant to both the U.S. Department of Justice and the Federal Communications Commission on issues of antitrust and regulatory policy. I have served as an expert witness before state and federal courts. For example, this past summer, I testified in federal district court in litigation brought by the U.S. Department of Justice against American Express. I was offered by the Department of Justice as an expert in economics and so designated by the

court. I have also provided testimony before state regulatory commissions and the U.S. Congress. In addition, I was commissioned by the Congressional Research Service to write a report on the economic effects of home copying on the markets for recorded music and for electronically recorded visual images.[9]

10. From January 1994 through January 1996, I served as the Chief Economist of the Federal Communications Commission. I participated in the formulation and analysis of policies toward all industries under Commission jurisdiction. As Chief Economist, I oversaw both qualitative and quantitative policy analyses.

11. From September 2001 through January 2003, I served as the Deputy Assistant Attorney General for Economic Analysis at the U.S. Department of Justice. I directed a staff of approximately fifty economists conducting analyses of economic issues arising in both merger and non-merger enforcement. My title as Deputy Assistant Attorney General notwithstanding, I am not an attorney.

12. I have also advised private clients on software licensing fees and product pricing.

III. THE STATUTORY STANDARD

13. Section 114 of the Copyright Act establishes a "willing buyer/willing seller" standard for the setting of statutory royalty rates applicable in this proceeding:[10]

> In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright

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9 Michael L. Katz , *Home Copying and Its Economic Effects: An Approach for Analyzing the Home Copying Survey*, Mar. 9, 1989, report commissioned by Congressional Research Service for *Copyright and Home Copying: Technology Challenges to the Law,* October 1989.

10 Copyright Act, 17 U.S.C. § 114(f)(2)(B).

> Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller. In determining such rates and terms, the Copyright Royalty Judges shall base their decision on economic, competitive and programming information presented by the parties, including—
>
> > (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
> >
> > (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

14. If interpreted literally and narrowly, the willing-buyer/willing-seller standard would exhibit a broad range of indeterminacy in the level of license fees. An economically rational party will not agree to a transaction that makes it worse off. This fact implies that:

- a seller will not agree to a price below its marginal or incremental cost of providing the good or service, including the opportunity cost of doing so; and
- a buyer will not agree to a price above the value that it derives from the good or service.

15. Conversely, faced with an all-or-nothing choice, a rational party will be "willing" to agree to a contract as long as it leaves that party in no worse a position than it would be in absent the agreement. Hence, interpreted in a narrow, literal sense, any price above marginal cost could be considered to be price at which a seller would be willing to transact. And, under this literal interpretation, even a monopolist charging the monopoly price would constitute a willing seller that faces willing buyers.

16. This literal reading of the standard is untenable for at least two reasons. First, there typically will be a very large gap between marginal cost (the minimum price that a seller is "willing" to accept) and the highest price at which a buyer would be willing to purchase at least some of the good, which typically will be even higher than the monopoly price. Hence, this interpretation would provide essentially no guidance for rate setting. Second, an interpretation under which even a monopolist charging the monopoly price would constitute a willing seller facing willing buyers would be inconsistent with past Congressional actions. Specifically, from the perspective of economics, it would make no sense for Congress to have enacted a statutory rate-determination process if Congress intended that monopolistic license fees could meet the statutory standard. If Congress had intended monopoly rates to prevail, then it could simply have created the statutory license and given SoundExchange antitrust immunity unilaterally to set rates on behalf of the industry. Congress did not do so.

17. The creation of a rate-determination process and its willing-buyer/willing-seller standard can best be reconciled with economic principles and common sense by interpreting willing buyers as those who have meaningful choices among competing sellers, rather than facing a single, all-or-nothing offer from a monopolist. This interpretation is fully consistent with the Librarian of Congress's recognition in Web I that the willing-buyer/willing-seller standard calls for rates that would have been set in a "competitive marketplace."[11] In related proceedings, an economist repeatedly retained by

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[11] *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Final Rule and Order, 67 FR 45240 (July 8, 2002) (hereinafter, *Web I Decision*), at 45244-45.

SoundExchange agreed that, in order for a privately negotiated licensing agreement to serve as an appropriate benchmark there should not be excessive market power on either the buyer side or the seller side of the market,[12] and in a similar proceeding testified that,[13]

> for an economist, absent a public policy decision actually to *distort* pricing structure (through taxes or subsidies), the fundamental objective in a rate setting proceeding such as [SDARS I] should be to "mimic" what an effectively competitive marketplace accomplishes in an unregulated setting…

18. As I will now discuss, an effective-competition standard resolves the indeterminacy identified above, and it does so by identifying prices near marginal or incremental costs as the appropriate level.

IV. THE ECONOMICS OF EFFECTIVE COMPETITION

19. The degree of market competitiveness lies on a spectrum. At one end, there are markets satisfying the textbook conditions of perfect competition, with rivalry among a large number of sellers of identical products and the possibility of free entry into the

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[12] In the previous proceeding, *Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings* (hereinafter, Web III), SoundExchange's economic expert, Professor Janusz Ordover, testified that

> [c]onsistent with my testimony in the SDARS Proceeding, and more generally with a sound economic approach to the determination of rates that best conduce to long-run economic efficiency, licensing rates negotiated in an unfettered marketplace, that is, in a marketplace free of regulatory compulsion and undue market power on either side of the bargaining table, represent benchmarks that are most closely aligned with the statutory requirement.

(Written Rebuttal Testimony of Janusz Ordover, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, June 7, 2010 (hereinafter *Ordover WRT Web III*) at 5.)

[13] Testimony of Janusz Ordover, *Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, October 30, 2006 (hereinafter, *Ordover WDT SDARS I*), at 12.

market by additional suppliers. At the other end, there are markets subject to monopoly or a cartel, and into which further entry is blocked. It is evident that perfectly competitive markets are competitive and that monopolized markets are not. But what of markets in the middle? This question is of particular relevance in the present proceeding because, as the Judges have declared, the statutory standard is one of *effective* competition, not *perfect* competition.[14]

20. In order to understand what constitutes an effectively competitive price, it is valuable to understand the economics of why competitive pricing is desirable and, thus, why Congress would find it desirable to set rates that reflect the prices that would emerge from effective competition. It is also valuable to understand what price would emerge from a fully or perfectly competitive market because such a price serves as a baseline for identifying an effectively competitive price.

A. THE BENEFITS OF COMPETITION

21. Many U.S. public policies, including antitrust and regulatory policies, seek to protect competition because of the benefits it delivers to consumers. These benefits typically arrive in the form of lower, cost-based prices, greater innovation and variety, and/or improved product and service quality.

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[14] *Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Final Rule and Order, 79 FR 23102 (April 25, 2014) (hereinafter, *Web III Remand Decision*) at 23114, n. 37 and sources cited therein.

22. Promoting efficiency through competition is widely recognized as the most effective means in most markets to promote overall consumer welfare. As the Federal Trade Commission has explained,[15]

> Free and open markets are the foundation of a vibrant economy. Aggressive competition among *sellers* in an open marketplace gives consumers — both individuals and businesses — the benefits of *lower* prices, higher quality products and services, more choices, and greater innovation.

The Supreme Court has repeatedly reached the same conclusion. For example, the Court stated:[16]

> The Sherman Act reflects a legislative judgment that, ultimately, competition will produce not only *lower* prices but also better goods and services. "The heart of our national economic policy long has been faith in the value of competition." *Standard Oil Co. v.* FTC, 340 U. S. 231, 340 U. S. 248. The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain -- quality, service, safety, and durability -- and not just the immediate cost, are favorably affected *by the free opportunity to select among alternative offers*.

Similarly, economists have long recognized the benefits of competition:[17]

> Economic efficiency means that, under competitive conditions, the net value of society's scare resources is maximized…a competitive market creates a maximum of net social value. This means that society's resources have been allocated in efficient fashion. The sum of consumers' surplus and factor or producers' surplus is maximized when net social value is maximized under competition.

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15 U. S. Federal Trade Commission, *Guide to Antitrust Laws*, http://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws, emphasis added.

16 National Society of Prof. Engineers v. United States, 435 U.S. 679 (1978) at 695, emphasis added.

17 Robert B. Ekelund, Jr. and Robert D. Tollison (1997), *Microeconomics: Private Markets and Public Choice* (5th ed.), Boston: Pearson/Addison Wesley, at 97.

23. In addition to describing the benefits of competition, the quotations from the Federal Trade Commission and Supreme Court above identify the critical role of buyer choice in promoting competition. Indeed, competition arises only when buyers have the ability to substitute the offerings of one seller for those of another. As will be discussed below, it is this possibility of substitution that generates consumer benefits by driving sellers to offer higher quality and lower prices in order to attract buyers to themselves rather than to their rivals.

B. COMPETITIVE PRICES

24. The study of competitive prices is one of the oldest topics in economics. Indeed, in 1776, Adam Smith wrote that "The natural price, or the price of free competition ... is the lowest which can be taken...[It] is the lowest which the sellers can commonly afford to take, and at the same time continue their business."[18]

25. In modern terminology, rivalry among competitive suppliers drives them to set prices near their incremental or marginal costs of supplying the relevant good or service. The reason competition has this effect is as follows. When a supplier lowers its price, it can expect to enjoy increased sales as buyers switch away from rival suppliers. If the supplier's revenues rise by more than do its costs, then the supplier will enjoy higher profits when it lowers its price. Stated another way, the price decrease will be profitable as long as the incremental revenue associated with that price change is greater than the incremental cost of supplying the additional output sold as a result of the price

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[18] Adam Smith, *The Wealth of Nations* (1776), Book I, Chapter VII.

reduction.[19] A supplier in a competitive market will face a demand curve that is highly responsive to the price that firm charges, so that the firm can significantly increase its sales without having to make large price cuts. For such a firm, the incremental revenue associated with selling an additional unit of output (*i.e.,* the firm's marginal revenue) will be approximately equal to the price at which the firm sells its output. Indeed, for a perfectly competitive firm, price and marginal revenue are equal to one another. As explained by a prominent economics textbook:[20]

> It is profitable for a firm to expand output as long as the extra revenue from selling an additional unit exceeds the extra cost of producing that unit. The extra revenue from selling an additional unit is price, and the extra cost is the marginal cost. That is, the optimal (profit-maximizing) production rule for a competitive firm is to expand its output until its marginal cost, MC, equals price, p.

26. Society will gain from increased consumption of a good or service whenever the consumer benefits from the additional consumption are greater than the costs of supplying the additional output. Similarly, net social benefits will fall from increased consumption of a good or service whenever the consumer benefits from the additional consumption are smaller than the costs of supplying the additional output. In other words, from the perspective of promoting social benefits, consumption should increase up to the point at which the marginal benefit of additional consumption is equal to the marginal cost.

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19 Similarly, if raising price would reduce revenue by less than amount that costs would fall, a supplier would find it profitable to increase its price.

20 Dennis W. Carlton and Jeffrey M. Perloff (2005), *Modern Industrial Organization* (4th ed.), Boston: Pearson/Addison Wesley, at 58.

27. One of the great virtues of competitive prices is that they guide consumers and firms to the point at which society's benefits are maximized (*i.e.,* the point at which the marginal benefit of additional consumption is equal to the marginal cost). Competitive prices do so because an economically rational buyer will purchase additional output as long as the marginal benefit is greater than the price. Therefore, a competitive price equal to marginal cost generates incentives for buyers to purchase additional units of the good or service up to the point that the marginal benefit derived from consumption is equal to marginal cost. This process, through which competitive pricing maximizes the net benefits society enjoys from the good or service, is what Adam Smith famously referred to as "the invisible hand."

28. In addition to maximizing society's overall benefits, competition also ensures that buyers face relatively low prices and, thus, buyers enjoy much of the benefit generated by the good or service. Price competition among incumbent firms, as well as the free entry of additional firms, leads to an equilibrium in which suppliers earn zero economic profits.[21, 22] Protecting competition to promote consumer benefits is a fundamental objective of U.S. public policy such as antitrust enforcement and telecommunications

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21 See, *e.g.,* N. Gregory Mankiw (2015) *Principles of Economics, Seventh Edition,* Cengage Learning, Stamford, CT, at 291.

22 Economic profits are not the same as accounting profits. The term "economic profits" refers to profits in excess of those necessary to provide a competitive return on the assets invested in the firm. ("Positive economic profits are returns above and beyond the total (explicit plus implicit) costs to the owner of or investor in a firm. They are returns above the opportunity cost of the owner's capital investment in the firm, that is, they are above the normal return…." Robert B. Ekelund, Jr. and Robert D. Tollison (1997), *Microeconomics: Private Markets and Public Choice* (5th ed.), Boston: Pearson/Addison Wesley, at 218.) Economic profits include as a cost the opportunity cost of capital in its next-best use. Hence, even though economic profits are zero in a perfectly competitive market, accounting profits still are positive in such markets.

regulation. That is one of the reasons the quotations of the Federal Trade Commission and Supreme Court in the previous section refer to the virtues of "lower" prices. In summary, competition typically leads to a distribution of benefits that favors buyers; it does not necessarily split the gains from trade equally between buyers and sellers.

C. REASONABLE, WORKABLE, OR EFFECTIVE COMPETITION

29. The theoretical conditions of *perfect* competition often are not satisfied in actual markets. In particular, in the presence of economies of scale, marginal cost will be below average cost so that pricing all of its products at marginal cost would cause a supplier to incur losses. In the case of intellectual property and software markets, for example, marginal costs typically are near zero, so that marginal cost pricing would not allow suppliers to cover their fixed costs. Moreover, even when there are many different suppliers of a good or service, each supplier may offer output that is somewhat different from that offered by other suppliers. This product differentiation will tend to insulate each supplier from competition to some degree, leading to prices above marginal cost.

30. It is thus necessary to consider markets that are competitive, but not perfectly so. Economists have long examined this concept, beginning with Professor J.M. Clark, who introduced the concept of "workable" competition.[23] Economists also refer to such markets as reasonably or effectively competitive.[24] A prominent economics textbook recently stated an implicit definition as follows:[25, 26]

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[23] J. M. Clark (1940), "Toward a Concept of Workable Competition," *American Economic Review*, **30**(2) Pt. 1: 241-56.

[24] SoundExchange's economic expert in the SDARS I and SDARS II proceedings, Professor Ordover, defined effectively competitive markets as "markets not distorted by

> Even though few industries fit the requirements of perfect competition, economists often speak of certain types of industries as being reasonably competitive if they have certain characteristics. Price-taking behavior, many firms, and free entry and exit are often used as criteria to judge the competitiveness of a market. Free entry and exit typically result in firms eventually earning zero [economic] profits.

31. Prices in reasonably, workably, or effectively competitive markets allow suppliers to cover their average costs. There are at least three points that should be kept in mind in assessing whether prices cover costs.

- First, costs should include a competitive return to capital invested in the firm but should not include supra-competitive or monopoly profits.[27]
- Second, in free markets, there is no guarantee that any given supplier will be profitable. In earlier proceedings, the CRB concluded that the statutory license

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undue exercise of monopoly power on the part of sellers or monopsony power on the part of buyers. (Testimony of Janusz Ordover, *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, November 28, 2011 (hereinafter, *Ordover WDT SDARS II*), ¶ 19; *see, also, Ordover WDT SDARS I* at 25-26.)

25 Dennis W. Carlton and Jeffrey M. Perloff (2005), *Modern Industrial Organization* (4th ed.), Boston: Pearson/Addison Wesley, at 85.

26 As discussed above, a supplier earning zero *economic* profits will cover all of its costs, including the costs associated with financing its capital investments.

27 It is important to recognize that capital refers to the market or replacement value of the productive assets that must be used by the firm to offer its goods or services. These investments do not necessarily equal the full amount that owners have paid to purchase a firm. The reason is that the sales price of firm earning excess economic profits would be capitalized into the sales price of the firm and treatment of the sales price as an investment in productive assets would thus mask the earning of excess economic profits.

fees should not be set with the aim of guaranteeing a given rate of return to any licensee.[28] Exactly the same economic principle applies to licensors.

- Third, in considering whether a firm's prices allow it to cover its costs, one must consider *all* of the products offered by that firm. For example, a record company derives several revenue streams from its catalog of recordings other than statutory license fees, and these revenue streams help cover the fixed costs the record company incurs to create recordings. The multi-product perspective also generates important insights regarding the effects of a shifting mix of products. For example, to the extent that consumers are increasingly listening to simulcasting as a substitute for listening to terrestrial broadcasts for which the record companies do not receive any performance royalty, *any* positive license fee for simulcasting means that greater listening to simulcasting results in an increase in the record industry's overall revenues and profits.

D. BUYER CHOICE IS THE ESSENCE OF COMPETITION

32. When examining whether specific licenses represent the outcomes of effectively competitive markets and therefore might serve as potential benchmarks, it is essential to recognize that buyer choice is the essence of competition. Specifically, competition

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[28] In *Web III*, the analysis of Live 365's expert was rejected in part because it assumed that a representative willing buyer would not agree to a royalty that resulted in an operating profit margin of less than 20 percent. (*Web III Remand Decision* at 23107.) In *Web II*, the judges noted,

> It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient.

(*Web II Decision* at 24088, n. 8)

arises *only* when buyers have the ability to substitute the offerings of one seller for those of another. It is this possibility of substitution that drives sellers to offer higher quality and lower prices in order to attract buyers to themselves rather than their rivals. Conversely, when buyers lack the ability to substitute among the offerings of different sellers, there is no competition among sellers to attract customers.

33. The conclusion that competition can exist only if buyers have the freedom to exercise choice among substitute offerings is valid whether one is considering perfect competition or effective competition. Indeed, the concept of buyer choice among several substitute suppliers plays a critical and central role in all of the definitions of workable or reasonable competition in the academic literature. A critical element of Professor Clark's concept is the "free option of the buyer to buy from a rival seller or sellers of what we think of as 'the same' product."[29] Nobel Laureate George Stigler also emphasized the importance of buyer choice when he wrote that[30]

> An industry is workably competitive when (1) there are a considerable number of firms selling closely related products in each important market area, (2) these firms are not in collusion, and (3) the long-run average cost curve for a new firm is not materially higher than that for an established firm.

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[29] J. M. Clark (1940), "Toward a Concept of Workable Competition," *American Economic Review,* **30**(2) Pt. 1: 241-56, at 243.

[30] George J. Stigler (1942), "Extent and Bases of Monopoly," *American Economic Review,* **32**(2) Pt. 2, Suppl.: 1-22, at 2-3.

Professor Corwin Edwards also identified several conditions for a market to be workably competitive, one of which is that:[31]

> There must be an appreciable number of sources of supply and an appreciable number of potential customers for substantially the same product or service. Suppliers and customers do not need to be so numerous that each trader is entirely without individual influence, but their number must be great enough that persons on the other side of the market may readily turn away from any particular trader and may find a variety of other alternatives.

Additionally, in the quotations of the Federal Trade Commission and Supreme Court above, which manifestly refer to real-world markets, the Commission identifies the virtues of "[a]ggressive competition among sellers," and the Court identifies the benefits that flow from the "free opportunity to select among alternative offers."[32]

34. The fact that competition can exist only if buyers have the freedom to exercise choice among substitute offerings has two very important consequences: (1) a monopolized market is not effectively competitive, and (2) suppliers of complementary products do not compete with one another. I consider each, in turn.

1. A monopolized market is not competitive.

35. As used by economists when describing markets, the term *competition* refers to *rivalry among sellers* to attract the patronage of buyers. By definition, when there is only a single seller, buyers have no choice of seller and there is no competition.[33] There is

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31 Corwin Edwards, *Maintaining Competition* (New York, 1949), at 9-10, as quoted by Jesse W. Markham (1950), "An Alternative Approach to the Concept of Workable Competition," *The American Economic Review*, **40**(3): 349-361 at 356.

32 See paragraph 22 above.

33 The distinction between competition and monopoly is central to the antitrust laws. "In the Sherman and Clayton Acts, as well as in the Robinson-Patman Act, 'Congress was

sometimes confusion as to whether the presence of large, sophisticated buyers can offset a seller's monopoly power and somehow induce the competitive outcome. As I will now demonstrate, even if there were large, sophisticated buyers, they could *not* induce a competitive outcome in negotiating with the SoundExchange monopoly.

36. Economists have identified conditions under which large, sophisticated buyers may be able partially to offset seller power by promoting increased rivalry among sellers even when there are only a few suppliers in a market.[34] Large buyers can do so by: (a) having the ability to make well-informed choices among available options and to shift large purchases among competing suppliers on either a short- or long-term basis, or (b) promoting entry either by integrating into supply themselves or by sponsoring entry (by either committing to future purchases or providing financing).[35] Critically, neither (a) nor (b) is a feasible strategy in a market with a monopoly seller and no realistic chance that

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dealing with competition, which it sought to protect, and monopoly, which it sought to prevent.' A. E. Staley Mfg. Co. v. Federal Trade Comm., 7 Cir., 135 F.2d 453, 455." (Standard Oil Co. v. FTC 340 U.S. 231 (1951)).

34 I focus on large buyers because economic theory identifies reasons why large buyers might be particularly able to offset seller market power. As will be evident from the discussion that follows, if large buyers cannot avail themselves of the strategies described below to offset seller market power, then neither can small buyers.

35 *See*, for example, Mary Lou Steptoe (1993), "The Power-Buyer Defense in Merger Cases," *Antitrust Law Journal*, **61**(2): 493-504.

The *Horizontal Merger Guidelines* make similar points:

> The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects [among multiple sellers].

(U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, August 19, 2010, § 8.)

an entrant will be able to offer a viable substitute for the monopolist's product. The existence of a monopoly seller means that buyers can't shift purchases among competing suppliers (strategy (a)), and the lack of a realistic chance of entry precludes strategy (b). This finding is an important one because SoundExchange acted as a monopolist in reaching its Webcaster Settlement Act agreements with the NAB and Sirius XM, and it was—and remains—impractical for a webcaster to integrate into the music business or to sponsor meaningful entry of a new record company. Thus, these strategies for offsetting SoundExchange's market power were not available to either the NAB or Sirius XM.

37. In contradiction to the well-established economic theory just discussed, the *Web II Decision* expressed the view that a large buyer could offset monopoly power and obtain a "competitive" price even in the absence of competition. Specifically, it asserted that[36]

> … a ''competitive'' price could be deemed to have been set in a marketplace where sellers and buyers had roughly equal bargaining power, because the resulting price would be much closer to the perfectly competitive price than to a price determined in circumstances where the sellers exercised pure monopoly power or the buyers exercised pure monopsony power.

As described above, the conclusion reached in Web II also runs counter to Congress's apparent conclusion that the monopoly outcome would not be effectively competitive even in the presence of large buyers. If Congress had determined that the price resulting from bargaining between a monopoly licensor and various buyers was satisfactory, then there would been no reason to do more than mandate a statutory license and allow Sound Exchange to bargain with large buyers free from any statutory restraints. The most

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36 *Web II Decision* at 24093, note 23.

logical explanation for the statute's creation of a judicial rate-setting process is that Congress did not want a monopoly price to prevail and did not think that large buyers could protect themselves.

38. Economic analysis demonstrates that there are, in fact, sound reasons to be concerned that buyers could not protect themselves. Economic analysis indicates that the price set in a market with a single seller and a few large buyers will tend to give rise to prices much closer to the pure monopoly price than to a competitive price even if the parties are equally skillful and sophisticated bargainers. In other words, the prices that result from bargaining between a buyer and seller with equal bargaining power do *not* satisfy a standard requiring prices at the levels that would obtain in an effectively competitive market.

39. In Part A of the Technical Appendix, I present a formal model using a standard approach to the economics of bargaining to demonstrate that—even when there is only a single, large buyer, which has equal bargaining with the seller—the resulting price would *not* be much closer to the perfectly competitive price than to a price determined in circumstances where the sellers exercised pure monopoly power.[37] Moreover, when a

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[37] The present paragraph and Part A of the Technical Appendix describe a situation in which there is no statutory license available as an option, which is the setting in which various interactive licenses that have sometimes been used as benchmarks were negotiated. For negotiations involving rights for which a statutory license exists, the *outside option principle* indicates that the presence of a statutory license will have no effect the bargaining outcome unless the statutory fee is set lower than the level to which the parties would agree in a situation where the buyer had no option of a statutory license. (For a discussion of the outside option principle, see, Ken Binmore, Ariel Rubinstein, and Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, **17**(2): 176-188.) In other words, when the statutory license fee is set above an effectively competitive level, it cannot induce private parties to

monopoly licensor faces two or more potential licensees, the resulting price will be even higher and, thus, further away from the competitive level. Intuitively, the monopolist will be able to play the potential licensees off against each other to obtain higher license fees: each music service will be in the position that, if it does not reach an agreement with the monopolist, it will go out of business, while the monopolist will be able to continue making sales to the other licensee(s). Hence, the monopolist is in a much stronger bargaining position.[38]

2. Suppliers of complementary products do not compete with one another.

40. Two products are said to be economic complements if an increase in the price of one product decreases the demand for the other.[39] Intuitively, two products are complements when a buyer needs both products in order to enjoy the full benefits of either. For example, if computer printers and ink must be used together to produce printing services for consumers, then printers and ink are economic complements. Just as

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negotiate an effectively competitive rate unless the bargaining takes place in what truly are effectively competitive markets.

38 Under mainstream economic theories of bargaining, the license fee agreed to by a potential licensee and licensor is determined both by the total amount of value, or surplus, created by the transmittal of the licensor's content by the potential licensee and by the licensor's and potential licensee's "disagreement points," which are determined by what would happen to each parties' profits in the absence of an agreement.

If the parties cannot come to an agreement, then the potential licensee cannot transmit the content and will have to cease operations; it's disagreement point entails zero profit. However, in the presence of multiple potential licensees, the monopoly licensor can still earn profits from at least some of the sales that otherwise would have been made to the potential licensee with which it cannot reach agreement because those sales would be diverted to other licensees. In other words, the presence of multiple buyers strengthens the seller's disagreement point and, thus, its bargaining position.

39 See, *e.g.*, N. Gregory Mankiw (2015) *Principles of Economics, Seventh Edition*, Stamford, CT: Cengage Learning, at 98.

an increase in the price of a product would decrease the demand for that product, it would also decrease the demand for a complementary product that is consumed together with the product for which the price has risen. For example, a large increase in the price of ink will reduce the quantities of both ink and printers demanded.

41. By logic first identified by Cournot (1838), firms offering complementary products tend to set *higher* prices than would even a monopoly seller of the products.[40] This effect arises because each individual seller ignores the adverse effects that its price increases have on the other sellers, while a monopolist would internalize this effect. Professor Ordover and Dr. Pelcovits both agree with this economic principle.[41] As discussed above, the monopoly price manifestly is neither a competitive nor effectively competitive price. It follows that the even *higher* price set by oligopolists offering complementary products is even further from the competitive level and, thus, is not effectively competitive.

42. This point can be seen another way. As described above, competition arises only when buyers have the ability to *substitute* the offerings of one seller for those of another. It is this possibility of substitution that drives different sellers to offer lower prices in order to attract buyers to themselves rather than to their rivals. When products are complements, buyers lack the ability to substitute among the offerings of different sellers.

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40 Cournot, Antoine Augustin [1838] (1897). *Researches into the Mathematical Principles of the Theory of Wealth* (translated by N. T. Bacon), London: Macmillan.

41 Written Rebuttal Testimony of Janusz Ordover, *Web III*, June 10, 2010, (hereinafter, *Ordover WRT Web III*) ¶ 53 and Appendix Two; Pelcovits, Hearing Tr., *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, April 19, 2010 (hereinafter, *Pelcovits Web III Hearing Tr.*), at 157-58, 164-66.

Indeed, under the strongest form of complementarity, a buyer must purchase all of the complementary products in order to derive benefits from any of them. Consequently, in this case, there is no competition among sellers to attract buyers.

43. The fact that an oligopoly of suppliers of complementary products might charge higher prices than would a monopoly supplier is an illustration of the fact that suppliers of complements do not compete with one another. This fact in no way renders the monopolist's pricing effectively competitive. To claim otherwise would be to demonstrate a fundamental misunderstanding of basic economics.

V. DR. PELCOVITS'S WEB II INTERACTIVE SERVICES BENCHMARK WAS SO SERIOUSLY FLAWED AS TO BE UNUSABLE.

44. Although the benchmark analysis provided by Dr. Pelcovits in Web II is not directly at issue in this proceeding, it was adopted by the Judges in setting the Web II rates, and those rates influenced the royalty rates set in private WSA negotiations and in the subsequent Web III proceedings. (See section VI below.) Thus, it is important to examine the Web II benchmark analysis in the light of evidence that has emerged since it was presented—not to provide corrections, but rather to demonstrate that it was so severely flawed that the analysis and the rates stemming from the analysis should be abandoned completely. Unfortunately, because it influenced the WSA negotiating process and the Web III remand decision, Dr. Pelcovits's flawed Web II benchmark analysis has had a significant and lasting effect in raising royalty rates above the effectively competitive level.

45. In the remainder of this section, I discuss several critical flaws in the analysis by Dr. Pelcovits on which the Web II decision relied. Most notably, Dr. Pelcovits failed to account for the lack of competition among the major record companies in selling their licenses to interactive services. Second, Dr. Pelcovits relied on a small sample of noninteractive, subscription services despite the fundamental differences between subscription and nonsubscription services. Third, although it was not known at the time, the services used by Dr. Pelcovits in his analysis were not in equilibrium. Finally, in limiting his benchmark to major label licenses, Dr. Pelcovits likely relied on a biased sample.

A. DR. PELCOVITS FAILED TO ACCOUNT FOR THE LACK OF COMPETITION AMONG RECORD COMPANIES SELLING TO INTERACTIVE SERVICES.

46. Dr. Pelcovits based his benchmark in Web II on a set of license agreements negotiated between the major record companies and a small set of interactive services providers. In doing so, he failed to account for the fact that the major record companies are not meaningful competitors in the sale of sound performance licenses to interactive services, so that these negotiated rates are well above competitive levels.[42]

47. It is now well-recognized that, from the perspective of interactive services, licenses to the catalogs of the three major record companies are not substitutes for one

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[42] In addition to the failure of his empirical analysis to account for actual record company market power, his core theoretical framework is that of a monopoly seller facing atomistic buyers who are textbook perfect competitors with one another. (Testimony of Michael Pelcovits, *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, October 31, 2005, (hereinafter, *Pelcovits Web II WDT),* § IV.) This structure is manifestly not one of either equal bargaining power or effective competition in the sale of licenses. Thus, the underlying framework of his analysis would not generate the outcome that would be expected to result from effective competition.

another. That is, an interactive webcaster cannot choose to purchase a license to one major's catalog as a substitute for another major's catalog. Rather, an interactive webcaster needs to have licenses to all three major record companies' catalogs in order to have a commercially viable service. Because it needs licenses to all three catalogs, an interactive service cannot credibly threaten to refuse to take a license to one major record company and instead purchase a substitute license from another. The clear implication of this fact is that the major record companies do not compete with one another to sell licenses to interactive webcasters.

48. While acting as SoundExchange's economic expert in Web III, Dr. Pelcovits testified to this point and conceded that, because the record companies were not providing substitute products, there would not "be fierce price competition among substitutes" even if SoundExchange did not exist and the majors were individually negotiating with the services.[43] Because the major record companies do not compete with each other in the sale of licenses to interactive services, it follows that the license fees paid by interactive service providers to the major record companies were not determined under conditions of effective competition.

49. From the perspective of an interactive service provider, the major record companies offer complements rather than substitutes. As discussed above, two products are said to be economic complements if an increase in the price of one product decreases the demand for the other. For an interactive webcaster, a license to the catalog of one

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[43] *Pelcovits Web III Hearing Tr.*, at 157-58. *See, also*, *Pelcovits Web III Hearing Tr.*, at 164-66. See also his testimony in Web II, Pelcovits, Hearing Tr., *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, May 15, 2006, at 144-46.

major record company is worth little if the webcaster does not also have licenses covering the other two majors. Thus, in assessing whether to purchase a license from one major, the interactive webcaster needs to take into account the total amount it is going to have to pay for all three licenses. Consequently, an increase in the price of one license lowers the willingness to pay for the others, which is the economic definition of complements.

50. One of the two leading federal antitrust agencies, the Federal Trade Commission, recently assessed the nature of competition among the major record companies and found the major record companies' catalogs to be complements when licensing interactive services. Specifically the Commission examined the impact of the acquisition of EMI Recorded Music by Vivendi, S.A. (Universal) on competition to serve interactive music streaming services:[44]

> Staff focused on whether Universal would have enhanced bargaining leverage after the acquisition, allowing it to extract from streaming services superior financial terms, or advantaged positioning for its content. Commission staff sought to determine whether the transaction would lead to higher costs to interactive streaming consumers or a more limited selection of recorded music. Commission staff found considerable evidence that each leading interactive streaming service must carry the music of each Major to be competitive. Because each Major currently controls recorded music necessary for these streaming services, the music is more complementary than substitutable in this context, leading to limited direct competition between Universal and EMI.

Notably, the Commission staff explicitly found that, in connection with licensing interactive streaming services, the majors' music was "more complementary than

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[44] Statement of Bureau of Competition Director Richard A. Feinstein *In the Matter of* Vivendi, S.A. and EMI Recorded Music September 21, 2012, *available at* http://www.ftc.gov/sites/default/files/documents/closing_letters/proposed-acquisition-vivendi-s.a.emi-recorded-music/120921emifeinsteinstatement.pdf, *site visited* August 5, 2014.

substitutable" even before the merger and that competition between Universal and EMI was already limited.[45] Each major record company already had considerable market power because it was essential to the commercial success of an interactive service. In other words, the majors were not constraining each other because they were not substitutes for one another. Following the merger, a license to the catalog of the combined company clearly would be even more important to the success an interactive-service provider than was a license to either of the separate companies pre-merger. Moreover, the overall market was even more concentrated. In other words, the industry moved even farther from being effectively competitive.

51. In summary, when the major record companies sell licenses to interactive webcasting services, the majors are selling complementary products. Consequently, the prices they individually extract will exceed even the monopoly price. It follows a fortiori that these are not effectively competitive prices and, therefore, are not appropriate benchmarks for the prices to which a willing buyer and willing seller would agree in an effectively competitive market.[46]

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[45] In Web II, the Judges cited testimony that "Yahoo! was able to operate its custom radio channels without Universal Music for two years" as contradicting the assertion "that the repertoires of all four majors are necessary as a prerequisite prior to undertaking the operation of a consumer music service in the various digital music service markets." (*Web II Decision, note 24* at 24093.) Importantly, custom radio is a noninteractive service where the service controls what is played, not an interactive service where the user controls what is played. Therefore, rather than supporting the proposition that the benchmark was a competitive market, this evidence confirms a critical difference between the benchmark and target markets.

[46] Another problem with relying on interactive services to estimate the effectively competitive prices for noninteractive services is that noninteractive services are likely to have greater promotional value due to music discovery (*i.e.,* the noninteractive service makes recommendations to the listener) and less cannibalization of other music sales

B. DR. PELCOVITS'S STATISTICAL ANALYSIS RELIED ON INAPPROPRIATE DATA.

52. In addition to improperly focusing on the license fees obtained by the major record companies in a market in which they don't compete with each other, Dr. Pelcovits's benchmark analysis of the interactive service licenses that formed the basis for the Web II rates suffered from other fatal defects.

1. Dr. Pelcovits based his analysis on data for services using a very different business model.

53. As I discuss below, in Web II, Dr. Pelcovits attempted to craft a royalty rate for noninteractive services based on the percentage royalty for interactive services, where the interactive service royalty was determined as a percentage of interactive subscription revenues. Dr. Pelcovits's focus on subscription revenues raises considerable doubt about the validity of his analysis given that the vast majority of noninteractive services consumed were (and are) nonsubscription services.[47] Nonsubscription, noninteractive services have adopted a fundamentally different business model than have the

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(because interactive services allow a consumer to pick specific songs to be played at the time of the consumers' choosing, interactive services pose a much greater risk that consumers will substitute interactive services for CDs and paid downloads).

[47] At the time of Dr. Pelcovits analysis in 2005, I understand there were no significant noninteractive services that used a subscription model. (Interview with Elizabeth Moody, September 30, 2014.) Dr. Pelcovits stated that "[A]lthough the majority of listeners use free non-interactive services, subscription services do make up a significant part of overall listening." He does not quantify the "significant part." (*Pelcovits WDT Web II*, at 56.) Another SoundExchange economist, Dr. Erik Brynjolfsson, testified that, in 2005, nonsubscription services accounted for 91.8 percent of the total listening time to noninteractive services. (Written Direct Testimony of Dr. Erik Brynjolfsson, Web II, at 49-50, Table 10). On cross examination, Dr. Pelcovits stated that he relied on the 10 percent "slice of the market" represented by subscription services. (Pelcovits, Hearing Tr., *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, May 15, 2006 at 273-74.)

subscription, interactive services and even subscription, noninteractive services; nonsubscription services rely on advertising revenue rather than revenue collected from listeners. The differences in the ways the services generate revenues (*e.g.,* whether the listener is charged or not) can be expected to result in the suppliers of these different services facing different demand curves, with different demand elasticities. These differences would, in turn, affect the service providers' derived demand for music licenses. Consequently, economic theory indicates that the royalty rates paid by subscription-based services in an effectively competitive market could differ substantially from those paid by nonsubscription services in an effectively competitive market. Given the different characteristics of the services (*e.g.,* the degree to which consumers can choose the songs to which they listen), economic theory indicates that the differences between royalty rates for subscription-based, interactive services and nonsubscription, noninteractive services could be particularly large.

54. Dr. Pelcovits attempted to counter criticism of his focus on subscription-based services in part by asserting that advertising revenue per play could rise to the level of subscription revenue per play.[48, 49] Information from Pandora, by the far the largest

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48 *Pelcovits WDT Web II*, at 55 ("…it is by no means the case that ad-supported webcasters are, or will remain, the poor cousins to subscription services.").

The *Web II Decision* (at 24094) appears to adopt this approach:

> Therefore, to the extent that ad-supported revenues may not yet have equalized subscription revenues on a per-listener hour basis but are expected to grow over the term of this applicable license, SoundExchange's proposed phase-in of the per-performance rates to the level indicated by the benchmark analysis represents a wholly reasonable approach to dealing with this potential issue.

49 Dr. Pelcovits offers several other defenses of his focus on subscription revenues. For example, in he asserts that

noninteractive webcaster,[50] demonstrates that Dr. Pelcovits's assertion was not borne out. In 2010 (the last year of the time period for which rates were set in Web II), for example, Pandora earned a far higher revenue per play from its subscription services than from its nonsubscription services. In 2010, Pandora's subscriber revenue per play was **[[ ]]** percent higher than its advertising revenue per play (**[[ ]]** for subscriber; **[[ ]]** for ad supported).[51]

55. The fact that the revenues per play have not equalized between subscription and nonsubscription services is not a surprise. Subscription and nonsubscription services have very different business models: one entails offering a high-value product to

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> the best evidence from the marketplace of the value that consumers attach to a good or service is the price they are willing to pay for the service in the free market. Indirect measures, such as the advertising revenue collected by non-subscription services, are likely to underestimate the true value of the music in the marketplace.

(*Pelcovits WDT Web II*, at 54.) This statement evinces a fundamental misunderstanding of how advertiser-supported media operate. Advertising-based music services function as what are known in the economics literature as *two-sided platforms*, and can derive value from either or both sides. Economics does not provide a basis for the claim that the "true value of music in the marketplace" is derived solely from consumer payments or even consumer valuations (in the case where consumers are not charged for the services).

His other rationalizations are similarly weak. For instance, he admits that "the majority of listeners use free non-interactive services" but justifies ignoring data based on these listeners on the grounds that "subscription services do make up a significant part of overall listening." *Id.* at 56.

[50] At the time of its initial public offering of stock, Pandora cited a November, 2010 report by Ando Media estimating that Pandora had in excess of a 50 percent share of "internet radio listening time among the top 20 stations and networks in the United States." (Pandora Media, In., Form S-1, February 11, 2011 at 1.) More recently, Pandora cited a September, 2013 report by Triton estimating that Pandora has more than a 70 percent share of "internet radio among the top 20 stations and networks in the United States." (Pandora Media, Inc. Form 10-K (transition report) for the eleven months ended December 31, 2013, at 3.)

[51] In order to assess the validity of Dr. Pelcovits's numbers, we requested from Pandora and were provided with Pandora's revenue per subscription performance, revenue per nonsubscription performance, and overall revenue per performance for 2010.

subscribers for a fee, while the other offers a comparatively low-value product (because of the exposure of advertisements) to subscribers at no charge and earns revenue from a different source (*i.e.*, advertising). Economics provides no reason to think that the value of the licensed content should be the same under the two different business models.

2. Dr. Pelcovits based his analysis on data for an industry that was not in equilibrium.

56. Another reason that the royalty set in subsequent proceedings should not be based on Dr. Pelcovits's benchmark analysis in Web II is that his analysis was based on license fees charged to companies in a rapidly changing, nascent industry (interactive webcasting) and based on a comparison of subscription prices from two rapidly changing, nascent types of services (interactive and noninteractive webcasting). The evolving nature of the industry raises doubts about the reliability of a benchmark based on a snapshot of contracts and subscription prices. For example, the snapshot could well have been taken at a time when rates were unsustainably high or when subscription prices were not sustainable.[52] Indeed, many of the services on which Dr. Pelcovits relied have not survived, which suggests that the services may have been paying royalties that their business could not sustain.

57. Dr. Pelcovits based his benchmark analysis on seven interactive services: Y! Music Unlimited; Musicmatch on Demand; Rhapsody Unlimited; Napster Membership;

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[52] In the Web I proceedings, it was recognized that negotiated rates in a nascent industry may not be reliable. See, for example, Report of the Copyright Arbitration Royalty Panel, *Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, at 47 and 51-54.

MusicNow; MusicNet; and Virgin Digital.[53] Of these seven services, only Rhapsody continues to be offered. Two, MusicNet and MusicNow, were acquired by Napster.[54] A third, Virgin Digital, went out of business and its customers also were acquired by Napster.[55] Napster, in turn, was purchased by BestBuy.[56] Due to poor performance, BestBuy sold Napster to Rhapsody in 2011.[57] MusicMatch on Demand was acquired by Yahoo. However, Yahoo discontinued the service in 2007. Yahoo had another interactive service considered by Dr. Pelcovits, Y! Music Unlimited. This service was discontinued in 2008 and its users migrated to Rhapsody.[58] In summary, six of the seven services on which Pelcovits relied ceased to exist within a few years of his analysis.

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53 See, *Pelcovits WDT Web II*, Appendix Table 2.

54 MusicNet: "Private Equity Firm Buying MusicNet," Forbes, April 12, 2005, *available at* http://www.forbes.com/2005/04/12/cz_pkah_0412musicnet.html, *site visited* October 2, 2014; MusicNow: Billboard," Napster Nabs AOL Music Now Subscribers," January, 2007 *available at*: http://www.billboard.com/biz/articles/news/1327824/napster-nabs-aol-music-now-subscribers, *site visited* October 5, 2014.

55 Billboard," Napster Nabs AOL Music Now Subscribers," January, 2007 *available at*: http://www.billboard.com/biz/articles/news/1327824/napster-nabs-aol-music-now-subscribers, *site visited* October 5, 2014.

56 Billboard, "Rhapsody to Acquire Napster From Best Buy," October 3, 2011, *available at* http://www.billboard.com/biz/articles/news/1165403/rhapsody-to-acquire-napster-from-best-buy, *site visited*.

57 Rhapsody does not use the Napster brand in U.S. With respect to the U.S, it was primarily purchasing customers. (Interview with Jon Maples, digital media consultant focusing on music content, October 3, 2014; "Is it 2000? Rhapsody is Buying Napster," The Wall Street Journal, October 3, 2011, *available at* http://blogs.wsj.com/deals/2011/10/03/is-it-2000-rhapsody-is-buying-napster/, *site visited* October 2, 2014.)

58 Yahoo Launchcast Plus: Michael Liedtke, "Rising royalties send Yahoo's Launchcast to CBS," AP Newswire, December 3, 2008; "Yahoo! And Clear Channel Announce Entertainment Agreement, June 28, 2012, *available at* https://yodel.yahoo.com/blogs/partnerships/yahoo-clear-channel-announce-entertainment-agreement-11445.html, *site visited* October 2, 2014; Yahoo! Music Unlimited: Marshall Kirkpatrick, "The Final Days of DRM: Yahoo Music Store Closing, Will Eat your Purchased Music, Readwrite, July 24, 2008, *available at*

58. In addition, several of the noninteractive services used by Dr. Pelcovits also went out of business, including MSN Radio Plus, MusicMatch Radio Gold; Wolf FM Membership; and Howlin' Oldies Membership.[59, 60] The experience of Yahoo Inc.'s noninteractive, Launchcast service is informative in this regard. In 2008, Yahoo ceased operating it as a standalone service because of the "dramatically higher fee for airing music online."[61]

3. Dr. Pelcovits relied on what is very likely a biased sample of contracts.

59. Lastly, Dr. Pelcovits relied on contracts that interactive webcasters had with the major record companies but not those with independent record companies.[62] As noted in the *Web III Remand Decision* when discussing a similar problem in Dr. Pelcovits's Web III interactive benchmark, the failure to consider a significant set of contracts otherwise

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http://readwrite.com/2008/07/24/yahoo_music_store_closing, *site visited* October 2, 2014.)

59 These services were among several used in Dr. Pelcovits's regression analysis. Yahoo Launchcast also was used in Dr. Pelcovits's direct comparison of interactive and noninteractive subscription prices. (*Pelcovits WDT Web II*, Table 6.2.)

60 MSN Radio Plus: "MSN Music Shutting Down for Zone," Neowin, November 3, 2006, *available at* http://www.neowin.net/news/msn-music-shutting-down-for-zune, *site visited* October 2, 2014; "MSN flips off switch on Pandora," Seattle Times, June 20, 2008, *available at* http://seattletimes.com/html/businesstechnology/2008007825_msnpandora20.html, *site visited* October 2, 2014; Howlin' Oldies Membership and WOLF FM Membership: "Station Update," *available at* http://web.archive.org/web/20101010165639/http://www.wolffm.com/, *site visited* October 5, 2014.

61 Michael Liedtke, "Rising royalties send Yahoo's Launchcast to CBS," AP Newswire, December 3, 2008.

62 *Pelcovits WDT Web II* at 3.

available to SoundExchange reduces the probative value of the analysis.[63] Moreover, the contracts on which Dr. Pelcovits focused are particularly inappropriate because, as discussed in the previous subsection, the major record companies had substantial market power with respect to interactive service providers, and the benchmark rates were not determined in effectively competitive markets.[64]

60. More generally, the greater the buyer's ability to shift usage to or from a seller with whom the buyer is negotiating, the more competitive will be the resulting price. Hence, negotiations between any given buyer and small labels will tend to be closer to effectively competitive rates than corresponding deals between that buyer and a major record company because significant share shift is more likely to be possible with respect to the smaller labels.

61. This general consideration also reveals the inappropriateness of Dr. Pelcovits's reliance on contracts between interactive services and major labels in terms of the buyer side of the market. All else equal, a buyer with a greater ability to shift usage will pay a lower price than a buyer with a lesser ability to shift usage because the ability to engage

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63 *Web III Remand Decision* at 61.

64 Dr. Ordover, an economic expert for Sound Exchange in the Web III (as well as SDARS I and SDARS II) testified in the SDARS I proceeding to the effect that the major record labels possess substantial market power that drives license fees upward: "A larger label with a broad catalog of popular recordings across a number of genres likely will negotiate a higher rate than each small label with the same collective catalog could negotiate. The bigger the label and the larger its catalog of popular recordings, the more important it is for Sirius XM to avoid operating at a competitive disadvantage due to the absence of that entire catalog…The nature of Sirius XM's tiered royalty structure is consistent with the presence of a positive relationship between a label's importance (as measured by share of plays) and the label's negotiating position vis-a-vis Sirius XM." (*Ordover WDT SDARS II*, ¶¶ 24-25.)

in substitution corresponds to the ability to create competitive pressure on the seller. Hence, the royalties paid by those buyers with the greatest ability to engage in substitution are the royalties that most closely approximate those that would emerge under effective competition. In other words, even buyers that cannot engage in extensive substitution should receive royalty rates based on a benchmark driven by buyers that can engage in extensive substitution. Interactive services have less ability to shift share among labels than do noninteractive services, including simulcasters. Hence, even for contracts that are not with majors, interactive license fees will be higher than those that would obtain under conditions of effective competition.

C. APPLYING DR. PELCOVITS'S METHODOLOGY TO ACCOUNT FOR NONSUBSCRIPTION SERVICES WOULD HAVE YIELDED A MUCH LOWER PER-PLAY ROYALTY.

62. Dr. Pelcovits's methodology is based on the unsupported assertion that subscription, interactive services and noninteractive services should pay the same percentage of revenue as royalties. Even if one accepted his flawed framework, Dr. Pelcovits grossly erred in deriving a per-subscriber (and ultimately, per-play) royalty rate. He did so by applying the interactive service percentage of revenue to an estimate of noninteractive services' revenues that totally ignored the predominant business model used by noninteractive services: nonsubscription, advertising-supported services.

63. As I show in Part B of the Technical Appendix, even if one accepted the remainder of Dr. Pelcovits's flawed framework, applying his percentage-of-revenue figure to advertising revenue per play of the largest noninteractive service (Pandora) would have yielded a royalty rate per play (**[[ ]])** that was only **[[ ]]** of

the rate Dr. Pelcovits recommended ($0.00234).[65] Simply put, even accepting the flaws in his underlying interactive services benchmark, Dr. Pelcovit's Web II analysis grossly overstated what the noninteractive royalty based on that benchmark should be. This finding—as well as examination of the other weaknesses of his approach—indicates that there is a need for a clean break from Dr. Pelcovits's benchmark in setting the statutory, noninteractive royalty rates. Unfortunately, the errors in Dr. Pelcovits's benchmark were not confined to Web II, but instead have perpetuated themselves through the regulatory process.

VI. THE NAB/SOUNDEXCHANGE WSA AGREEMENT IS NOT A VALID BENCHMARK

64. The NAB and its members were not satisfied with the royalty rates set in Web II, which were based on an interactive-services benchmark and suffered from the flaws discussed above. As an alternative to the statutory process for rate setting for the 2011-2015 period, the NAB entered into a negotiation with SoundExchange under the Webcaster Settlement Act of 2008, to set rates for the 2009-2015 period.[66] These negotiations took place in a situation in which SoundExchange had been empowered by Congress to act as the licensor/seller representing the industry and the negotiations took place on a very compressed time frame set by the WSA. The parties had six weeks to

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65 My calculation uses Pandora internal data for 2010. For Dr. Pelcovit's recommended royalty, see, *Pelcovits WDT Web II*, Table 6.3.

66 Webcaster Settlement Act of 2008, Public Law 110–435, 122 Stat. 4974 (hereinafter, *WSA*).

negotiate in early 2009, at a time when the radio industry was in poor financial condition due to the Great Recession.[67]

65. The first topic of discussion between the negotiating parties was the royalty rate. The NAB also had a strong interest in obtaining a lower rate, but SoundExchange was unwilling to negotiate. According to the NAB's lead negotiator, SoundExchange made it clear that it was happy with status quo rates and relying on Web III in the event that no deal was reached. In contrast, it was important to the NAB to achieve some short-term relief in the rates effective for 2009-2010 and the NAB negotiators were concerned that the outcome in Web III might be even worse for webcasters than was Web II. According to the lead NAB negotiator, SoundExchange was willing to negotiate changes in the rates over time as long as the rates hit an average rate target over the life of the negotiated contract. This led to an agreement that the rates would increase over time, with some relief in the 2009-2010 contract years and higher rates later in the contract term.

66. SoundExchange was also willing to negotiate certain copyright issues regarding web simulcasts of terrestrial broadcasts (*e.g.*, preannouncements of songs) and accommodations regarding reporting requirements for small-market broadcasters.

67. In summary, the NAB negotiators perceived that they had little bargaining power, and the negotiations led to only a few, minor concessions by SoundExchange.

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[67] Information about the NAB/SoundExchange negotiations is based on an interview with the lead NAB negotiator, Steve Newberry, President and CEO, Commonwealth Broadcast Corporation, September 5, 2014.

The NAB also had to negotiate with individual major record companies and the independent label association to get them to sign on too, so there was considerable time pressure. *Id.*

A. SoundExchange Possessed Monopoly Power

68. From the perspective of economics, the outcome of the bargaining between the NAB and SoundExchange was unsurprising given that SoundExchange was a monopolist. Another way of thinking about a monopoly is that its existence implies that there is no possibility of a buyer's shifting sales among sellers and, thus, bringing competitive pressure to bear. In effect, the NAB was negotiating with the entire recording industry at once, so that the NAB could not credibly hold out the prospect that its members would increase the number of performances for a particular record label the way they might be able to do if they were in negotiations with individual labels. Hence, there was no means of generating competitive pressure of any sort.

69. As discussed in Section IV.D.1 above, even if there were two large buyers, each accounting for 50 percent of the royalty payments, the resulting outcome would not be an effectively competitive one when there is a monopoly seller. Therefore, even if "at the time of the WSA Agreement negotiations, the NAB broadcasters had accounted for over 50% of the royalty payments to SoundExchange in the immediately preceding calendar year,",[68] the NAB would not have had the ability to offset SoundExchange's market

68 *Web III Remand Decision* at 23114. Although the *Decision* cites Dr. Ordover for this proposition, Dr. Ordover's statement was limited to the royalty payments "from Webcasters." (*Ordover WRT Web II* at 23.) He said nothing about the magnitude of those payments compared to other payments received by SoundExchange, such as those paid by SiriusXM for its SDARS service.

power to any meaningful degree. In short, these negotiations did not take place under conditions of effective competition.[69]

70. Although apparently recognizing SoundExchange's monopoly position, the *Web III Remand Decision* stated that[70]

> It is not at all apparent, however, that the market power of SoundExchange to command a high rate would be appreciably greater (if at all) than the power of the major record companies, who owned approximately 85% of supply (the sound recordings) and therefore comprise an oligopoly. 4/20/10 Tr. at 299 (Pelcovits).

It is critical to recognize that the possibility that the major record companies might charge as much or more than SoundExchange does not change the fact that SoundExchange is a monopoly seller. And the potential exercise of oligopoly power does not imply that SoundExchange's monopoly price is the price that would be reached by a willing buyer and willing seller negotiating in an effectively competitive market. Indeed, the monopoly price is manifestly not an effectively competitive price. Consequently, the WSA agreement between the NAB and SoundExchange does not reflect the outcome of an effectively competitive market.

B. THE PARTIES' EXPECTATIONS AND WILLINGNESS TO LITIGATE

71. Under mainstream economic theories of bargaining, the nature of the agreement that is reached depends on how the parties expect to fare if they fail to reach an

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69 Professor Ordover recognized this point in SDARS I, when he testified that SoundExchange was likely to have "substantial market power" because the "record companies are allowed jointly to negotiate license fees with the SDARS under the auspices of SoundExchange." (*Ordover WDT SDARS I* at 21.)

70 *Web III Remand Decision* at 23113.

agreement. The reason is that, in determining how hard to bargain, each party should account for the fact that strong demands might lead to a failure to reach agreement.[71]

72. The NAB negotiating team had what were, for it, pessimistic expectations at the time of the WSA negotiations.[72] Based on the results of the Web II decision and the way those results were reached, the NAB negotiators were concerned that the outcome in Web III might be even worse for webcasters. In fact, Dr. Pelcovits submitted a similar study in Web III, but the judges recognized it as flawed in the light of additional record evidence provided by Dr. Michael Salinger. The Judges properly did not accept his proposed $0.0036 rate.[73] However, the NAB negotiating team had no way of confidently predicting this outcome at the time the NAB/SoundExchange WSA Agreement was negotiated.

73. The NAB team's pessimism meant that the legal fees it might expend by participating in the proceeding were large relative to the expected benefits of litigation. In economic terms, future litigation was not an attractive option for the NAB, which weakened its bargaining position. In contrast, Sound Exchange was going to involved in

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[71] Observe that the consequences of failing to reach an agreement matter even if the bargaining parties never actually walk away from each other. An analogy illustrates why. Suppose a town installed a camera at its main intersection and set the fine for running the traffic light at a very high level. Suppose, further, that these actions completely deterred red light violations. Then the high fine would influence driving behavior even though no one ever actually paid it.

[72] Moreover, the NAB negotiators did not believe that later, direct negotiations with record companies would succeed in obtaining effectively competitive rates for NAB's members.

[73] In the *Web III Remand Decision*, the Judges did not adopt Dr. Pelcovits's $0.036 royalty in total, but concluded that it was "of assistance in establishing a zone of reasonableness in this proceeding, but only after making certain significant adjustments to that proposed benchmark." (*Web III Remand Decision* at 23115.)

the litigation in any event and, based on the Web II outcome, had greater cause for optimism with respect to the likely Web III outcome. Moreover, Sound Exchange benefits from greater economies of scale: it amortizes the costs of participating in statutory rate-setting proceedings over all of the licenses. In contrast, any one licensee or group of licensees amortizes the costs of participation over only its own set of licenses.

74. In addition to NAB's agreement to the WSA rates, the CRB in Web III cited adoption of the NAB/SoundExchange WSA agreement rates by other entities as evidence that those rates constituted an appropriate benchmark. It observed that 404 entities had opted into the NAB agreement, including about 100 startups, so that "the rates contained in the NAB Agreement clearly were acceptable to a large number of webcasters."[74] However, this adoption merely demonstrates that these parties lacked more attractive options, not that the WSA agreement was effectively competitive.[75] More generally, the fact that a monopoly seller makes positive sales to some buyers at the monopoly price does not render the monopoly price competitive. The same critique applies to the CRB's Web III conclusion that the rates were an appropriate benchmark because the webcasters that entered into the NAB/SoundExchange agreement had advertising-based revenue models.[76]

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[74] *Web III Remand Decision* at 23111.

[75] Similarly, the *Web III Remand Decision* noted that several commercial webcasters had opted into the SIRIUS XM agreement and concluded that "[t]he fact that these webcasters, who did not participate in the negotiations, nonetheless adopted the terms of the agreement is evidence that the negotiated rates and terms were reasonable and acceptable to the webcasters." (*Web III Remand Decision* at 23111.) This conclusion is unwarranted for the same reasons discussed in the text.

[76] *Web III Remand Decision* at 23111.

C. THE ROLE OF PRECEDENT

75. After SoundExchange and the NAB had come to an agreement on the rate levels and structure over time, SoundExchange insisted on the agreement being precedential as a condition of doing the deal. The ability of SoundExchange to negotiate over whether a given agreement is precedential or not has two very significant implications for the resulting rate levels and their suitability as benchmarks. First, SoundExchange has the incentive and ability to create selection bias in the agreements that can be used as a precedent. This selection bias renders the available agreements inappropriate to serve as benchmarks. Second, the ability to use certain contracts as precedents tends to raise the prices in those contracts above effectively competitive levels.

76. Consider first the selection bias. SoundExchange allowed only a limited number of WSA agreements to be designated precedential. Five other WSA agreements were designated as being non-precedential.[77] Hence, the set of precedential licenses does not constitute a random sample. As an economically rational decision maker, Sound Exchange will consider the precedential value when negotiating whether a given WSA agreement is eligible to serve as benchmarks for statutory rates. SoundExchange has incentives to allow only those agreements with relatively high royalty rates to be precedential because doing so may result in higher statutory rates and, thus, higher

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[77] See, Notification of Agreements Under the Webcaster Settlement Act of 2008, 74 FR 9293, 9294-95 (March 3, 2009) (agreement with Corporation for Public Broadcasting for 2008-10); *id.* at 9302 (agreement for "Eligible Small Webcasters"); Notification of Agreements Under the Webcaster Settlement Act of 2009, 74 FR 34796, 34797-801 (July 17, 2009) (agreement for certain "Commercial Webcasters, Including Small Pureplay Webcasters"); Notification of Agreements Under the Webcasters Settlement Act of 2009, 74 FR 40614, 40620-21 (agreement with Corporation for Public Broadcasting for 2011-15); *id.* at 40624-27 (agreement for certain noncommercial webcasters).

payments from webcasters not party to the present negotiations. Because these other webcasters, which will pay the statutory rates, are not parties to the negotiations, their interests will not be represented in the bargaining outcome. Stated another way, Sound Exchange has incentives to designate low rates as non-precedential, while designating high rates as precedential. The licensee in a specific WSA negotiation does not have offsetting incentives to protect other webcasters from potentially higher statutory rates by demanding that agreements with high rates be designated non-precedential. Indeed, it is even possible that a webcaster may indirectly benefit if its rivals are disadvantaged as a result of higher statutory rates. Consequently, economic logic indicates that the reported royalty rates are unrepresentative of what a willing buyer and willing seller would agree to absent the distortions induced by the statutory regime.

77. A similar analysis applies to the rate levels negotiated in WSA agreements. As an economically rational decision maker, Sound Exchange will consider the precedential value when negotiating private settlements that are eligible to serve as benchmarks for statutory rates. SoundExchange has incentives to seek high prices even for an agreement that is not precedential, but it has even greater incentives to do so for an agreement that is precedential because the higher prices obtained for the initial agreement may result in higher statutory rates and, thus, higher payments from webcasters not party to the present negotiations. The possibility of influencing statutory rates upward thus create an incentive for SoundExchange to bargain even harder for higher rates than it otherwise would. Just as described above for negotiations over whether an agreement is precedential, the licensee in a specific WSA negotiation does not have countervailing incentives. The reason is that holding down the rates paid by other webcasters is not a

benefit to the negotiating buyer. Indeed, to the extent that a webcaster's negotiated agreement to pay higher rates over a given period raises the statutory license rates likely to be paid by its rivals over some or all of that period, the precedential value of the higher rates may actually be a benefit for the licensee.

78. The *Web III Remand Decision* found that:[78]

> In the absence of any such evidence, the Judges cannot simply assume a multi-party conspiracy among SoundExchange, the NAB, and Sirius XM to increase the rates charged to the NAB and Sirius XM, in the hope that the Judges would utilize those WSA rates to establish the statutory rates.

However, this statement fails to recognize that the logic indicating WSA agreements will lead to overly high rates does not rely on the existence of an explicit conspiracy. For the reasons described above, while (a) SoundExchange has incentives to allow only WSA agreements with particularly high rates to be precedential, and it has incentives to seek especially high rates in any agreement that is precedential, (b) licensees negotiating WSA agreements do not have countervailing incentives. Thus, economic analysis clearly indicates that precedential WSA agreements present a biased sample with unrepresentatively high rates. The experience of the NAB/SoundExchange WSA negotiations is fully consistent with this analysis.

VII. THE ADVERSE EFFECTS OF THE WEB II RATES CONTINUE TO BE FELT

79. The overly high royalty rates set in Web II have biased the precedential WSA Agreements and the Web III statutory rates upward, so that they exceed the rates that would be observed in an effectively competitive market. The Web II rate was too high

[78] *Web III Remand Decision* at 23112.

because the major record companies' interactive service agreements were not reflective of effective competition; the benchmark analysis focused on subscription rates when a correct analysis would have reduced rates to account for far lower nonsubscription service revenue; and there were serious flaws with the underlying data analysis. The WSA agreement between the NAB and SoundExchange was a direct result of Web II. As in the case of Web II, the NAB/SoundExchange agreement did not reflect the price that would obtain in an effectively competitive market: rather, it was based on expectations set in Web II and SoundExchange was a monopolist. The WSA agreement between Sirius XM and SoundExchange suffered from the monopoly problem as well, and it is quite likely that the expectations set by Web II as well as the NAB/SoundExchange agreement led to a supra-competitive price. Lastly, the Web III statutory license rates were a direct result of the NAB/SoundExchange WSA agreement, "corroborated" by a reprise of the interactive service analysis that led to unreasonably high rates in Web II.

VIII. BOUNDS FOR SIMULCASTING RATES

80. In this section, I address the zone of reasonableness for the royalty rate that will be set in the current proceeding as it applies to simulcasters. I first show that the lower bound of such a zone is near zero. I then address the upper bound of the zone and find that it is lower than the upper bound established for Sirius XM, properly adjusted. Given the information currently available to me, I cannot determine an exact value of the upper end of the zone of reasonableness, but I expect to be able to make a more precise determination after reviewing evidence that is introduced by other parties or otherwise obtained in the discovery process.

A. THE LOWER BOUND OF THE ZONE OF REASONABLENESS IS ZERO PERCENT OF SIMULCASTING REVENUES.

81. Some forms of music performance generate promotional benefits that, on balance, stimulate the sale of recordings, to the benefit of record companies. For example, terrestrial radio broadcasts have long been recognized as an important source of promotion for sound recordings, leading to higher record company sales of music to consumers. The existence of promotional benefits has implications for the bargain that would be reached between a willing buyer and willing seller of music performance rights: the royalties agreed to by a willing buyer and willing seller would reflect the promotional benefits generated by the buyer. Specifically, because the promotional benefits are equivalent to a fee paid by the buyer to the seller (*i.e.*, a form of payment in kind), economic theory predicts that, all else equal, a buyer that generates greater promotional benefits will pay a lower royalty fee.

82. Experience with terrestrial radio broadcasts illustrates this economic prediction. Terrestrial broadcasters do not have to obtain a license to broadcast recorded music, and record companies typically collect no royalties for terrestrial airplay.[79] For this reason, one might expect record companies to discourage radio airplay (hoping to drive listeners to other forms of music consumption that yield revenue to the record companies) or, at least, not to encourage it. In fact, record companies spend millions of dollars per year to

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79 There reportedly are exceptions. An industry-leading broadcaster has agreed to pay certain labels a share of its terrestrial broadcasting revenues. (Ben Sisario, "Clear Channel-Warner Music Deal Rewrites the Rules on Royalties," *The New York Times*, September 12, 2013, *available at* http://www.nytimes.com/2013/09/13/business/media/clear-channel-warner-music-deal-rewrites-the-rules-on-royalties.html?_r=0, site visited October 6, 2014.)

encourage terrestrial broadcasters to play musical recordings.[80] As Mr. Kocak has testified, record companies seek terrestrial radio airplay because of the promotional benefits:[81]

> For as long as I have been in the business, record labels have sought to leverage our stations' relationships with their listeners in order to promote their artists and recordings. Record label representatives and artists actively seek spins on our stations, including their streams, through personal visits, calls, emails, provision of recordings, and participation in promotions, including artist visits and giveaways. Just as important as winning spins, record labels and artists also seek the endorsement of songs and artists by our on-air talent, whose opinions and recommendations listeners trust.

Even when record companies receive no cash compensation for terrestrial broadcasts of their recordings, they receive valuable compensation in the form of promotion, which drives listeners to consume music in other ways that do yield revenue for the record company. Indeed, the size of record company expenditures suggests that, if there were

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[80] Evidence submitted in past proceedings confirmed the importance of radio promotion and the fact that record companies seek radio airplay and that activities related to securing radio airplay is a significant cost. (*See*, Radio Broadcasters' Proposed Findings of Facts and Conclusions of Law, *Web II*, December 15, 2006, § IV.A, especially ¶¶ 51-53 on promotion activities and ¶¶ 54-62 on the amount of spending on radio promotion. Although the figures for the amounts spent on radio promotion are redacted, the Radio Broadcasters conclude that the amount of spending is "hundreds of millions of dollars." (¶ 62). A Universal Music Group executive testified on the various types of radio promotion undertaken by Universal. (Kenswil, *Web II Hearing Tr.*, June 7, 2006, at 245-56.) Warner Music Group reported that it spent $422 million on selling and marketing costs worldwide in 2013. (Warner Music Group, Form 10-K for the fiscal year ended September 30, 2013, at 59.) This figure includes all promotional activities, and no breakout is given for radio promotion in particular, but Warner indicates that radio promotion activities are included in its selling and marketing cost figures. (Warner Music Group, Form 10-K for the fiscal year ended September 30, 2013, at 11.)

[81] Written Direct Testimony of Robert Frances Kocak (Buzz Knight), *Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)* (hereinafter *Kocak WDT Web IV*), ¶ 3. See, also, ¶¶ 27-31. In addition, see Written Direct Testimony of John Dimick, *Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)* (hereinafter *Dimick WDT Web IV*), ¶¶ 4, 41-50.

not laws prohibiting payments by record companies to obtain favorable airplay for their recordings, in many instances the license fee for terrestrial broadcasting of a musical recording could be *negative*.

83. The available evidence indicates that promotional benefits also arise from web simulcasts of terrestrial broadcasts. Specifically, simulcasts have the same content as the terrestrial, over-the-air broadcasts that they replicate and have the same relationship between the source and the listener (*i.e.*, they are noninteractive services in which the broadcaster/webcaster chooses the recordings to play and thus serves as an expert recommender to the listener). Mr. Dimick has testified:[82]

> Because our music station streams are simulcasts of our over-the-air broadcast, their music content is the same. The promotional effect of the music played is, therefore, no different. I have never had an artist or label tell me they did not want their music broadcast on our stream. In fact, our streaming technology has the added promotional effect of displaying the title, artist and album, as well as the ability to "tag" the song for future purchase on the stream display, which would facilitate the purchase of the music by the listener.

84. These considerations indicate that an effectively competitive license fee for simulcasting could well be negative for many recordings and simulcasters. However, in other situations, the value of promotion might be less, resulting in a positive price under effective competition. Moreover, a negative statutory rate would be problematical because a licensee that did not provide significant promotional benefits would have the ability to "game" the system by insisting on taking a license and getting paid. Taking into account the heterogeneity in promotional value and the possibility of gaming, I find

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[82] *Dimick WDT Web IV*, ¶ 51. See, also, *Kocak WDT Web IV*, ¶ 29.

that a negative statutory license fee would be unreasonable, but that the lower bound of the zone of reasonableness for a statutory rate for web simulcasting is near zero.

B. THE UPPER BOUND OF THE ZONE OF REASONABLENESS IS LESS THAN 13 PERCENT OF SIMULCASTING REVENUES FOR MUSIC-FORMATTED STATIONS.

85. From the perspective of economics, the standard for setting a statutory rate for satellite radio transmission (*e.g.*, the SDARS II proceeding) is similar to the effective competition standard in this matter, although, for satellite radio, there are four potential adjustment factors under Section 801(b) of the Copyright Act that are not applicable in the present proceeding.[83] In SDARS II, the judges found that 13 percent constitutes a sensible upper bound on the zone of reasonableness before adjusting to account for Section 801(b) factors.[84] The rate was then reduced by an additional two percent for the third 801(b) factor, which was specific to Sirius XM and the SDARS II proceeding.[85]

86. The 13 percent that was a starting point for finding the upper bound for the zone of reasonableness for the SDARS royalty rate can also be used as an initial guidepost for finding the upper bound for the zone of reasonableness for simulcasting. Because SDARS and simulcasting transmit both music and non-music content, it is necessary to

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83 The Judges have approached the two standards in the same way, at times with the same starting benchmarks. In SDARS I, as in Web II, the Judges started with a subscription interactive services benchmark and made an interactivity adjustment (in SDARS I, the Judges then applied the Section 801(b) factors to the "marketplace" agreements). (*SDARS I Decision* at 4088 and 4093-94.) In SDARS II, the Judges reaffirmed this approach, citing SDARS I and explaining that the proper mode of analysis was to start with "marketplace benchmarks" and then "determine whether adjustments to the rate. . . if any, are warranted." (*SDARS II Decision* at 23066.)

84 *SDARS II Decision* at 23070-071.

85 *SDARS II Decision* at 23068-70.

make an adjustment that accounts for the possibility that music may play a greater or lesser role in generating value for simulcasting than for Sirius XM.[86]

87. This adjustment has two components. The first adjustment, which I call the *music-listening adjustment*, examines the percentage of total listening that is listening to music on simulcasting compared to the corresponding percentage on Sirius XM. The second adjustment, which I call the *music-revenue adjustment*, accounts for the fact that some radio stations do not play music at all and so would not be subject to sound performance royalties. Market data allow one to estimate these adjustments and to derive an estimate of the importance of music to simulcasting relative to music's importance to Sirius XM. These data indicate that music is responsible for a similar percentage of the value of the simulcasting of music-formatted AM/FM radio stations as it is for Sirius XM.

88. Consider first the music-listening adjustment. Survey data reveal that **[[ ]]** percent of listening to Sirius XM is to music.[87, 88] The corresponding percentage of music

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86 "[T]he Judges [in SDARS I] plainly stated that it was their intention to unambiguously relate the fee charged for a service that an SDARS provided to the value of the sound recording performance rights covered by the statutory licenses. *SDARS–I,* 73 FR at 4087." (SDARS II Decision at 23072).

87 Edison Research, Share of Ear Survey, May 2014.

Edison Research conducted a survey in May 2014 in which 2,096 participants kept a listening diary. Each participant recorded what they listened to (including the audio source (*e.g.*, AM/FM radio, owned music, podcasts), audio type (*e.g.*, music, talk and information), and device type (*e.g.*, AM/FM radio, computer, Sirius XM receiver) during each 15-minute increment of a 24-hour period (or, noted that they did not listen to any audio).

88 In SDARS I, Professor Ordover testified that music accounted for 55 percent of the value of all content distributed by the SDARS (*Ordover WDT SDARS I* at 41); and in SDARS II, he testified that music accounted for half of the value of Sirius XM. (*SDARS II*

listening on AM/FM radio simulcasts is **[[ ]]** percent.[89] Multiplying the Sirius XM rate by a factor of **[[ ]]** (= **[[ ]]** percent / **[[ ]]** percent) adjusts the Sirius XM royalty rate for the fact that music accounts for a lower percentage of listening on AM/FM radio than on Sirius XM.[90] Because the estimated amount of listening to music on AM/FM radio simulcast is based on a relatively small sample, I also examined the percentage of time listening to music on AM/FM radio overall (*i.e.*, including both terrestrial broadcasting and web simulcasting). The music-listening percentage on AM/FM radio overall figure is **[[ ]]** percent.[91] Multiplying the Sirius XM rate by a factor of **[[ ]]** (= **[[ ]]** percent / **[[ ]]** percent) adjusts the Sirius XM royalty rate for the fact that music accounts for a lower percentage of listening on AM/FM radio than on Sirius XM. This adjustment is conservative because the Edison survey data on which it is based may exhibit an upward bias because respondents have to choose a single category of listening (*e.g.*, "music" or "news") for each 15 minute listening period. The

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Decision at 23063.) It would not be surprising for music to generate half of the value of both satellite and terrestrial radio while accounting for substantially more than half of the listening. As Mr. Kocak testifies, "… the music that a radio station plays is not exclusive to that station, and any musical niche that is developed can be readily copied by competitors. Thus, in order to succeed at a high level, our stations must do much more than play music." (*Kocak WDT Web IV*, ¶ 2. See, also, ¶¶ 14-26.) In addition, see *Dimick WDT Web IV*, ¶¶ 3 and 30-32; Written Direct Testimony of Ben Downs, Bryan Broadcasting, *Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)* (hereinafter *Downs WDT Web IV*), ¶¶ 26-31. Exclusive or unique non-music content provides greater opportunities for a radio station or webcaster to differentiate itself.

89 *Id.*

90 Of course, the percentage of value generated by music versus other content depends, in part, on the quality of the non-music content. This fact raises the question of whether Sirius XM might have more-valuable non-music content than AM/FM radio. However, if it did, then one would expect that value to manifest itself in a higher percentage of non-music listening on Sirius XM than on AM/FM radio, which is not what the data show.

91 Edison Research, Share of Ear Survey, May 2014.

bias can arise because music-formatted terrestrial radio stations frequently have significant non-music content.[92] Hence, a survey respondent may listen to non-music content on a music-formatted radio station (via either a terrestrial broadcast or web simulcast) a significant number of minutes yet report his or her listening as having been all music. This bias is less likely to arise with Sirius XM because the channels in its line up tend to be either all music or all non-music.

89. Consider next the music-revenue adjustment. It is necessary to account for the fact that non-music-formatted stations generally will not be paying royalties. Because the royalties will be paid on a base that is smaller than all industry revenues, it is necessary to scale up the royalty rate by a corresponding amount. In particular, if the royalty is being collected on a base of *X* percent of the industry revenues, then the royalty rate should be scale up by a factor of 1/(*X* percent). I estimate the share of industry revenues accounted for by music-formatted stations using two different data sources.

90. First, Media Monitor provides estimates of advertising revenue for music-formatted terrestrial stations and other terrestrial stations. These data indicate that music-formatted stations accounted for slightly less than **[[ ]]** percent of terrestrial industry revenues.[93] Under the assumption that music-formatted stations are responsible for the same proportion of web simulcasting revenues, it is appropriate to scale the royalty rate upward by a factor of **[[ ]]** (= 1 / (**[[ ]]** percent)).

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92 See, for example, *Kocak WDT Web IV*, ¶ 2; *Dimick WDT Web IV*, ¶¶ 3 and 30; *Downs WDT Web IV*), ¶¶ 26-30.

93 Media Monitor Data.

91. Second, according to data collected by BIA/Kelsey, radio stations with sports, news & talk, or religion formats accounted for about 23 percent of total radio industry revenues, indicating that music-formatted stations generated about 77 percent of industry revenues.[94] Under the assumption that music-formatted stations are responsible for the same proportion of web simulcasting revenues, it is appropriate to scale the royalty rate upward by a factor of 1.30 (= 1 / (77 percent)).

92. Applying the music-listening and music-revenue adjustment factors simultaneously yields the overall adjustment figure:

- Using the simulcasting listening percentage and the Media Monitor number yields an adjustment of **[[ ]]** = **[[ ]]** × 1/**[[ ]]**.
- Using the all-radio listening percentage and the Media Monitor number yields an adjustment of **[[ ]]** = **[[ ]]** × 1/**[[ ]]**.
- Using the simulcasting listening percentage and the BIA/Kelsey number yields an adjustment of **[[ ]]** = **[[ ]]** × 1/.77.
- Using the all-radio listening percentage and the BIA/Kelsey number yields an adjustment of **[[ ]]** = **[[ ]]** × 1/.77.

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94 BIA/Kelsey 2012 data as reported by InsideRadio, "Changes among radio's top-billing formats," *available at* http://www.insideradio.com/article.asp?id=2710554&spid=32060#.VDBqZ2ddV8E , site visited October 4, 2014. To be conservative, I have assumed that no religion-formatted stations would pay music royalties.

This range of numbers strongly suggests that an adjustment factor of one is appropriate. In words, the factor to account for the importance of music content in generating service revenues should be the same for simulcasting as for Sirius XM.

93. It is important to recognize that, although it follows that the reasonable royalty rate for simulcasting is no higher than 13 percent, there are strong reasons to conclude that the actual upper bound on the zone of reasonableness is significantly lower than 13 percent. In particular, the SDARS II rate is based in large part on an analysis of interactive services prices conducted in SDARS I that failed to adjust the benchmark rates downward to reflect the lack of competition.[95] Specifically, the SDARS I upper bound of 13 percent was based on an analysis of subscription, interactive music services conducted by Professor Ordover.[96] This analysis, like Dr. Pelcovits's analysis discussed in Section V.A above, suffered from a failure to correct for the lack of effective competition in the market for licenses to interactive services.[97] Hence, the resulting royalty rate was higher than what would have been reached in an effectively competitive market. The figure reached in the SDARS II Decision was based on the SDARS I analysis. Thus, this figure, too, is higher than the royalty rate that would have been reached in an effectively competitive market. Because of the lack of an adjustment to account for the lack of competition inherent in the 13 percent figure, setting a royalty rate

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95 See, *SDARS II Decision* at 23068-71.

96 See, *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, Final Rule and Order, 73 FR 4080 (hereinafter, *SDARS I Decision)* at 4093-94.

97 *Ordover WDT SDARS I,* § V.B. Although Professor Ordover considered royalties for several different audio and video services, the SDARS I decision relied on the interactive subscription music services. (*SDARS I Decision* at 4093-94.)

near this rate in the present proceeding would be unlikely to represent the price that would be reached between a willing buyer and willing seller operating in an effectively competitive market.

IX. CONCLUSION

94. Drawing on my training and experience as an economist, my examination of the public records of earlier proceedings, and my analysis of the relevant industries, I find that the statutory rates adopted in Web II were based on a severely flawed benchmark analysis conducted by Dr. Pelcovits that led to rates well in excess of those that would have been negotiated by a willing buyer and willing seller in an effectively competitive market. The rates set in Web II created significant upward pressure on rates in the WSA agreements subsequently negotiated and, thus (along with SoundExchange's monopoly position), rendered those agreements inappropriate benchmarks for what a willing buyer would have paid a willing seller in the absence of the statute. Consequently, there is a need to break with the past by taking a close look at new benchmarks that are meaningfully similar to the licenses at issue and that do not reflect undue licensor market power.

95. I also find that: (a) an analysis of the economic relationship between record companies and terrestrial radio broadcasters establishes that the lower bound for reasonable royalties to be paid by webcasters that simulcast terrestrial radio broadcasts is near zero, and (b) an analysis of the statutory rate established in SDARS II demonstrates that, when expressed as a percentage of a music-formatted radio station's simulcasting revenues, a royalty of 13 percent or higher would be unreasonably high.

TECHNICAL APPENDIX

A. A MONOPOLIZED MARKET IS NOT EFFECTIVELY COMPETITIVE.

96. In this appendix, I examine a formal model of a situation in which there is a single seller and single buyer having equal bargaining power. Consider a hypothetical monopoly licensor facing a linear demand curve for licenses, which is the functional form used by Dr. Pelcovits in his benchmark analysis that was adopted in the *Web II Decision*.[98] Specifically, suppose that demand is given by $x = \alpha - p$. In addition, suppose that the marginal cost of production is c. As is well known, the monopoly price is $p^m = \frac{1}{2}(\alpha + c)$ and the competitive price is $p^c = c$.

97. There are multiple possible interpretations of what it means for the buyer and seller to have equal bargaining power. One interpretation is that the price that emerges from bargaining between a buyer and seller with equal bargaining power is the one that shares the gains from trade equally between the two parties. At a price of p, the buyer will consume $\alpha - p$ units of the good and enjoy surplus equal to $S(p) = \frac{1}{2}(\alpha - p)^2$. The corresponding profits earned by the seller will be $\pi(p) = (p - c)(\alpha - p)$. The bargaining price that equalizes the two parties' gains from trade is the solution to $S(p) = \pi(p)$, or $p^e = \frac{1}{3}(\alpha + 2c)$.

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98 *Pelcovits Web II WDT* at 32 and 33.

My use of this demand curve should not be taken to imply that I agree with the analysis that Dr. Pelcovits conducted making use of this demand curve; I do not.

98. Comparing the differrent prices, one finds that $p^m - p^e = \frac{1}{6}(\alpha - c)$, while $p^e - p^c = \frac{2}{6}(\alpha - c)$. In other words, the difference between the bargaining price and competitive price is twice as great as the difference between the bargaining price and the monopoly price even when there is only one buyer.

99. Another interpretation of the equal bargaining power is that the equilibrium price will maximize the so-called *Nash product*, $S(p) \times \pi(p) = \frac{1}{2}(\alpha - p)^3(p - c)$.[99] Straightforward calculations demonstrate that the solution is $p^n = \frac{1}{4}(\alpha + 3c)$.[100] Comparing the different prices under this interpretation, one finds that $p^m - p^n = \frac{1}{4}(\alpha - c) = p^n - p^c$. In this case, the bargaining price lies halfway between the competitive price and the monopoly price even when there is only one buyer.

100. In summary, even when there is only a single buyer and that buyer has equal bargaining power with the seller, the resulting price is not closer to the competitive price than to the monopoly price, and such a price is not effectively competitive as that term would be understood by competition economics. Moreover, if there were two or more potential licensees, the price would be even higher.

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[99] See, for example, Ken Binmore, Ariel Rubinstein, and Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics,* **17**(2): 176-188.

[100] The first-order condition simplifies to $\alpha - 4p + 3c = 0$.

B. **APPLYING DR. PELCOVITS'S METHODOLOGY TO ACCOUNT FOR NONSUBSCRIPTION SERVICES WOULD HAVE YIELDED A MUCH LOWER PER-PLAY ROYALTY.**

101. Ultimately, Dr. Pelcovits estimated a license fee for noninteractive services as a percentage of subscription revenue, which he then converted to a per-play rate. He did so based on a very unrealistic assumption about the revenues of noninteractive services. Even if one accepts the rest of Dr. Pelcovits's methodology—which, as discussed in Section V above and the present section below, is highly flawed—correcting for his unrealistic revenue assumption leads to a rate well less than half of the rate asserted by Dr. Pelcovits.

102. Dr. Pelcovits explains his calculation of a per-play rate as[101]

> Accordingly, to predict the per play rate that would be negotiated if the adjusted [redacted in original] play proved unacceptable to music services, my starting point is the per subscriber minimum derived for the non-interactive market. In this scenario, *the per play rate should be equal to the per subscriber rate divided by the number of plays*. [Emphasis added.]

Expressed algebraically:

$$license\ fee\ per\ NI\ play = \frac{license\ fee\ per\ NI\ subscriber}{plays\ per\ NI\ subscriber} \quad .$$

103. Dr. Pelcovits derives a per-subscriber fee for noninteractive services based on data for interactive services. He does this by relying on the assumption that there is a constant ratio of license fee to consumer price. Specifically, he proceeds by estimating "the appropriate consumer subscription price in the noninteractive market and then

101 *Pelcovits Web II WDT* at 45.

applying the same ratio of license fee to subscription price that exists in the interactive DAT market."[102] Expressed algebraically:[103]

$$license\ fee\ per\ NI\ subscriber = revenue\ per\ NI\ subscriber \times \frac{license\ fee\ per\ I\ subscriber}{revenue\ per\ I\ subscriber}\ .$$

104. Substituting the expression for license fee per NI subscriber from the second equation into the first and rearranging terms yields the expression:

$$license\ fee\ per\ NI\ play = \frac{revenue\ per\ NI\ subscriber}{plays\ per\ NI\ subscriber} \times \frac{license\ fee\ per\ I\ subscriber}{revenue\ per\ I\ subscriber}\ .$$ [104]

In other words, to derive a recommended value for the license fee per noninteractive play, Dr. Pelcovits multiplied his estimate of *revenue per play for noninteractive subscribers* times his estimate of the *percentage royalty rate paid by providers of interactive services*.

105. In his Web II testimony, Dr. Pelcovits calculated that:[105]

$$\frac{license\ fee\ per\ I\ subscriber}{revenue\ per\ I\ subscriber} = .36\ .$$

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102 *Pelcovits Web II WDT* at 41. See, also, *Pelcovits Web II WDT* at 31.

103 Because Dr. Pelcovits focuses solely on subscription-based services, his consumer subscription price corresponds to a service's revenue per subscriber in his calculations.

104 This expression corresponds to the logic expressed by Dr. Pelcovits:

> Applying the methodology employed earlier, it is appropriate to set the per play rate for the non-interactive market by maintaining in that market the same ratio of license fee to consumer subscription price that exists in the interactive market.

(*Pelcovits Web II WDT* at 44.)

105 This percentage is redacted in the text of Dr. Pelcovits's Written Direct Testimony, but it appears later in the report at Table 6.3 as the unadjusted percentage of revenue royalty rate recommendation.

The license fee used by Dr. Pelcovits in this calculation was the average license fee from 17 contracts between interactive services and major record companies.[106] The revenue used was the average monthly subscription price of seven interactive services, where the average used both monthly subscription prices and the monthly equivalent price of annual subscriptions.[107] As discussed above, the use of a benchmark based on interactive services doesn't make sense when one is trying to establish a rate for noninteractive services.

106. Despite the problems with Dr. Pelcovits's estimated percentage of revenue, for present purposes I will assume that it is correct in order to highly the effects of other critical deficiencies of Dr. Pelcovits's analysis. Under the assumption that the license fee per interactive-service subscriber is 36 percent of the service provider's relevant revenues, Dr. Pelcovits's formula for the noninteractive, per-play royalty is

$$license\ fee\ per\ NI\ play = \frac{revenue\ per\ NI\ subscriber}{plays\ per\ NI\ subscriber} \times 0.36 \quad .$$

107. Dr. Pelcovits estimated the fraction on the right-hand side of the equation above as follows. For the denominator, he estimated plays per noninteractive subscriber using data from Live365.[108] For the numerator, he estimated revenue per noninteractive subscriber as the average subscriber fee for interactive services multiplied by an

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[106] *Pelcovits Web II WDT* at 36 and Appendix Table 1.

[107] *Pelcovits Web II WDT* at 36 and Appendix Table 2.

[108] *Pelcovits Web II WDT* at 45.

adjustment factor of .55, which was his estimate of the "value of interactivity."[109] In doing so, Dr. Pelcovits used data for interactive services' subscription revenues as a proxy for subscription, noninteractive services' revenues, which he, in turn, used as a proxy for nonsubscription, noninteractive services' revenues. Instead of adjusting proxy data to create another proxy measure, it would have been preferable to examine the actual revenues of nonsubscription, noninteractive services. In fact, actual data are available for Pandora, by far the largest provider of noninteractive webcasting services.[110] Those data reveal that, in 2010, Pandora's total revenue per play was **[[ ]]**.[111] Hence, even if one accepted Dr. Pelcovits's methodology, applying that methodology to the correct revenue figures yields a *license fee per NI play* of .36 × **[[ ]]** = **[[ ]].** This figure is far smaller than the $0.00234 per-play royalty that Dr. Pelcovits advocated.[112, 113]

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[109] *Pelcovits Web II WDT* at 41.

[110] See note 50 above.

[111] Pandora internal data.

[112] *Pelcovits WDT Web II*, Table 6.3.

[113] Dr. Pelcovits may assert that his approach cannot be applied in this way because the relevant elasticity of demand for advertiser-supported services is not sufficiently close to that of interactive services. If that were the case, however, then he would have to admit that his entire methodology is inappropriate for setting the rate charged to licensees making use of by far the most predominant revenue model for interactive services. Thus, either his recommended *license fee per noninteractive play* should been less than half of the rate he advocated or it should not have been considered at all. In either event, there is no sound basis for concluding that $0.0023 was an appropriate benchmark.

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EMPLOYMENT

July 1987 to present

Sarin Chair in Strategy and Leadership
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Joint appointment in the Economics Department and Haas School of Business. Member, Academic Senate Committee on Budget and Interdepartmental Relations. Former Director of the Institute for Business Innovation and Associate Dean for Academic Affairs. Past chair of Economic Analysis and Policy Group, Strategic Planning Committee, and Policy & Planning Committee. Research areas include competition and public policy in network and system industries, innovation, and pricing. Principal teaching in areas of business strategy and microeconomics.

July 2007 to June 2009

Harvey Golub Professor of Business Leadership
New York University
Appointed to Department of Management and Organizations, Stern School of Business. Research areas included healthcare competition. Taught business strategy courses.

September 2001 to January 2003

Deputy Assistant Attorney General for Economic Analysis
U.S. Department of Justice
Oversaw economic analysis in support of all Antitrust Division enforcement activities. Reported directly to the Assistant Attorney General for Antitrust. Managed unit of approximately 55 professional economists. Undertook multidimensional effort to integrate economists more fully into investigation, decision, and litigation processes.

January 1994 to January 1996

Chief Economist
Federal Communications Commission
Responsible for integrating economics into all aspects of Commission policy making. Reported directly to the Chairman of the Commission. Formulated and implemented regulatory policies for all industries under Commission jurisdiction. Managed teams of lawyers and economists to design regulatory policies and procedures.

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Assistant Professor of Economics
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Conducted research on sophisticated pricing, standards development, cooperative R&D, and intellectual property licensing. Served as Assistant Director of Graduate Studies. Taught courses in microeconomics, industrial organization, and antitrust and regulation.

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D.Phil. 1982
Oxford University
Doctorate in Economics. Thesis on market segmentation and sophisticated pricing.

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As an undergraduate, completed courses and general examinations for Economics doctorate.

SERVICE

Coeditor, *Journal of Economics & Management Strategy*, 1991-2001 and 2003-present.

Editorial Board member, *Information Economics and Policy*, 2004-present.

Editorial Board member, *Journal of Industrial Economics*, 2007-present.

Editorial Board member, *California Management Review*, 1998-2000 and 2003-2007. Editor 2000-2001.

Board Member, Berkeley Executive Education, February 2013-present.

U.S. Advisory Board member, NTT DOCOMO, Inc., October 2011-April 2013.

Spectrum Policy Invited Expert, President's Council of Advisors on Science and Technology, September 2011-May 2012.

Member, Committee on Wireless Technology Prospects and Policy Options, The National Academies, 2003-2011.

Deputy Marriage Commissioner, City and Country of San Francisco, October 2, 2010.

Member, Computer Science and Telecommunications Board, The National Academies, 2000-2001 and 2004-2008.

Member, Spectrum Policy Working Group, Digital Age Communication Act Project, Progress & Freedom Foundation, January 2005-March 2006.

Member, Consumer Energy Council of America, Universal Service Forum, 2000-2001.

AWARDS AND HONORS

Chairman's Special Achievement Award, Federal Communications Commission, 1996.

The Earl F. Cheit Outstanding Teaching Award, University of California, Berkeley, 1992-1993 and 1988-1989. Honorable Mention, 1999-2000 and 1996-1997.

Alfred P. Sloan Research Fellow, 1985-1988.

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John H. Williams Prize (awarded to the Harvard College student graduating in Economics with the best overall record), 1978.

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Principal Investigator, Nokia Corporation grant on business-model innovation, 2009-2012.

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Recipient, Berkeley Committee on Research grant, 2004-2005, 1996-1997.

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“A More Complete View of Incomplete Contracts,” joint with Benjamin E. Hermalin, 1991-1993.

“Game-Playing Agents and the Use of Contracts as Precommitments,” 1988-1989.

“The Analysis of Intermediate Goods Markets: Self-Supply and Demand Interdependence,” 1985-1986.

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"How to License Intangible Property," co-authored with Carl Shapiro, *Quarterly Journal of Economics* Vol. CI (August 1986).

"An Analysis of Cooperative Research and Development," *Rand Journal of Economics* Vol. 17, No. 4 (Winter 1986).

"Product Compatibility Choice in a Market with Technological Progress," co-authored with Carl Shapiro, *Oxford Economic Papers: Special Issue on Industrial Organization* (November 1986).

"The Welfare Effects of Third-Degree Price Discrimination in Intermediate Goods Markets," *American Economic Review* Vol. 77, No. 2 (March 1987).

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Before the
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In The Matter Of:		
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

<u>DECLARATION OF MICHAEL L. KATZ</u>

I, Michael L. Katz, declare under penalty of perjury under the laws of the United States that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed on this 7th day of October, 2014.

Michael L. Katz

B

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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF
STEVEN W. NEWBERRY, COMMONWEALTH BROADCASTING CORP.
(On behalf of the National Association of Broadcasters)

1. My name is Steven W. Newberry. I am the President and Chief Executive Officer of Commonwealth Broadcasting Corporation, a twenty-station radio broadcast group, with facilities located in several markets in Kentucky. I have held this position since 1996. I offer this statement in support of the National Association of Broadcasters ("NAB") in this proceeding. My statement is based on my long experience in the radio business as well as my personal involvement in the operation of Commonwealth and in the negotiations leading to the 2009 agreement under the Webcaster Settlement Act between NAB and SoundExchange.

Summary

2. As an owner and operator of radio stations and as a longtime veteran of the radio industry, I think that it is important to understand that a primary reason that people listen to local radio is the connection that the station develops with its community. This connection is developed in many ways, including through the

community-oriented information a station provides and the interaction of station personnel within the community. We are not just a music service. We take the obligation to broadcast in the public interest very seriously. Our stations, including our music-formatted stations, therefore, are constantly providing information about community news and events and participating directly in those events, such as by providing free air time for charitable functions and broadcasting local high school games. Our streams serve this same purpose of helping to create a sense of community that is the heart of local radio.

3. As the leader of the NAB team that negotiated the 2009 agreement between the NAB and SoundExchange under the Webcaster Settlement Act, I also want to comment on that agreement. I can say without any doubt that that those negotiations did not result in an agreement between a willing buyer and a willing seller that was unaffected by the rate setting process. Rather, due to the 2007 decision by the Copyright Royalty Board dramatically hiking streaming rates, the lack of any reason for NAB to believe that another litigation would lead to a better result from the same Judges, the economic hardship in the industry resulting from the 2008 recession, and an opposing party that knew it had all the leverage while we had none, the agreement was really a take-it-or-leave-it result between a monopoly seller that held all of the cards and a buyer that had no viable alternatives. In these circumstances, the entirely one-sided nature of the agreement, including the rates and the "precedential" designation demanded by SoundExchange, is hardly surprising.

Professional Background and Commonwealth Broadcasting Corp.

4. I began my career in radio at the age of fourteen, when I took a job with a local station in Glasgow, Kentucky. As a high school sophomore, I worked 24 hours on the air on weekends, and continued to work as an on-air personality while obtaining my degree from the University of Kentucky.

5. In 1984, during the final semester of my senior year of studies, I purchased my first radio station. I was 21 years old. The station was a full-service Adult Contemporary formatted station that operated out of a double-wide house trailer in Cave City, Kentucky. I wore a variety of hats, which helped familiarize me with virtually all of the important aspects of the radio business. In addition to running the station and managing our small staff, I managed the station's sales, served as on-air talent for the morning show, did sports play-by-play, covered community events, and helped to keep the facilities operating by performing basic technical installations and repairs.

6. In 1996, I joined with the prior Governor of Kentucky, Brereton Jones, and formed Commonwealth Broadcasting. We started acquiring stations in 1997. The group quickly grew to 35 stations. In 2006, I acquired the Governor's interest in the company.

7. Commonwealth Broadcasting now has offices in seven small cities and towns in rural Kentucky, including Elizabethtown (population about 40,000), Glasgow (population about 15,000), Princeton, Madisonville, Elizabethtown, Campbellsville, and Bowling Green. A list of our stations and the communities they serve is attached as Appendix A.

8. I served as Chairman of the Joint Board (radio and television) of NAB, which functions as the Association's Board of Directors, from June 2009 through June 2011. Immediately before that, I served as Chairman of the Radio Board (the radio members of the Joint Board) from June 2008 through June 2009. I am a member of the board of directors and executive committee of the Radio Advertising Bureau. I have also served as President of the Kentucky Broadcasters Association (1993-1994).

9. I was honored to receive NAB's National Radio Award, the industry's highest leadership honor, in 2011. I have also been inducted into the Kentucky Broadcasters Association's Hall of Fame, and received their Distinguished Kentuckian Award in 2009.

10. I am a graduate of the University of Kentucky with a B.A. in Telecommunications. In 2013, I received the Outstanding Alumnus Award from the University's College of Communications and Information.

Radio Serves the Community and Offers a Connection to the Community

11. Local radio provides the community with a mix of information, entertainment, and personality. In fact, we are required by law to serve the public interest. More generally, local radio establishes and provides a connection to the community. People listen because of that connection. Radio, even radio that is described by a music format, is not simply a music service. Music is just part of what we offer; it is not the only thing. There are plenty of places for people to get music, if that is what they want, including their own albums and other types of services that focus entirely on music. Other services may call themselves "radio," but they do not

do what broadcasters do every day to serve their communities and they do not have obligations to serve the public interest under the law.

12. Commonwealth serves the communities in which it broadcasts in numerous ways, both on the air and off. We cover community news and events, annual Christmas parades, local school news, local obituaries, little league news, and local scouting stories. We provide free air time for charitable activities, such as Rotary club auctions and other fund raisers, and participate in events to benefit charities such as the American Cancer Society, the American Red Cross, local food pantries and dozens of other charities. We provide play-by-play coverage of local high school sports. We provide critical weather information, particularly during weather emergencies, such as tornado and storm warnings.

13. A good example of what radio can do for a community occurred in 1998, when the major employer in Campbellsville closed its plant that had employed 4,500 people. The town could have been devastated, but instead it banded together and overcame the adversity. I am proud to say that Commonwealth Broadcasting was able to help. We held a job fair, spent time on the radio talking about job opportunities, kept the community informed about developments, and generally provided a positive message and encouragement. The community was able to recover and convince new employers to come to town, including an Amazon.com distribution center.

14. At Commonwealth, we provide Internet streams of the broadcasts of four of our twelve primary music-formatted stations (and one secondary HD2 transmission) as another way to try to connect with and serve our communities. We

want to make it possible for our over-the-air listeners to hear our stations over the Internet, if that is what they want. Although the main way we reach our listeners is with our over-the-air broadcasts, streaming offers a secondary way to reach them. It is just another platform for the same audience to hear the same content as provided by our over the air signal. Only a very small percentage of our audience listens over the Internet.

15. The focus of all of our activities, including our streaming, is on our local listeners. We do not stream to try to reach listeners outside of our markets. Even if we reached other listeners, we could not convince our local advertisers that distant listeners offered them any value.

The 2009 NAB-SoundExchange Agreement Did Not Adopt Reasonable Fees.

16. In late 2008, I was asked by NAB to lead its negotiations with SoundExchange under the newly passed Webcaster Settlement Act. At the time, I was Chairman of the NAB Radio Board.

17. Congress passed the Webcaster Settlement Act in the wake of the Copyright Royalty Judges' decision setting streaming fees for 2006 through 2010. I understand that this decision is commonly referred to as "Webcasting II."

18. NAB believed that the Webcasting II decision was a major setback for streaming by broadcasters. It would be an understatement to say we were disappointed; more accurately, we were shocked by the outcome.

19. The Webcaster Settlement Act gave us an opportunity to try to make the outcome of the Webcasting II case less bad. Congress gave us a very limited time

to work out a deal with SoundExchange. The discussions started at the beginning of 2009. The law gave us a deadline of February 15, 2009 to reach an agreement.

20. We entered the negotiations with no leverage. Unfortunately, we knew that we had no leverage, and SoundExchange knew that we had no leverage. The rates set by the CRB for 2006 through 2010 necessarily formed the baseline of the discussions. SoundExchange knew that it had the benefit of those rates and was not willing to agree to significant financial changes.

21. SoundExchange claimed that any deal that it did to reduce broadcasters' rates would cause problems in its dealings with others. We could not judge the truth of this statement. Although SoundExchange knew what was going on in all of its discussions, we had no information about those discussions.

22. NAB did not consider litigation over rates for the 2011 to 2015 period to be a meaningful option. That proceeding had already begun by the time that we began our discussions with SoundExchange. Having received what we viewed to be highly unfavorable rates for the 2006-2010, we did not view the CRB as a forum that was likely to adopt reasonable license fees for broadcasters or webcasters in the next proceeding. The Judges had just raised the rate for streaming from 0.0762 cents per performance in 2005 to 0.19 cents per performance over the five-year period. We were concerned that there was a real risk that the Judges would continue to raise rates in a similar pattern. We did not believe that the rates adopted by the Judges were reasonable or that they reflected what broadcasters or webcasters would pay in a real marketplace, but we did not expect the same Judges

to be more favorably disposed to broadcasters in a proceeding in 2009-2010 than they were in the proceeding in 2006-2007.

23. At the time that we were negotiating, we also did not have the stomach to spend money to litigate over streaming. The country was suffering through the Great Recession of 2008-2009. That recession hit the radio industry particularly hard. The industry was in the middle of the worst downturn it had suffered in years. Radio revenues had declined dramatically during the period. Streaming was not a high enough priority for broadcasters to spend millions of dollars in litigation costs, particularly after the terrible outcome in the Webcasting II case.

24. During the negotiations, SoundExchange told us that it had an average rate that it needed to have for the period from 2009 through 2015. We were given the opportunity to meet that average by allocating the fees over the period. This was the only flexibility that SoundExchange showed on rates. We were unsuccessful in attempts to reduce the average.

25. We concluded that it would be better to try to reduce the rates in 2009 and 2010, even if that led to higher rates in the later years. Our hope was that, if the reduced rates kept stations from stopping their streams, it would help us to develop a more cooperative relationship with SoundExchange that would enable us to re-negotiate the rates for the later years. That hope proved to be misguided.

26. With little that we could do to negotiate the rates, we attempted to address other concerns that we had. We thought it important to address specific problems with the reporting requirements that smaller broadcasters were having. They often did not

have the resources in personnel or technology to provide census reports. Given that those stations were paying only the minimum fees, our view was that it did not make sense to impose further reporting or processing burdens either on the stations or on SoundExchange. To address those problems, we negotiated an exemption from the reporting requirements for very small broadcasters.

27. We also were concerned about the incompatibility between normal over-the-air radio practices and certain conditions on the statutory streaming license. For example, radio station disc jockeys often announce songs that are about to be played. Our understanding is that the record companies want us to do that so that listeners can identify recordings that they like and buy them. Radio stations also sometimes play a complete album side or sides or feature a particular group or artist with multiple consecutive songs. I am not a lawyer, but we felt strongly that we did not want broadcasters to be exposed to claims by record companies that they were committing copyright infringement by violating the terms of the statutory license simply for simulcasting the same type of programming that broadcasters had always provided over the air.

28. To address these issues, we negotiated a series of waivers of the statutory license conditions with the major record companies and with the American Association of Independent Music on behalf of its indie members. We did not negotiate the waivers with SoundExchange. Its negotiators had informed us that it could not provide such waivers. These waivers were an important part of the overall package and had significant value to us. I attach a copy of the waiver agreements as NAB Ex. 1.

29. We were also concerned about the incompatibility of certain broadcast practices with the need to count specific numbers of listeners for each song to determine the right royalty fee. It was our understanding that significant amounts of syndicated and network programming broadcast by radio stations was delivered to stations in ways that would not allow stations to count the number of listeners to each song included in those programs. Thus, we sought, and were given, the ability for broadcasters to pay SoundExchange for music used in a certain percentages of their programming on the basis of Aggregate Tuning Hours (assuming a certain number of songs played during each hour), rather than counting the actual performances in that programming.

30. The question of whether the agreement should be precedential was not something that we negotiated. As I recall, the language was included in a draft provided in the final weekend of the process by SoundExchange, after the business terms had been worked out. SoundExchange said that it needed the language for its negotiations with webcasters and other parties that were happening at the same time. I did not fully comprehend that SoundExchange would be able to use the agreement against broadcasters in the future, or claim that the agreement represented willing buyer/willing seller rates in future proceedings. I would have fought harder to keep the language out if I had understood that it could be used in that way. The agreement certainly did not reflect free market license fees – it was a direct result of the rates set by the Judges in Webcasting II.

A Per-Performance Fee Should Be Applied with Caution as it Is Inconsistent with the Way People Listen to Radio

31. Finally, I would like to add a few thoughts about the per-performance basis on which broadcasters are required to pay for their streaming. From my experience, this approach is inconsistent with the way people use radio and may over-state a reasonable royalty. Radio is a passive experience, not an active one. It is common for people to leave their radio on without thinking about it. The radio often stays on, even if there is nobody who can hear it. The stream is, for many people, just like radio.

32. Our audience typically does not think of leaving the radio on as wasteful. It is not the same as leaving the water running. Water has a cost, radio doesn't. And our audience treats radio in this fashion no matter how it is delivered – whether over-the-air or through the Internet.

33. One flaw in the per-performance fee is that it is charged in a way that assumes someone is listening. If no one is listening, the performance has no value. With radio, it is often true that no one is listening. As a result, any per-performance fee should be set conservatively to account for the fact that it likely will be charged for streams that nobody is listening to.

34. In addition, it doesn't make sense to charge a fee for a song the listener demonstrates by his or her actions that he or she doesn't want to hear. If the listener quickly shuts off the stream, the song has no value to either the listener or to the radio station. When a listener quickly stops the stream, it is clear that the listener was not interested in hearing the song.

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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF STEVEN W. NEWBERRY

I, Steven W. Newberry, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed this 6th day of October 2014.

Steven W. Newberry

C

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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF JOHN DIMICK
(On behalf of the National Association of Broadcasters)

Summary

1. My name is John Dimick. I am the Senior Vice President of Programming & Operations at Lincoln Financial Media Company ("LFMC"). I have 35 years of experience working in the radio industry, with the last seven years at LFMC. I offer this statement in support of the National Association of Broadcasters' Direct Case. My statement is based on my own experience in the radio industry, my personal knowledge of LFMC operations and financial matters, and my work with other LFMC employees.

2. I am providing this statement in order to describe the economics of Internet simulcasts of our over-the-air radio broadcasts. Simulcast streaming is very challenging financially and I expect it to continue to be so for the foreseeable future. While LFMC has been attempting to make streaming of our music stations profitable for many years, streaming is not now profitable and it never has been. One of the major reasons is the cost of sound recording royalties. These royalties are our largest streaming

expense by a substantial margin. I believe that lowering the applicable per performance rate applicable to streaming to $0.0005 would result in lower direct costs for our streaming operations and would allow LFMC to more aggressively pursue streaming listeners.

3. I also provide this statement to emphasize that the success of radio, even music formatted radio stations, depends primarily on how we differentiate our stations from other radio stations. We must attract listeners by developing a relationship with them. Critical elements include our development of on-air personalities, community programming, community involvement, and contests and events. In addition, we invest substantial time and effort on developing our website content and Internet blogs, growing our social media presence, and improving our technology in order to engage listeners to the greatest extent possible. We have found that simply playing music will not improve ratings nor will it create a loyal listener base, primarily because music is not unique to us and does not differentiate our stations from their primary competitors.

4. Over-the-air radio and simulcast streams provide enormous promotional value to labels and artists. Labels and artists know this, as their behavior demonstrates. Labels and artists stay in constant contact with our programming personnel (in many different ways, including in-person contact), provide stations with notification and copies of new and pre-release music, engage independent third parties to promote their artists and recordings to broadcasters, and make artists available to stations for in-studio performances and appearances. My consistent experience is that radio is a key component of a new release becoming a hit or a new artist breaking out to become well known.

Professional Background

5. As Senior Vice President of Programming & Operations, a position I have held since 2010, I oversee all over-the-air and digital operations (which includes streaming and other interactive elements of our operations) for LFMC. Prior to assuming my current position, I was Vice President of Programming & Operations at LFMC, a position that I held from 2007 to 2010. From 2004-2007, I was the Program Director of HOT 97 (WHQT) in New York City, one of the most recognizable and listened-to stations in the country. Prior to that position, I was the Operations Manager for Jefferson-Pilot Communications Company ("Jefferson-Pilot") in San Diego from 1998 to 2004. Before 1998, I was the Program Director of WNCI in Columbus, Ohio (during which period I was promoted to Vice President of Programming) and before that I held programming positions with Fisher Broadcasting and KPLZ in Seattle, Washington. All told, I have overseen radio programming operations in numerous cities (including New York, Seattle, Denver, San Diego, Atlanta, Miami, and Salt Lake City), and with many different formats (including Top 40 (CHR), country, soft rock, adult hits, hip hop, sports, oldies, and classic hits).

6. I have a Bachelor of Arts degree. I am active in the National Association of Broadcasters, served on the Agenda Committee for Country Radio Broadcasters for several years, and was a Board Member for the Media Ratings Council from 2008 through April 2014.

Lincoln Financial Media Company's Radio Stations

7. Lincoln Financial Media Company operates radio stations in four of the top twenty media markets in the country. In 2006, LFMC acquired the radio stations of

Jefferson-Pilot. LFMC is based in Atlanta, Georgia and operates as a wholly-owned subsidiary of Lincoln National Life Insurance Company. The broadcasting operation of LFMC is a separate legal entity and is operationally and financially segregated from its parent company.

8. LFMC now owns and operates sixteen radio stations serving listeners in four markets: Atlanta, Denver, Miami, and San Diego. Ten of our stations have music formats and six are sports, comedy, or talk stations. All four of our markets provide radio broadcasts in analog and in digital "HD" transmissions. Our current station lineup is as follows:[1]

Atlanta (9th Largest Market)[2]

WSTR Star 94 FM	Hot Adult Contemporary
WQXI ESPN 790 AM ("The Zone")	Sports

Miami/Ft. Lauderdale (11th Largest Market)

WMXJ Magic 102.7 FM	70s and 80s Classic Hits
WLYF 101.5 LITE FM	Soft Adult Contemporary
WAXY 104.3 FM /WAXY 790 AM ("The Ticket")	Sports

San Diego (17th Largest Market)

KBZT 94.9 FM	Alternative
KIFM Easy 98.1 FM	Soft Adult Contemporary

[1] In addition to HD1 broadcast of the primary station's programming, our stations also broadcast the following additional HD channels: WSTR HD2 (Simulcast of ESPN 790 AM - The Zone); WSTR HD3 (Mainstream Urban "Streetz 94.5"); KYGO HD2 (Simulcast of 103.1 Comedy); KQKS HD2 (Mile High Sports); WMXJ HD2 (Oldies-1950s and 60s); WMXJ HD3 (Simulcast of WAXY AM); KIFM HD2 (Smooth Jazz); KBZT HD2 (Bob Radio); KBZT HD3 ("Glow" Dance Music); KSON HD2 (Legendary Country). We stream all of the HD1 stations, as well as KSON HD2 and KBZT HD2 and HD3. LFMC tracks revenue, expenses, performances and royalties for these HD stations as part of the licensed station for which they are associated.

[2] Market rankings are per Nielsen.

KSON/KSOQ FM	Country
<u>Denver (19th Largest Market)</u>	
KYGO 98.5 FM	Country
KQKS 107.5 FM	Rhythmic Top 40
KKFN 104.3 FM ("The Fan")	Sports
KEPN 1600 AM ("The Zone" – Sports),	Sports
Comedy 103.1 FM	Comedy
KWRZ 950 AM	Oldies

9. LFMC's stations are leaders and innovators in the industry. For example, LFMC's San Diego KIFM Easy 98.1 FM was nominated as a 2014 NAB Marconi Radio Award finalist for Station of the Year and received the 2005 NAB Macaroni Award for Smooth Jazz station format. Several other LFMC stations have also won NAB Marconi Radio Awards: Denver KQKS (2014 award for Best Contemporary Hits format station); Denver KYGO (2011 award for Best Country format station); Miami WMXJ (2009 award for Oldies format station); and San Diego KSON (2012 award for Station of the Year (large market)). KYGO has been a finalist for the Country Music Radio Station of the Year Award seven times, and has won the category three times (including 2009).

<u>Lincoln Financial Media Company's Streaming Operations</u>

10. LFMC's stations began streaming in the late 1990s when they were owned by Jefferson-Pilot Communications. During the 2002-04 time period, Jefferson-Pilot elected to stop streaming due to issues with advertising agencies regarding the right to transmit radio advertising over the Internet. In around 2005-06, the stations began streaming again because they were able to replace over-the-air commercials with other material to avoid these issues.

11. LFMC now streams all of its stations. For in-market listeners, these streams are simulcasts of the over-the-air broadcasts; the stream is virtually identical to the over-the-air broadcast, with the only potential difference being minor commercial changes. The stream is also identical for out-of-market listeners with respect to non-commercial program content, but we replace more commercials for out-of-market listeners at the request of our advertisers and to obtain additional ad insertion revenue.

12. We limit access to most of our streams to the continental U.S. At our direction, most listeners outside of the U.S. are blocked from receiving the stream by our streaming provider. Our Miami and San Diego stations permit out-of-country streaming to the Caribbean and Mexico, respectively. In June 2014, we limited our KWRZ 950 AM station to the state of Colorado. We have also adopted measures to limit streaming sessions to ninety minutes. These timing and geographic restrictions have been implemented to reduce costs and avoid potential out-of-country license fees.

13. Our streaming provider is Triton Digital, which provides the technology backbone for the stream for all of our stations. We have used Triton Digital (previously Ando Media) to provide streaming services since approximately 2009.

14. LFMC's stations are streamed through each station's website, through TuneIn, a website and mobile streaming application, and through station applications available for mobile devices. LFMC streams in order to provide another way for our audience to hear our radio programming. Part of the value we provide as a broadcaster is enabling our listeners to hear our programming in the car, at work, in their home, and wherever else they may be.

The Challenges We Face in Monetizing Streaming

15. LFMC has worked hard to monetize our streams, but this effort has not met with great success. I do not believe that we are alone in this regard; I understand from colleagues in the industry that few broadcasters are able to boast a profitable streaming operation. In the current environment, streaming presents broadcasters with numerous economic challenges.

16. As discussed in more detail below, the cost of streaming far outweighs the revenue we can earn from the stream. This has been the case for many years, and we foresee it being the case for at least the next several years.

17. The sound recording performance royalties increase with every additional listener. However, an incremental listener does not necessarily bring any additional revenue. This disincentivizes expansion of our streaming audience. There is no reasonable likelihood of earning additional revenue to cover the increased royalty fees, let alone to make a profit. It has simply not been the case that such additional revenue from streaming is readily available. This is true even for the major markets in which we operate (Atlanta, Miami, Denver and San Diego).

18. There is a marketplace gap in how advertisers value simulcast streaming. Many of our advertisers are unwilling to pay anything extra for inclusion of their advertisements on our streams. Many even take the position that streaming should be thrown in for free. Although I believe advertisers understand that there are some listeners for the stream, a major problem with converting that understanding into advertising dollars has been the lack of a demonstrated audience or a consistent ratings boost based on the streaming listenership. While streaming audience measurement remains in its infancy, advertisers have a high comfort level with over-the-air ratings. Radio

advertising rates are based on well-established ratings information and broadcasters generally have not been able to provide accepted ratings data with respect to the streaming listenership.

19. As part of our effort to monetize streaming more effectively, we recently moved to Nielsen's Total Line Reporting ("TLR") for our music stations, which is a change in ratings methodology provided by Nielsen that provides (i) ratings for a broadcasters' stream on a station-by-station basis, and (ii) a cumulative overall rating for a station (that is, a cumulative rating for the over-the-air broadcast and the streaming simulcast). Some of our stations moved to Nielsen TLR in September 2013, while others were transitioned in early 2014. Nielsen TLR has strict compliance requirements and has been endorsed by the Media Ratings Council.[3] We moved to Nielsen TLR because the revenue from ad insertion on the stream and streaming pre-roll advertisements was minimal and because the ad insertion technology resulted in a lower quality sound for the streamed programming. We could not sell all of the time available on the stream (for ad insertion) and what we could sell was at unacceptably low rates. As part of our effort to sell available streaming time, we engaged third party brokers for this activity (Katz and Triton), which further diminished our revenue because of commissions. Despite all of our efforts, we could not sell all of the available advertising time. This resulted in excessive runs of public service announcements and duplicative advertising, which degraded the listening experience. We moved to Nielsen TLR with the goal of capturing the streaming audience within our Nielsen rating, thereby perhaps obtaining increased advertising rates. We hope that the Nielsen TLR will allow advertisers to accept and value our streaming

[3] In order to participate in the Nielsen TLR, LFMC is required to fully simulcast its over-the-air program, with very limited exceptions.

audience, but we cannot be sure that will occur. Even if it eventually does, stream audiences remain a very small fraction of our over-the-air audience despite the fact that we have been streaming continuously for more than eight years.

20. The Nielsen TLR reports we have received show that streaming has not had a material effect on our audience ratings. For example, for KQKS (Denver – Rhythmic Top 40), KYGO (Denver – Country), and WMXJ (Miami – 70s and 80s Classic Hits) our Nielsen reports reflect virtually no streaming audience since we began TLR for those stations. That is, in 2014 there are no recorded AQH Persons[4] for our relevant age demographic for these stations, no independent AQH Rating[5] for those stations and, therefore, no increase in the total rating (terrestrial plus the stream) for those stations. We have had slightly more success with WLYF (Miami – Soft Adult Contemporary); however, even that station's AQH Persons is a small fraction of its terrestrial AQH Persons. The stream garners no independent AQH Rating, and it has only increased the overall AQH Rating by a 0.1 in January and August of 2014.

21. These low and inconsistent figures do not allow us to argue forcefully to advertisers that they should pay more because our over-the-air programming is also streamed. Advertisers base their buys and the rates they are willing to pay on consistent, demonstrated ratings. An upward flicker in the rating of 0.1 (the smallest possible increase) will not enable LFMC to demand more for its spots.

[4] Nielsen defines AQH Persons as the "average number of persons listening to a particular station for at least five minutes during a 15-minute period."

[5] Nielsen defines AQH Rating as the "AQH Persons estimate expressed as a percentage of the population being measured."

22. Despite the challenges, LFMC actively seeks revenues from its streams. Sales staff have both over-the-air revenue targets as well as targets for our "interactive" audience (which includes revenue from our websites, social media, texting, streaming and contesting). Growth of our digital and streaming revenue is a focus of LFMC and our executives and managers are charged with making streaming a profitable enterprise.

Streaming of our Over-the-Air Broadcast is Done at a Loss

23. Streaming currently loses money for LFMC's music stations. Presently (2014), our direct revenue for streaming comes from (i) pre-roll advertisements (that is, advertisements that precede the stream once a listener clicks on the "listen now" button), and (ii) ad-insertion for our out-of-market listeners.[6] We do not believe our listeners would pay a subscription fee to receive our streams.

24. LFMC has put accounting procedures in place for tracking streaming revenue at all of our stations. We have done so in an effort to more carefully track the revenue and expenses associated with streaming; however we have historical streaming revenue data only for our Denver and Miami markets.[7]

25. As can be seen from the table below, revenue that we can directly attribute to streaming is relatively minimal. Revenue also drops off in 2014 (as compared to 2013), because we now have less ad insertion revenues from the stream due to our move to Nielsen TLR. The move to Nielson TLR, however, was intended to allow us to capture our total listening audience (over-the-air plus streaming), thereby potentially

[6] Prior to our implementation of Nielson TLR, we inserted ads more frequently within market.

[7] Our Atlanta and San Diego markets have not yet been able to implement the new procedures for tracking streaming revenue and expenses.

improving our ratings. As discussed above, we have not yet seen the ratings boost necessary to drive additional advertising revenue.

26. As can be seen from the table, the revenue attributable to the stream is almost the same as, or is exceeded by, LFMC's applicable performance royalty fees for our Miami stations in 2013. Likewise, the performance royalties are more than half of the streaming revenue for our Denver stations in 2013. In 2014, the applicable performance royalties are outpacing our streaming revenue for three of the four stations reported below. The amount paid to SoundExchange grew consistently from approximately **[[**

]] in 2013. The decline in royalty fees was due to our geofencing and limitations on the amount of streaming time. For 2014, royalties are on track to be approximately the same as 2013, perhaps slightly above. The fees paid to SoundExchange are, by far, the single largest expense that we track for our streaming operations. They exceed the total of our streaming connectivity costs, ad insertion fees, and composer royalty fees.

27. Obviously, music performance royalties are not the only expense associated with streaming. We have at least three other major expenses directly attributable to streaming: (i) the cost of the stream itself (fees paid to Triton), (ii) our costs for insertion for advertisements into the stream (tracked as "scheduling" fees), and (iii) our additional composer royalty fees for ASCAP, BMI and SESAC. If these costs are taken into account, the non-viability of streaming as a stand-alone financial operation becomes even more clear, with each of the four stations operating at a loss for 2013 and 2014:

Time Period	Station	Streaming Revenue[8]	Sound Recording Royalties paid to SoundExchange	Streaming Bandwidth, Scheduling, Composer Royalties[9]	Approximate Loss
2013 (full year)	Miami WLYF	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Miami WMXJ	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Denver KYGO	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Denver KQKS	[[ ]]	[[ ]]	[[ ]]	[[ ]]
2014 (through 8/31)	Miami WLYF	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Miami WMXJ	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Denver KYGO	[[ ]]	[[ ]]	[[ ]]	[[ ]]
	Denver KQKS	[[ ]]	[[ ]]	[[ ]]	[[ ]]

28. There are additional costs of streaming as well. Executives, including myself, our head of Digital Strategy, and our station managers and advertising

[8] These revenues are net of the advertising commission paid. 2014 direct streaming revenues are tracking to be materially lower than 2013 because ad insertion revenue is down sharply due to our transition to the Nielsen TLR.

[9] LFMC tracks the SESAC fees applicable to streaming; however, ASCAP and BMI fees applicable to streaming are not specifically tracked with respect to streaming. Therefore, the ASCAP and BMI fees included herein were calculated using the direct streaming revenue multiplied by the applicable ASCAP / BMI license fee of 1.7% (for the base fee) x 75% (for streaming). Last, streaming bandwidth and schedule fees were taken from LFMC's standard profit and loss statements, which are rounded to the nearest thousand dollars.

executives, must spend a portion of our time on our streaming operations. These individuals must ensure that the technical requirements of streaming are met, which includes interacting with and overseeing Triton, ensuring our other technology is functioning properly to enable the stream, staying abreast of technical innovations, and overseeing applications development. There are other functional requirements and hard costs, such as implementing accounting policies to track streaming revenue and expenses, costs of applications development, etc. While we have not specifically quantified these costs, they undoubtedly are real and increase our loss on our streaming operation. Furthermore, to the extent we can ever confidently allocate a portion of over over-the-air net advertising sales to our stream based on Nielsen TLR or other data, such an allocation would have to take into account the costs associated with the programming included in the streamed content, as well as the sales and marketing costs associated with the over-the-air advertising. Indeed, if streaming is viewed as an independent operation, our streamed music stations are already getting the benefit of fully programmed content (music selection and organization, on-air personalities, contests, etc.), the costs of which are not reflected in the above figures.

29. In sum, SoundExchange royalties are the greatest impediment to the financial viability of our streaming operations. If we convert an over-the-air listener to a streaming listener (or to a listener of both over-the-air and streaming), our costs increase. Furthermore, there is no benefit to us because of scale - we pay the same amount of royalties for our first streaming listener as we would for our millionth listener.

Our Non-Music Programming is Critical to the Success of our Music Stations

30. Six of our stations are sports or comedy formatted stations that broadcast little or no music. Our remaining ten stations have music formats. Differentiating our station programming is critical to our success particularly for our music-formatted stations, because everyone has access to the same music. We have competitors in our markets with similar music formats, so we must differentiate our stations and attract listeners with personalities, contests, social media, Internet blogs, events, and other programming.

31. Our on-air personalities are an important part of differentiating our music-formatted stations. Our music stations typically have morning, mid-day, and afternoon (drive-home) personalities. Depending on the station, on-air personalities can be our number one priority in terms of programming decisions. We search for and develop good talent and we highly compensate that talent as well. We attempt to groom our personalities for higher ratings time slots. In sum, all of our competitor music stations are playing roughly the same music; however, the on-air personalities distinguish one station from another.

32. Our morning shows on KQKS (Larry, Kendall & Kathie Show) and KYGO (Ryno & Tracy Show) are top morning shows in Denver. These programs draw listeners and drive advertising revenue. The personalities are paid salaries reflective of their importance to the success of the stations. A great morning show can even draw listeners from outside the base music demographic of the station. On the other hand, an unsuccessful morning show can require substantial resources and expense to get back on track. For example, we are in the process of retooling the morning show on WSTR in Atlanta because the show has not been effective.

33. LFMC stations also serve their communities in many ways. We take seriously our obligation to operate our stations in the "public interest, convenience and necessity." Our stations provide the basic information listeners expect from radio, such as providing news, weather, school closings, and traffic updates. Of course, we also broadcast emergency information.

34. We go beyond these basic obligations by engaging in, and informing listeners of, other community activities. We announce community events over-the-air and display them on our websites. For example, our station websites have links to dozens of community events, including charity walks, art events, food and wine festivals, pet adoptions, children's activities, clothing drives, etc. NAB Ex. 2. Station personalities often appear at these events in order to engage with listeners directly and increase station awareness, for example, by participating in a walkathon or bike ride for a particular charitable organization, or attending a food festival.

35. We also organize and sponsor events and fundraising, raising substantial funds for important organizations. NAB Ex. 3. For example, WSTR in Atlanta hosted its 6th annual Little Black Dress party in early September 2014, benefitting, for the past three years, the Young Survival Coalition, a breast cancer organization aimed at assisting young women facing this disease. This event has raised over $70,000 since its inception in 2008. KSON in San Diego hosted its 26th Annual Radiothon in December of 2013, which has raised over $11 million in the past 25 years for the benefit of St. Jude Children's Research Hospital. We often broadcast these events in their entirety, or cut to the events for brief periods during our over-the-air programming.

36. Contests and promotions, such as Denver KYGO's Workday Payday contest where listeners have the chance Monday through Saturday to win $100 an hour from 9am-4pm, are an integral element of creating brand loyalty. NAB Ex. 4. WLYF provides a chance to win up to $1,000 five times a day, including mid-day working hours. A popular contest or promotion can draw attention to a station and thereby attract new listeners. We believe that it also may increase streaming listenership by encouraging working listeners to tune-in throughout the workday.

37. We also put a great deal of effort into our Internet presence to grow and reinforce our stations' brands and to directly connect to our audience. Various LFMC stations use different approaches, but many have blogs aimed at certain listener groups, tributes (for example, to overseas troops), contests, events, local news and traffic, and a presence on Twitter, Instagram, Facebook, and Pinterest. NAB Ex. 5.

38. Many of our stations have blogs that focus on listener interests. For instance, our Denver KQKS Morning Show has a blog, which primarily focuses on humorous items of interest. WSTR in Atlanta has Cindy's Mommy Blog focusing on "All Things Mommy" and San Diego's KIFM has an Easy Blog that covers a wide variety of topics such as entertainment, events, food, health, lifestyle, music, and San Diego news.

39. Our websites provide an important connection for the local events that are discussed above. They also serve to honor local individuals. For example, KYGO in Denver has a "Wall of Honor" recognizing the sacrifice of Colorado men and women serving away from home. NAB Ex. 6.

40. In addition, all of our stations have a presence in social media – Twitter, Instagram, Facebook, and Pinterest – so that listeners can interact directly with our on-air talent. This facilitates building relationships with individual listeners and, even more importantly, a community of listeners, to a station or particular program. NAB Ex. 7.

Our Broadcasts Provide Promotional Value for the Music We Play

41. We also go to great lengths to provide an enjoyable music experience to our listeners—identifying and playing the music they want to hear, introducing them to new songs and artists, and selecting and organizing music for our listeners. Our program directors, music directors and on-air personalities have extensive knowledge of the musical genres they program.

42. The nature of our industry is such that we develop relationships with labels, promoters and artists. Radio stations are important outlets through which record companies can introduce new artists and songs to listeners (prospective music purchasers). I strongly believe that record labels and artists agree and that they remain focused on obtaining airplay for their songs. My personal experience, which includes being a program director in several major markets including New York City, is that record labels and artists devote a great deal of energy and money to ensuring that radio stations have their music and will play that music. We engage with labels, promoters and artists regularly in this regard; however, our focus is on our listeners and we make artist and song selections for airplay based on our own judgment, which includes our experience and knowledge of our listeners.

43. In my experience, record label promotional activities directed to radio have remained strong over the past decade. There has been some change because of label

mergers and cost cutting; however, I think the level of intensity and focus remains the same. Some of the promotional activity comes in different forms now – for example, we get more email blasts of new releases from labels, as these are lower cost communications. I have not seen, however, a change in attitude from the labels in terms of their view of the value of radio play for their artists.

44. Record labels continue to heavily promote their music to radio programming personnel in many different ways. I polled our program directors for several stations with respect to the level of promotional activity from labels. Live communications (in person meetings and phone calls) remain one of the key ways label and independent promoters seek the attention of programming personnel.

a. Our program directors are constantly interacting with labels and independent promoters of music. Our Program Director for KSON (San Diego – Country) advised the he interacts with 32 record label representatives and approximately eight independent promoters on a regular basis, taking calls throughout the week and during scheduled music call times once per week. Our KYGO Program Director in Denver has lunches and dinners with label representatives about ten times per month, and is regularly interacting with about ten label representatives via phone, email and text. Our Atlanta Assistant Program Director/Music Director speaks with twenty different label representatives per week. My experience is that such regular contact is pervasive throughout the industry.

b. Some of our program directors set aside particular times to speak with label personnel. Scheduled appointments are sometimes necessary to limit the amount of time spent with labels. It is important to note that stations and markets are different. For example, in Atlanta, we may get more "in-person" promotional activity, as many label personnel maintain homes here, while our Denver stations might receive more calls and email communications.

c. Radio station music programmers can receive a great deal of attention of from the labels (especially those at high profile stations). My experience at HOT 97 in New York, where I was the programming director, was that both the music director and I were bombarded with requests for airplay and air time. HOT 97 was and is an important Hip Hop station that can take an artist from obscurity to success simply by playing his or her music. Artists would ask for our music director to come to recording sessions, listen to unreleased music, and help identify the best song for airplay. Promoters would beg for our time and airplay. We could have spent virtually all of our available time interacting with artists and labels in this way.

d. Record labels will also invite our programming staff to "off-site" events. This often includes taking program personnel to artist concerts and performances. Labels use these types of events to help build relationships with stations and encourage airplay for the music they are promoting.

45. We also receive email communications from promoters asking us for airplay, requesting meetings, identifying new releases and artists, informing us of hits and airplay of their artists by other stations, etc. NAB Ex. 8. We also receive acknowledgements and messages from labels and promoters thanking us for our role in making their song, album or artist a success. NAB Ex. 8. Our stations and program

directors have scores of elaborate plaques presented to us by the labels recognizing our role in their success and sales. NAB Ex. 9.

46. Labels and independent promoters continue to send us new music. Our program directors informed me that, on average, they receive 5-10 new singles a week from labels, which come in the form of CDs and digital .wav files. Our stations may only add a few new songs each week, so the labels are vying for these spots. LFMC programming personnel also receive a few new full length CDs per month. Additionally, we receive new music through online music services (*e.g.*, PlayMPE). Our program directors have accounts with these services and labels will identify music to our program directors through these services, making the music available for downloading. We also receive email blasts of new releases. Labels will also frequently ask our program directors for feedback on new artists and music. For example, they may ask for our opinion on which single of a new album should be played on the air. This reflects the value that labels place on our distribution capabilities as well as our expertise in knowing what will become a hit.

47. In addition to sending us current music and interacting directly with our program directors, artists at the behest of their labels – will give their time to our stations, providing interviews, attending events, performing, recording station liners and video greetings, and interacting with local fans. Artists and labels do so in order to strengthen their ties to our stations and obtain our support. For artists with whom we have strong ties, we may give their new music additional consideration and perhaps make room for their new release or take a risk that we might not take for another artist. It is my experience that this is the case throughout the industry and the labels foster and rely on

these relationships. There is time and great expense associated with some of these activities and I simply do not think the labels would incur these expenses unless they believed that there was a significant benefit to them.

48. For example, numerous artists visit our stations for interviews and in-studio performances. For KSON in San Diego (Country format), the following artists have visited the stations since May 2014: Justin Moore (Valory Records); Dylan Scott (Sidewalk Records); Dean Alexander (WEA Records); Olivia Lane (Big Spark Music Group); Jackie Lee (Broken Bow Records); Kelsea Ballarini (Black River); Hunter Hayes (Warner Bros); Kristian Bush (Streamsound Records); Samantha Landrum (Star Farm Entertainment). For KQKS in Denver (Rhythmic Top 40), we have had the following artists visit the station in the past six months: Lil Jon (Epic); G-Eazy (RCA); August Alsina (Def Jam); TydollaSign (Atlantic); Jeezy (Def Jam); Wiz Khalifa (Atlantic); Rico Love (Interscope); Adrian Marcel (Republic); Schoolboy Q (Interscope). In Atlanta, recent station visits include: Hilary Duff (RCA); One Republic (Interscope); Echosmith (Warner Brothers); Matt Nathanson (Vanguard); Paramore (Roadrunner); Eric Hutchinson (In2une); Neon Trees (Island); Us The Duo (Republic). There are many other examples.

49. Artists will often perform at specific events that we arrange. These might be charity events or contest winner events. For example, Ed Sheeran (Atlantic Records) performed at the Star Lounge on July 8, 2014, for 100 of our winners of A-List Lounge. Better Than Ezra (ADA Records) performed at our “Little Black Dress Party” on September 6, 2014, which, as I mentioned above, was for the benefit of a local breast cancer charity. Christina Perri (Roadrunner) performed at the Star Lounge on August 20,

2014, at the Marietta Museum of Art, for 100 winners of our New Music Room Live contest. These performances were provided at no charge[10] and we organize similar events in all of our markets. While these events are good "branding" for the labels and the artists, labels also use them to build their relationships with our stations.

50. Record labels provide other benefits to our listeners and fans at no charge to LFMC, such as concert tickets and trips, backstage passes and autographed merchandise. Although not quite as popular now as in the past, labels have also provided large quantities of CD's for on-air giveaway to help advertise that new music is in stores and available for purchase. There are also private "meet and greets" as well as offers for exclusive sound check parties for our listeners. All of this is done to expose potential consumers to the artist and the artist's new product.

51. Because our music station streams are simulcasts of our over-the-air broadcast, their music content is the same. The promotional effect of the music played is, therefore, no different. I have never had an artist or label tell me they did not want their music broadcast on our stream. In fact, our streaming technology has the added promotional effect of displaying the title, artist and album, as well as the ability to "tag" the song for future purchase on the stream display, which would facilitate the purchase of the music by the listener.

[10] We do pay for travel and incidental expenses, if needed.

Conclusion

52. Over the course of nearly a decade LFMC has made a serious effort to make streaming a financial success. We have yet to achieve that goal, or even reach a break-even point, primarily because the royalty rates for sound recordings present such an obstacle. Although we are moving to a new model using Nielsen Total Line Reporting, I have not seen evidence that the situation will be fundamentally changing in the near to medium term. Unfortunately, many advertisers are unwilling to pay for streaming ads, and certainly not at rates that would cover royalties and all of the other costs associated with streaming. For the time being, in my view, the primary beneficiaries of our streams are the record labels, who receive the promotional benefit of their music being on our stream while we incur all of the associated costs.

Before the
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Washington, D.C.

In The Matter Of: **Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)**	)	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF JOHN DIMICK

I, John Dimick, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed this 7th day of October 2014.

John Dimick

John Dimick

D

Before the
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LIBRARY OF CONGRESS
Washington, D.C.

In The Matter Of:	)	
	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF
ROBERT FRANCIS KOCAK (BUZZ KNIGHT)
(On behalf of the National Association of Broadcasters)

Summary

1. My name is Robert Francis Kocak. I have spent over thirty-five years in the radio industry, beginning as a disc jockey at my college radio stations. Since early in my career, I have been known professionally as Buzz Knight; that is the name by which most people in the industry know me. For the last seven years, I have held the position of Vice President of Program Development at Greater Media, Inc., where I have overall responsibility for the content broadcast and streamed by twenty-one FCC-licensed full power AM and FM radio stations with varying formats. My statement below is based on my own extensive experience in the radio industry.

2. Most successful radio stations, including most music-formatted stations, owe their success to elements other than music. I believe this is important to understand in the context of setting royalty rates for streaming. By their nature, commercial radio stations strive to attract and retain listeners and, thus, advertisers. Successful radio stations must bring something unique and different in order to stand out. In my experience, the key is to build an individual brand

identity for each station and to integrate that station into its local community so that it becomes prominent and well-known That effort requires: a substantial commitment to memorable on-air talent, particularly in the morning drive but also at other times in the day; consistent and prominent station involvement in the community, such as at charitable functions; informative and interesting on-air coverage of local issues and events; and active promotion of the station's brand, including through social media. Over time, listeners develop a sense of trust in our on-air personalities and in the stations themselves. It is through these efforts that we develop loyal listener bases, both for our over-the-air broadcasts and our streams of those broadcasts. In contrast, consumers can turn to a wide variety of sources and when they want to hear nothing but music. Likewise, the music that a radio station plays is not exclusive to that station, and any musical niche that is developed can be readily copied by competitors. Thus, in order to succeed at a high level, our stations must do much more than play music.

3. For as long as I have been in the business, record labels have sought to leverage our stations' relationships with their listeners in order to promote their artists and recordings. Record label representatives and artists actively seek spins on our stations, including their streams, through personal visits, calls, emails, provision of recordings, and participation in promotions, including artist visits and giveaways. Just as important as winning spins, record labels and artists also seek the endorsement of songs and artists by our on-air talent, whose opinions and recommendations listeners trust.

Professional Background

4. During my long career in radio, I have served as on-air personality, program director, operations manager, and programming executive at numerous radio stations in diverse markets around the country.

5. I graduated from the University of Dayton in 1978 with a bachelor's degree in communications. During college, I worked on-air at two on-campus radio stations. After graduation, I worked briefly at WKQQ in Lexington, Kentucky, and then moved to WRKI in Connecticut, where I worked from 1978 to 1987. At WRKI, I started on-air and eventually also served as assistant program director, program director, and then operations manager of the station, along with an AM sister station, WINE.

6. From 1984 to 1987, I also worked part time at WNEW FM in New York City as weekend on-air talent. WNEW was a legendary New York radio station that helped set the trends for rock music radio during the 1970s and 1980s. The station was very engaged in the local community and, among many other events, ran major fundraisers to benefit food banks, sponsored and organized concerts in the New York area, and broadcast live music from venues like the Hard Rock Café. The station's ethos embodied not just the music on its airwaves, but the culture and spirit of New York City in and around that music.

7. From 1987 to 1990, I worked at WLVQ- QFM96 in Columbus, Ohio. I started with an on-air position and also served as program director, but ultimately chose to concentrate my efforts on the program director position.

8. From 1990 to 1992, I worked at WNOR, a Saga Broadcasting station in Norfolk, Virginia, as program director. Then, in 1992, I moved to WZLX in Boston, Massachusetts. I was with WZLX until 2002. During that time I programmed WZLX. I also served as the classic

rock format captain for WZLX's parent company and helped with programming projects for stations outside of Boston.

9. In 2002, I joined Greater Media as program director of WMGK in Philadelphia, Pennsylvania. Later, I also began programming WROR in Boston, another Greater Media station. My role evolved to include advising rock and classic rock stations throughout the Greater Media portfolio on programming. I was named Vice President of Program Development at Greater Media on January 1, 2007; I have held that position in the company ever since.

10. In my current position, I supervise programming for all of the Greater Media stations, including streamed content. I work with the company's CEO and local teams, including the program director and general manager of each station, to plan, coordinate, and market their programming in a way that best serves the interests of their audiences, clients, and local communities. I spend most of my time working with the stations in each individual market to monitor performance and, when appropriate, help strengthen each station's brand and ratings performance.

11. I am actively involved in several industry organizations, including the National Association of Broadcasters' Committee on Local Radio Audience Measurement, the Arbitron (Now Nielsen) Radio Advisory Council, and the Council for Research Excellence (including Committees on Local Measurement, Social Media and Education). I was named among "Best Programmers" by Radio Ink Magazine in 2007 and 2010.

<u>Background of Greater Media</u>

12. Greater Media presently owns and operates twenty-one AM and FM radio stations in the Boston, Charlotte, Detroit, Philadelphia, and New Jersey markets. In addition to its radio stations, Greater Media also operates a group of weekly newspapers in New Jersey and owns several telecommunications towers throughout the United States. Greater Media was founded in

1956 by two Yale classmates and is a privately held company with its headquarters in Braintree, Massachusetts. From the beginning, Greater Media and its operating companies have stressed the autonomy of local management, dedication to local community service, and leadership in developing and adapting to new technology and services to improve the overall perception of the industry.

13. Greater Media currently operates the following radio stations:

Market	**Station**	**Format**
Boston	Magic 106.7	Adult Contemporary
Boston	105.7 WROR	Classic Hits
Boston	102.5 WKLB-FM	Country
Boston	Hot 96.9	Rhythmic AC
Boston	Radio 92.9	Alt. Rock
Charlotte	WBT 1100 AM / 99.3 FM	News-Talk
Charlotte	107.9 The Link	Personality Hot AC
Detroit	94.7 WCSX	Classic Rock
Detroit	Detroit Sports 105.1 FM	Sports
Detroit	101.1 WRIF	Rock
Philadelphia	102.9 WMGK	Classic Rock
Philadelphia	93.3 WMMR	Rock
Philadelphia	95.7 WBEN-FM	Adult Hits
Philadelphia	97.5 The Fanatic	Sports
New Jersey	98.3 WMGQ	Adult Contemporary
New Jersey	1450 WCTC	News Talk
New Jersey	105.5 WDHA	Rock

New Jersey	1250 AM WMTR	Classic Oldies
New Jersey	95.9 WRAT	Rock
New Jersey	100.1 WJRZ	Classic Hits

Greater Media streams all but one of these stations over the Internet. We have chosen not to stream WMTR, a New Jersey oldies AM station. The streams for Greater Media's stations can be accessed through the stations' websites, iHeart Radio, or station apps available for iPhones and Android phones.

Local Programming and Presence Is Key to
<u>Traditional Radio Stations' Continued Success.</u>

14. Five of our twenty-one stations, including WBT in Charlotte, which is licensed and broadcasts on both the AM and FM bands, are news-talk or sports-formatted stations that broadcast essentially no music. The remaining sixteen Greater Media stations are varieties of what would traditionally be considered music-formatted stations. Even as to these stations, however, it is my view that music is not the primary driver of success. That is true both with respect to the broadcasts and the associated streams.

15. For as long as I have been affiliated with Greater Media, we have always focused on integrating our stations into the local community. This is more challenging, risky, and costly than simply playing music that is widely available elsewhere. In an article I wrote for Radio Ink on May 21, 2012, I suggested that radio industry professionals should "Watch for local angles to serve topical cause related needs that help your communities and expose your radio station at the same time. Radio plays a vital role in serving our communities. If you follow your heart, you'll do the correct thing for your brand and your market." I continue to believe that today.

16. One critical component of our stations that is both local and exclusive is our on-air personalities. While morning drive is generally considered to be the most important day part

for personalities, in my view, they are important in building a successful station throughout the day. Our on-air personalities consistently wear a lot of hats; they are curators, they are concierges, and they are companions and friends. We feature personalities who have built their audiences over the course of decades on the air. For example, Nancy Quill and David Allen Boucher have been on the air at Magic 106.7 in Boston since the station began broadcasting more than thirty years ago; neither is currently on the morning drive. The Loren and Wally Morning Show has been broadcast on WROR in Boston for over twenty-five years. On 107.9 WLNK in Charlotte, we have personalities throughout the day, starting with the Bob & Sheri Morning Show, followed by mid-days with Kelly McKay, followed by Matt & Ramona in the afternoon, and then Anthony Michaels in the evening. Our Detroit Classic Rock station, WCSX, and our New Jersey Rock station, WRAT, have had most of the same on-air talent for years; thus, a relationship has been built with listeners. Our rock station WRIF has rocked Detroit since 1971 as a radio brand with live and connected personalities, many of whom have a long legacy with the market. Because of this wealth of on-air talent, which is generally exclusive to us, listeners have a reason to listen to our stations

17. Local personalities have always been important in radio. The growth of social media has, if anything, increased that importance, particularly in major markets. When I began in radio, the opportunities for listeners to interact personally with on-air talent were limited primarily to call-ins and local appearances; the relationship with the audience therefore had to be developed primarily through the one-way broadcast transmission. Now, communication runs both ways, with listeners interacting directly with our on-air talent through Twitter, Facebook, Instagram, and other social media. This facilitates building relationships with individual listeners and, even more importantly, a community of listeners to a station or particular program.

18. Even with the development of social media, our General Managers recognize the continuing need for their stations and their on-air personalities to be active and visible in their communities; tweeting is not enough. We nurture and promote our local connection through charity drives, public concerts, and other events such as: the Preston & Steve Campout for Hunger in Philadelphia, which raises tens of thousands of dollars and tons of food to support the local charity Philabundance; the Radio 92.9 Earthfest in Boston, a free live concert held at the Boston Hatch Shell each May to promote environmental awareness and earth-friendly products and services; John DeBella's Veterans Radiothon at WMGK in Philadelphia, which, over the last eight years, has raised well over a half a million dollars for veterans' charities (earning John in 2012 "Veteran Champion of the Year" from the Philadelphia Small Business Association); WCSX in Detroit and the Stone Soup Project, where listeners and local companies donate to build a car for charity; and WBT and WLNK in Charlotte creating Holiday on Ice and an outdoor skating rink for listeners in the heart of the city.

19. Of course, there are costs to a local, personality-driven approach. Talent can be costly, particularly when it has developed a large following in a market. Development of new talent, or the introduction of talent to a new market, can require a substantial investment of time and marketing expense. We are always seeking to build our bench strength so that a new personality can, for example, move from overnight to a more prominent day spot. We are also looking outside for new talent. Even with all of this investment, there is no guarantee of success. For every Loren & Wally Morning Show, there are legions of failures – far too many to count. And every one of those failures has nonetheless incurred substantial expense for the station's owners; except perhaps in very small markets, nothing gets on the air without analysis, testing, refinement, and promotion, all of which cost money.

20. Being part of the community also requires providing information. While we have five stations that are entirely dedicated to news, talk, or sports, the vast majority of our stations provide regular updates on local news, traffic, sports, and weather information, at least during the morning drive and, in some cases, during other day parts. In some markets, stations have individuals dedicated to providing these services; in other markets, these resources are generally shared but can be provided by individual stations when needed. Our listeners expect to receive this type of information, and it is part of the basic value package that attracts listeners to our stations.

21. While news, talk, sports, and weather information are always important, they assume particular (and sometimes overriding) significance when there are major events in the community. Depending on the particular situation, listeners may turn to us to receive essential information, to share their concerns, to feel a sense of community, or to vent their frustration. For example, our station WRAT in New Jersey became a primary source of news during the Hurricane Sandy crisis; I am proud to say that station management and staff demonstrated their responsibility to the community through their excellent reporting, winning an award for their news coverage of the crisis. In Boston, our cluster of stations provided extensive coverage and news alerts in connection with the Boston Marathon bombing and the citywide lockdown and manhunt that followed. This was accomplished with our stations' own resources and also in partnership with television station WCVB. In these types of situations, and others like them, it is particularly important that listeners interact with or receive information from on-air personalities with whom they already have a connection. We are also there with our listeners to celebrate happier times, such as sports championships; all of this is possible because we are primarily local broadcasters.

22. Another way that we increase the interaction with our audience is through contests and other promotions. Contests and promotions have been an integral element of local radio for as long as I have been in the business. A popular contest or promotion can draw tremendous attention to a station, build a sense of community and connection, and increase ratings. WMMR in Philadelphia has frequently done an on air promotion supported by direct mail marketing called "Grand Band," which results in a listener winning $1000 after hearing three songs from a station core artist.

23. Our stations' websites are also an important way that we keep in touch with our audience. Station websites, which are accessible directly or through our general company website, www.greatermedia.com, display information about station personalities and programs, news and entertainment items that may be of interest to our listeners, information about current promotions and contests, photos of gatherings and events, and tabs that allow listeners to see what songs have been played recently, in addition to advertisements. These sites, along with our Facebook pages, are important resources for our listeners, as well as serving as a portal to our stream.

24. Obviously, our radio stations compete most directly with the other stations in their local markets. But our local presence is also an asset when listeners are deciding what to listen to over the Internet. We can leverage our local talent, connections, and engagement in each of our marketplaces to provide a complete service to our listeners and customers that goes beyond just providing a collection of songs. For completeness, I should note that we have had two stations that are atypical for us in that the programming is almost all music. On one of these stations, Adult Alternative Rock station Radio 92.9 in Boston, we are developing a new sound and featuring more personality. The station personalities include Amy Brooks, who is featured prominently on the station's website, and Paul Jarvis (known as "Jarvis"), who, in addition to

serving as Assistant Program Director, also hosts morning drive on the station. Radio 92.9 also hosts and sponsors many local concerts, festivals, and other events in the community.

25. Our variety hits station 95.7 BEN FM in Philadelphia has a similar model with Marilyn Russell hosting the morning show and Rich Desisto (Assistant Program Director) and Kristen Hermann hosting the remainder of the day. Marilyn also does a regular community feature called "Woman of the Week" shining the spotlight on influential women from around Philadelphia.

26. About two years ago, I was interviewed by allaccess.com. In connection with a question about how radio had changed over the last few years, in particular with the adoption of the "people meter," I noted:

> At the beginning and still to this day, I come away with the feeling that as much as technology has changed things, it all still comes back to great brand management and a meticulous attention to detail in managing those brands. As much as the [portable people meter] changed certain things that required an adaptation in your thought process, in many respects very little has change[d]. It's still about things that make great radio tick – great content from great personalities who have a great understanding of the market. That's the localism that's really important is the ability to always build your programming to the point where your listeners feel that if they miss a day from your station, they feel like they've missed a lot.

I continue to believe that, as I stated in the interview, the key to success in radio is to make your listeners feel that, if they miss a day at your station, they have missed out on something. Music alone cannot inspire that feeling. When I started in the radio business, people had their collections of vinyl records, which subsequently migrated to cassettes, CDs, and then MP3s. Now, if people want to hear a particular song, they can either go to their iTunes collection or go to Spotify or some other interactive service. But we cannot give people that "I don't want to miss that" feeling with respect to music, because we do not have music exclusivity, and it is readily available from many other sources. Instead, we create that feeling by the content we create and the relationships that we build with our listeners.

Record Companies Depend on Local Radio Play To Promote Their Music.

27. Throughout my career, it has been clear that record companies rely on radio stations to promote and sell new music. Today, record companies are still highly invested in increasing spins or air time for their artists on our radio stations, including the station streams.

28. As I discussed above, neither Greater Media's stations nor any other radio stations can offer truly unique music programming, because the same songs by the same artists are available not only to all of our direct radio competitors but also through innumerable other sources. One thing we can do, however, is to present a better musical experience for the listener through a combination of research and our own knowledge and experience in programming. We spend a significant amount of time and money to provide a curated musical experience for our listeners. Many of our on-air personalities are known for their expertise in particular musical genres and can guide and aid listeners in their enjoyment of music. Nancy Quill, for example, our midday host at Magic 106.7 in Boston, has a degree in music education to go along with her thirty years of experience in radio broadcasting. Pierre Robert, our mid-day personality from WMMR, has had a thirty-year friendship with Jon Bon Jovi, which has included in-studio visits, acoustic performances, numerous interviews, and shout outs from on stage during Philly concert appearances. Jon Bon Jovi even recently asked Pierre to write the liner notes for his greatest hits box set, and he had Pierre host on stage a storyteller-like performance with full band for a private concert experience for one thousand of our listeners. WMMR was allowed to broadcast the hour long event in afternoon drive. The credibility of our on-air talent and their relationship with their

audience – in many cases a relationship developed over the course of many years – are invaluable to the record labels in promoting music sales.

29. Radio stations are important outlets through which record companies can introduce new artists and songs to prospective record purchasers, and where repeated play can propel a song to hit status. Record companies understand that radio is still vital to music discovery and engagement, and treat it as such. Never once has a label representative ever said to me "please don't play my song on the air – it might keep someone from buying it." To the contrary, they have always wanted airplay to gain sales. And, to be clear, since we started streaming, no record company representative or artist has ever indicated any aversion to being on our streams. The content on the stream is the same as it is on the broadcast, and the promotional effect should be no different. In fact, the stream has an added benefit in that, if accessed through our website or the app, a listener can readily identify a song that we are playing that he or she may wish to purchase. We also employ a feature in the majority of our markets called Tag Station, which enhances the in car listening experience with something called "Artist Experience," which displays the artist's name, song title, and album art for the recording being performed.

30. Record companies encourage radio stations like ours to consider playing their songs by offering prizes that radio stations use in on-air promotions. They also regularly offer backstage passes, autographed merchandise, and on-air interviews with their stars to help promote their product on-air.

31. Record companies also drive spins through direct asks to the station personnel, particularly program directors and music directors. Local and national label representatives, independent promoters, and artist representatives will personally visit our stations to push specific recordings or artists, lobbying us to add a song, increase spins, or keep a song in the

rotation because “it’s not done yet.” These visits often occur on a weekly basis; some stations have to limit the hours in which these visits will be accepted. It is also very common for record company representatives to email station personnel statistics linking the number of plays a certain song or artist has received on that station with record sales and downloads; even though I am no longer directly programming a particular station, I receive these emails constantly to this day. In addition to these direct efforts, labels will advertise extensively in trade publications such as FMQB (Friday Morning Quarterback) in order to publicize airplay and encourage more airplay. None of this massive effort would make sense unless the record labels believed – as I believe – that radio spins promote sales of recorded music.

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In The Matter Of: **Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)**	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF ROBERT FRANCIS KOCAK

I, Robert Francis Kocak, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed this 3rd day of October 2014 at Boston, Massachusetts.

Robert Francis Kocak

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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF
JOHNNY CHIANG
(On behalf of the National Association of Broadcasters)

Summary

1. My name is Johnny Chiang. I am the Program Director for the radio stations in the Cox Media Group in Houston, Texas. My statement below is based on my own extensive experience in the radio industry. The royalty rates to be applied to radio stations that stream sound recordings should take into account the enormous promotional benefit that radio brings to record companies. Record companies go out of their way to induce us to play their recordings and acknowledge that radio play is the single most important way that the labels can introduce new artists and promote their music to the public.

Professional Background

2. I have been a commercial radio Program Director and Content Producer for over 25 years, with major market experience in various radio formats: News/Talk, Adult Contemporary, Adult Hits, Classic Hits, Classic Rock, Contemporary Country, and Classic

Country. I graduated from California State – Northridge in 1991 with a bachelor's degree in journalism. Following graduation, I was hired by KFI-AM radio, a Cox radio station, as a morning show news editor. I left KFI in 1993 to become a news writer for KCAL TV, which was owned by Disney. In 1994, I returned to radio to become the assistant program director and music director for KOST-FM, an Adult Contemporary format station, where I remained until 2000. I was promoted to program director in 1999. I moved to Houston, the 6th largest radio market in the country, in 2000 to join Cox as the program director for radio station KHPT. By 2010, I became the program director for all three of the Cox radio stations in Houston: KKBQ FM Country 92.9FM ("The New 93Q"), KTHT FM Classic Country 97.1FM ("Country Legends 97.1") and KGLK/KHPT FM Radio - Classic Rock 107.5 FM/106.9FM ("The Eagle 106.9 107.5").

3. I have won several industry awards, including Radio Ink magazine's "Top Major Market Program Director" in April 2013 and April 2012; and "Top Country Program Director" in 2014, February 2013, February 2011, February 2010 and February 2009. On November 1, 2014, I will be inducted into Texas Radio Hall of Fame. I have been a member of the Board of Directors of Country Radio Broadcasters, Inc., a non-profit organization based in Nashville, Tennessee created to promote the growth of country radio and the country music industry through educational programs, since January 2010. Country Radio Broadcasters' Country Radio Seminar convention and trade show is one of the largest media gatherings of any kind in the United States, bringing together nearly 1,000 program directors, general managers, promotion managers, sales executives and air talent from country radio. Our stations also have won awards. For example, our Contemporary Country station KKBQ was named Country Station of Year at

the NAB Marconi Radio Awards in 2013, and Major Market Station of the Year (regardless of format) in 2014.

Record Companies Actively Seek Airplay from Local Radio Stations

4. I have worked in the radio industry programming music for twenty years. As program director, I am responsible for all content (except for advertising) that is produced and transmitted by the stations through on air, online, social media such as Facebook and Twitter, third party applications such as TuneIn Radio and I Heart Radio, and mobile apps. As part of my responsibilities, I manage and coach on air talent, listen to and select new music, adjust the stations' playlists (at least weekly and at most once every 2 weeks), schedule music played on air, work with the marketing and promotions department to schedule on air or community promotions; and work with the sales department to make sure needs of our advertisers are met. In my view, the title "Program Director" is archaic – it really should be "Content Manager" because I am responsible for all station content.

5. Record companies depend on radio airplay to promote and sell their music. A good example is this is our Country format station, KKBQ. Country is the No. 1 format in the United States, both by number of stations and share of listening. It is not surprising that KKBQ is inundated with requests from record labels to play music by their recording artists. I have daily contact with record label promotion managers – salespeople whose job is to get their label's songs played on radio stations. These promotions managers are in constant contact with radio program directors and music directors, both building and maintaining relationships and introducing them to new music from new and established artists. They do this through every

means possible – such as in person sales calls, on the phone, and bringing artists by the radio station to meet program directors and convince them to play and promote their music.

6. Label representatives and independent radio promoters hired by the labels often initially contact us a few weeks in advance of an "add date," when a song is released for radio airplay. This gives us time to listen to the track and discuss whether to add it to the playlist. Sometimes these e-mails include digital files or invite us to download music through music services such as PlayMPE. An example of these emails is shown in NAB Ex. 26. These download services are paid for entirely by the record labels, and are free for us to preview and download music. The labels typically will provide the music track for airplay along with other supporting materials. However, I am an old school program director, and I prefer to receive hard copy CDs. Most of the promoters that we work with know this and will send me CDs with promotional material, at no cost.

7. The promoters will then follow up as they get closer to the add date. For example, last week I was contacted by a representative of Sony Music Nashville who is pitching Carrie Underwood's new single "Something In the Water" (add date of October 6) as a great new song for KKBQ by an established superstar, and with a theme appropriate for the fall season. In addition to established artists like Carrie Underwood, we often get pitches from the labels for newer artists, claiming that we have never heard anyone like them before and we need to add them to our rotation. Current examples of this are a brand new group, The Railers who are promoting their first album, and emerging artist Sam Hunt, who is promoting a new single called, "Leave the Night On."

8. The record labels expend considerable money and effort to convince radio stations to play their artists' songs. For example, The Railers are a new country act signed by Warner Music, which is heavily promoting their first album. Warner spent a year grooming the band and working on their album before recently putting them on a radio tour across the United States. Artists on these tours visit dozens of radio stations to (if possible) appear on air for interviews and performances, and very importantly, meeting with program directors. The mere travel cost of moving four band members and several label representatives across the country must be substantial - just to introduce the band to radio.

9. Other ways in which record companies try to convince our stations to play their music is through invitations to showcases and other opportunities to see acts perform live, get to know their music and judge whether they will appeal to our listeners. Our corporate policy prohibits acceptance of such trips, but label representatives still make offers out of respect for us. Last week, a label offered to fly me and our music director to San Diego to watch an established artist and a new artist in concert; we declined the offer.

10. The labels believe that that radio airplay promotes the sales of music. The promoters openly talk about how radio airplay turns into sales, giving us examples of how increased sales in the Houston market resulted from increased spins. The promoters never talk about the possibility that radio airplay substitutes for sales; it is generally accepted that the more we play a song, more often than not, sales will go up.

11. The labels constantly provide us with details touting the success of our airplay. I hear from them in person and on the phone about these successes constantly. Many of them send emails with information about how well the track and album are selling compared to the number

of plays, or "spins," our radio stations make of those tracks – usually showing that the more we play those tracks, the more sales are made. I receive four to five of these emails per month from certain label representatives that believe that this helps convince us to give radio airplay to their singles. Just a few examples are shown in NAB Ex. 27. Emails are typified by a September 17, 2014 email to me from Jill Brunett at Mercury Nashville reports, "We had a great week of sales in Houston and I just wanted to share. Since you moved Canaan up, he's increased every week. Two weeks ago, you went from 8 to 20 spins and his sales increased 125%, last week they increased another 53%. You also moved Scotty up last week. Those 23 spins helped him increase sales 73%!" An email to me from Ray Vaughn at WarnerAtlanticReprise Southwest Region opined, "**THE POWER OF KKBQ AIRPLAY IS PRETTY DARN IMPRESSIVE!"** and reported that Frankie Ballard's "Sunshine & Whiskey" "Houston sales up 87% with 25 new spins" (compared with Minneapolis up 62% with 4 new spins; Orlando up 438% in sales (the #4 selling DMA this week) with 60 new spins; and St. Louis up 668% (the #5 selling DMA this week) with 12 new spins) and Dan + Shay "Show You Off" "Houston sales up 669% (the #1 selling DMA this week) …. THANK YOU VERY MUCH". An email to me dated August 13, 2014, from Mark Niederhauser – Manager, Regional Promotion at Warner Music Nashville, reporting: "Cole Swindell 'Hope You Get Lonely Tonight' [up 68% nationally] - Sales double in Houston with 4 new spins" and "Hunter Hayes 'Tattoo' [up 27% nationally] - Houston up 40% with 15 new spins". Another email to me from Mark Niederhauser dated September 4, 2014 reports, "BRETT ELDREDGE "Mean to Me" [up +11% nationally] Houston up about 5x vs. last week with 20 new spins… As always, thanks for Your Support!"

12. Occasionally, radio promoters at the record labels will attach detailed spreadsheets that they maintain from the Nielsen SoundScan database (sales of music) and

Mediabase database (number of spins that radio stations make). Examples of these spreadsheets also are shown in NAB Ex. 27. For example, an email from Ray Vaughn at Warner Music dated June 25, 2014, attaches a spreadsheet called “Top 50 Singles & Digital Sales Mediabase & SoundScan Week Ending: 06/22/2014.” The spreadsheet shows the number of spins by country radio stations, and the “sales per spin.” A spreadsheet showing our stations spins and sales, including “TW SPS” (this week sales per spin) was provided by Mark Niederhauser of Warner Music on October 2, 2014. This demonstrates that the labels believe that our radio spins are stimulating sales of the music.

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Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF JOHNNY CHIANG

I, Johnny Chiang, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed this 7th day of October 2014.

Johnny Chiang

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Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF
BEN DOWNS, BRYAN BROADCASTING
(On behalf of the National Association of Broadcasters)

Introduction and Summary

1. My name is Ben Downs. I am the Vice President and General Manager of Bryan Broadcasting, Inc. ("Bryan Broadcasting"). In this role, I am responsible for managing nine radio stations in the College Station, Texas area as well as publishing outlets and interactive and social media in this region. I have been managing these stations for nearly 25 years. This testimony is based on my experience in the radio broadcasting industry, as well as information provided to me by other Bryan Broadcasting employees.

2. Bryan Broadcasting currently streams eight of its nine radio formats over the Internet as a service to its loyal listeners. Doing so, however, has always resulted in losses to the company. This is, in large part, because the high royalties that SoundExchange collects from us under the current rate structure exceed the revenue we are able to generate from streaming advertisements. That, combined with the cost of purchasing bandwidth and other overhead expenses, has resulted in significant losses to the company from its streaming operations. That situation does not appear to be changing. Thus, if royalties for streaming sound recordings

remain at their current rates, we will have to reconsider whether we can continue to use our successful core business (*i.e.*, over-the-air broadcasting) to support unprofitable streaming. If we cannot do so, this would be a loss for both our listeners and the record companies and artists, who gain promotional value from streaming exposure.

Background and Experience in Radio Broadcasting

3. I have over forty-five years of experience in the radio broadcasting industry, having gotten my start in 1968 as a weekend announcer at KXAR AM in Hope, Arkansas (at the age of fourteen). I held that position for three years while attending high school. While attending Texas A&M University, I worked at WTAW in College Station, Texas as an afternoon and evening announcer as well as a news reporter. Since graduating from Texas A&M in 1976, I have generally been associated with radio broadcasting in this area. I was briefly Vice President of a small group of stations located in East Texas and lived in that area for two years, from 1987-1989. During my time in Bryan/College Station, I was manager of KORA/KTAM from 1983 to 1987, returning to College Station to manage WTAW/KTSR in 1989.

4. I have held various leadership positions in the radio broadcasting industry on a local, state, and national level. I was first elected to the Board of Directors of the Texas Association of Broadcasters in 1999 by other broadcasters in the Texas radio industry. I then was elected to serve as the Chairman of the Texas Association of Broadcasters (TAB) in 2003, and was recently re-elected to this position, effective for 2015. I will be the first broadcaster to have the honor of being Chairman twice. In 2010, the TAB voted me "Broadcaster of the Year." I have served as chairman of the TAB's EAS (Emergency Alert System) Task Force. At the national level, I was elected to represent the state of Texas on the National Association of

Broadcasters (NAB) Board of Directors; I served in that capacity from 2008 to 2014. While serving on the NAB Board, I was chairman of the AM Revitalization Task Force.

5. I hold a Bachelor of Business Administration degree (Magna Cum Laude) from the Mays Business School at Texas A&M. Since graduation, I have continued to contribute to the Bryan-College Station community in numerous capacities. I serve as a member of the Better Business Bureau Board of Directors for the Brazos Valley, the Treasurer of the Research Valley Partnership (an area-wide economic development group) Board of Directors Executive Committee, and I recently served as the Chairman of the Board of the Bryan-College Station Chamber of Commerce from 2012-2014. In January 2014, I was honored in a tribute as a supporter of the Brazos Valley Museum, and in September, I was recognized as a Business Patron of the Arts by the Brazos Valley Arts Council. I also was recognized for my dedication to the Bryan-College Station region with a Jefferson Award from The American Institute for Public Service in 2012.

Bryan Broadcasting

6. Bryan Broadcasting owns and operates nine different radio formats in the Bryan-College Station, Texas region (five talk and four music formats), with the first one (WTAW) having received a broadcast license from the Federal Communications Commission (FCC) over 90 years ago, in 1922. WTAW was licensed to "A&M College of Texas" in 1919 under an experimental license as station 5YA.

7. Our stations provide listeners access to local information and entertainment and are consistently acknowledged for their commitment to their communities through service and outreach. It is worth noting that, despite industry trends, the stations employ a large number of

full and part-time employees, presently 68 people. Our separate program formats are described below.

a. **WTAW 1620 AM** is one of the oldest radio stations in America, broadcasting a News/Talk/Sports format in the Brazos Valley. WTAW serves as the flagship for Texas A&M Athletics, and its news department is also one of the most recognized in the state. We have won the “Best Newscast in Texas” from the Associated Press for the past three years. WTAW is the home of not only some of the most noted local broadcasters in the Brazos Valley but several nationally syndicated talents as well. Our website updates daily with local news gathered by our news department. As a part of our commitment to the local community, WTAW broadcasts A&M Consolidated High School sports and conducts live candidate forums in the weeks before state and local elections. The station promotes local events through no-charge announcements twice hourly. Selected pages from WTAW’s website, http://wtaw.com, are attached as NAB Ex. 10.

b. **Zone 1150 AM (KZNE)** features local and national sports programming. The Zone is broadcast on 1150 AM and is home to Texas A&M sports talk and commentary in addition to national sports coverage through nationally syndicated shows from CBS Radio. Unlike most small market sports stations, KZNE features local talk shows from 8 a.m. to 6 p.m. daily. KZNE broadcasts the sports play-by-play of Bryan High School as well as several on-location local weekend sports programs. Selected pages from The Zone’s website, http://zone1150.com, are attached as NAB Ex. 11.

c. The Zone HD (KNDE-HD3) is usually a simulcast of our KZNE AM 1150 station. However, we program it separately when there are sports event schedule conflicts and also for play-by-play of Texas A&M Olympic sports.

d. **Candy 95.1 FM (KNDE)**, on air for about a decade, prides itself on service and contact with its audience. It broadcasts a Contemporary Hits Radio format and boasts a number of successful local radio personalities that have helped grow the Candy 95 brand. Candy 95 has large online followings at candy95.com, on Facebook, and on Twitter. In keeping with the belief at Bryan Broadcasting that public service comes first, Candy 95 spends countless time producing and promoting numerous area charity events. In 2012, the National Association of Broadcasters awarded the station its Crystal Award to recognize Candy 95's commitment to serving the local community. This year, KNDE was one of five finalists for the prestigious Marconi Award. In addition to community guests who appear to promote their events, Candy 95's Street Team will often appear at area events (at no charge) to provide music and on-air mentions. Selected pages from Candy 95's website, http://candy95.com/, are attached as NAB Ex. 12.

e. **Peace 107:7 FM (KPWJ)** is a relatively new station in the Bryan-College Station area, going on-air in 2012. Peace 107 airs Contemporary Christian music and programming and is home to a roster of locally broadcast shows and local on-air talent. These include daily shows hosted by our on-air staff Brian Christopher (6-10 a.m.), Kat McMullen (11 a.m.-1 p.m.), and Jami Mayberry (2-6 p.m.). The station bills itself as uplifting and encouraging. It does not proselytize but rather shares stories of encouragement and blessing with its listeners. Peace 107 also promotes local events through no-charge announcements hourly. Selected pages from Peace's website, http://peace107.com, are attached as NAB Ex. 13.

f. **KAGC 1510 AM Christian Family Radio** is a Christian Teaching/Talk station that centers on providing the Bryan-College Station region with a focus on family, faith, and talk. The weekly schedule at KAGC 1510 AM includes sports, news, and weather in addition to the worship related lineup. The Christian-based elements of Christian Family Radio's segments feature nationally syndicated shows, including Chuck Swindoll's Insight for Living, The Dave Ramsey Show, and Family Talk with Dr. James Dobson. The station also broadcasts local programming, including "Bonus Breakaway with Ben Stuart" (a daily segment from the non-denominational weekly Bible study on the campus of Texas A&M), periodic local weathercasts, and daily local news headlines aired during drive times. The station has a Polka show that is broadcast on Saturday and Sunday afternoons. This long standing program is in recognition of the earliest settlers in this area and their descendants who emigrated from the Czech Republic region of Europe. KAGC is a daytime station, licensed to operate only during daytime hours. Selected pages from KAGC's website, http://kagc1510.com, are attached as NAB Ex. 14.

g. **Navasota News 1550 AM (KWBC),** located in Navasota, Texas, is a local news station that broadcasts local news and syndicated talk programming. There are only two employees at the station; both are news people. Navasota News also broadcasts Navasota high school sporting events to the surrounding community. Before its acquisition by Bryan Broadcasting, the station had failed financially and was dark. Selected pages from KWBC's website, http://navasotanews.com, are attached as NAB Ex. 15.

h. **Rock Candy (KNDE-HD2)** broadcasts a rock format on an HD channel. This station, launched in 2011, is a music-only format. Selected pages from Rock Candy's website, http://aggielandsrock.com, are attached as NAB Ex. 16.

i. **Maverick 102.7 (KNDE-HD4),** launched in August 2014, airs country music aimed at younger audiences. In addition to airing country music, the station's programming includes daily morning, midday, and evening shows featuring local announcers. The station shares the news department with WTAW and broadcasts hourly local news in the morning as well as local public service announcements throughout the day. Selected pages from Maverick's website, http://maverickradio.com, are attached as NAB Ex. 17.

8. In addition to the nine active radio operations described above, Bryan Broadcasting is in the process of preparing to launch three additional stations in the area: WTAW-FM 103.5 (Buffalo, Texas); KVMK-FM 100.9 (Wheelock, Texas); and KKEE-FM 103.1 (Centerville, Texas). The specific content to be broadcast from these stations has not yet been fully determined.

9. For five consecutive years from 2008 to 2012, and again in 2014, the Texas Association of Broadcasters has chosen Bryan Broadcasting as the recipient of the Bonner McLane Public Service Award, which recognizes a radio or television station's contributions and service to its local communities. WTAW and KNDE have been finalists for the National Crystal Award every year from 2010 to 2013. WTAW has received numerous awards from the Associated Press for reporting. The stations also have received special recognition for no-charge public service commercial donations by the Texas National Guard.

Streaming

10. WTAW was one of the first radio stations to be streamed and has been available online since the mid-1990s. Bryan Broadcasting streams most of its other radio stations as well. The streams can be accessed at www.bryanbroadcasting.com and at www.radioaggieland.com, through our Radio Aggieland mobile app, and through the individual station websites. It is my understanding that our streaming audience is but a tiny fraction of our broadcast audience.

Bryan Broadcasting's Difficulty in Making Streaming Profitable

11. Despite our continuing efforts to monetize our streaming, it has always been a money-losing proposition for Bryan Broadcasting. While we make each of our stations' programming available online as a service to our listeners, many of whom are college students, the advertiser community to which we sell simply does not value streaming the way that it values our broadcasting operations. There is an aphorism that compares "Analog Dollars and Digital Dimes," which reflects our experience. Our cost per thousand (CPM) prices for over-the-air ads vary across our broadcast stations, but streaming in a market our size is of little or no value to advertisers. This makes it difficult for us to make money from it.

12. To illustrate, we have an ad insertion agreement with our stream provider, under which the provider undertakes to sell streaming-specific ads for a fee to advertisers for any or all of our stations. Bryan Broadcasting receives **[[ ]]** of the revenues from that effort. This agreement generates revenues across all of our stations of less than **[[ ]]** per month, often much less. For the first eight months of 2014, total advertising revenues across all of our stations from streaming were about **[[ ]]** – an average of about **[[ ]]** per month for all stations combined. NAB Ex. 18. Other than this insignificant income, the only other streaming revenue of note that we receive is unrelated to our music stations. We receive **[[ ]]** per month for the

splash screen on our mobile streaming player, and **[[ ]]** per month for the pre-roll that is activated when accessing the stream through the WTAW and KZNE talk station websites. Although we have no technical way to limit the splash screen on our mobile app to a single station, the client (The Bank and Trust) bought the product for the WTAW talk show and news stream only.

13. The minimal income that our streaming has been able to generate and the lack of interest by advertisers in our streaming show how little advertisers value this medium, particularly for music stations. Local advertisers especially are uninterested in purchasing our streaming products. Streaming does not even have the same money-making ability as selling bumper stickers. For example, in July 2014 we were able to sell an ad on the back of our Maverick 102.7 bumper sticker with our initial order of 6000 stickers for **[[ ]]**.

14. Apart from the few inserted ads discussed above, the ads on our streams are identical to those that Bryan Broadcasting runs over the air with the exception of national advertising, which we cover with public service announcements so as to avoid any issue with the American Federation of Television and Radio Artists ("AFTRA") or its successor (now "SAG-AFTRA"). We do not receive any extra money for running these simulcast ads on our streams. Currently, our local advertisers are included in our on-line stream. If we were to remove their commercials from the stream unless they paid an additional charge, we would need to justify that increase in advertising cost to our advertisers. In my experience, unless it was an insignificant amount (like 50 cents or a dollar) they would simply ask that we not include their commercials in the stream. In fact, recently we received a rate request from an advertising agency that specifically requested that we treat streaming ads as "value added" items for which the advertiser

would not be charged. “Valued-added” is ad agency-speak for something that should be thrown in at no charge because the agency does not believe it has meaningful value.

15. We have been unable to interest advertisers in even our most listened-to streaming stations. Our most listened-to streaming station, WTAW AM, had **[[ ]]** average concurrent listeners (ACL) and **[[ ]]** aggregate tuning hours (ATH) during the 12-month period from October 1, 2013 to September 29, 2014. Our most listened-to music formatted station, Candy 95, had only **[[ ]]** average concurrent listeners (ACL) and **[[ ]]** aggregate tuning hours (ATH) during that same 12-month period. As mentioned above, it is my understanding that our streaming audience is but a tiny fraction of our broadcast audience. As discussed above, advertisers view streaming ads as something they want us to thrown in for free when they purchase broadcast ads for any of our stations. To me, this demonstrates that, at least for markets and streaming audiences of our size, streaming ads have no intrinsic value to advertisers. Based on my experience, I am confident that even if we were able to grow our streaming audience to 100-200 average concurrent listeners, advertisers would still be unwilling to purchase streaming ads from us.

16. Our difficulty in making our streaming operations a viable standalone business is compounded by the linear nature of the royalties that we are required to pay to SoundExchange to perform sound recordings in our streamed programming. These royalties increase by a fixed amount for every additional listener to a sound recording performance. We are in a Catch-22. In order to even begin to interest advertisers in our streaming audience, we need to increase our listener base significantly. But if we become successful in doing that, our streaming royalties and other costs would increase dramatically and in direct proportion to that increased

listenership. Based on our understanding of our markets, our revenues would never catch up to the costs.

17. By way of example, our streaming ad income from our stream provider is measured by the cost-per-thousand (CPM), meaning the amount our Internet streaming provider receives for every 1000 ad impressions. An ad impression is a single instance of listener exposure to a streamed advertisement. Our provider's CPM for streaming on a weighted average for the January-August 2014 period was **[[ ]]**. NAB Ex. 18. We receive **[[ ]]** of that amount, which is equivalent to **[[ ]]** CPM, typically for 1 minute ads. NAB Ex. 18. The streaming royalties paid to SoundExchange at the 2014 rate of 0.23¢ per performance, alone, is equivalent to $2.30 CPM.

18. The lack of demand limits the number of ads our stream provider can sell on our streams. Even if the provider could sell the same number of ads as there are songs in a period of programming, which they cannot, we would still come out way behind. For each 1000 listeners who hear ads, we receive only **[[ ]]**. During that same period, because there are more songs than ads, we would have to pay SoundExchange more than 1000 times $.0023, or more than $23.00. Further, we have not seen increases in demand for ad CPM, and do not expect increases in the foreseeable future. If we succeed in attracting more listeners, our costs increase at a faster pace than our revenues. The increase in rates scheduled to take effect in 2015 will only worsen this already untenable situation.

19. The linear increase in streaming royalties under the present rate structure compares very unfavorably to broadcasting, where our transmission costs are fixed and each incremental listener costs us nothing to serve. In that medium, the more successful we are, the more revenue we generate. With streaming, the opposite is true – the more listeners we attract,

the more it costs us in streaming fees and bandwidth charges. The additional costs, however, are not accompanied by a commensurate increase in revenues. For example, while our streaming revenues have remained insignificant over the past three years despite having added additional streaming stations, our SoundExchange royalties have increased from approximately **[[ ]]** in 2011, to about **[[ ]]** in 2012, to over **[[ ]]** in 2013. NAB Ex. 19. We generated streaming revenues of only about **[[ ]]** in 2012, **[[ ]]** in 2013, and **[[ ]]** in the first eight months of 2014. A system that imposes fee increases that far exceed any revenue growth is unsustainable.

20. So far in 2014, we have lost over **[[ ]]** on our overall streaming operations. Our total streaming revenue through August – for <u>all</u> of our stations combined (both talk and music formats) – is **[[ ]]**. More specifically, from January through August of this year we earned **[[ ]]** for our phone app splash screen and **[[ ]]** from streaming ad insertions – but as noted above the splash screen was actually purchased for use with a non-music station, WTAW. On the other hand, we incurred Internet bandwidth fees of **[[ ]]** (through July) (NAB Ex. 20), stream player fees of **[[ ]]** (through August) (NAB Ex. 21), and streaming royalties to SoundExchange of **[[ ]]** (through August) (NAB Ex. 19). Of course, a significant portion of our bandwidth and player expenses is associated with streaming of our non-music formats, but our SoundExchange fees are almost entirely attributable to the streaming of our music formats. Even setting aside all the other costs involved (such as sales commissions and general overhead expenses), and any allocations of our programming costs, our music streaming operations resulted in a significant loss for the company. With the current SoundExchange rate structure our sound recording performance fees alone already far exceed

our streaming revenues. If our audience grows, our losses will only increase unless those rates are reduced significantly from their current level.

21. The current rate structure, with its automatic annual increases, has already caused our streaming fees to increase even where the number of streamed performances has decreased from previous years. For example, in the following illustration based on KNDE-FM (Candy 95) and KNDE-HD2 (Rock Candy) we showed a **[[ ]]** decrease in listeners yet fees increased **[[ ]]**. For the months of January 2011 through August 2011, those stations' performances totaled **[[ ]]**. That number decreased to **[[ ]]** for the same eight month period in 2014. But the royalty paid for those performances increased from **[[ ]]** to **[[ ]]**, an increase of **[[ ]]**. The increase for 2015 (to 0.25¢) will be 47% above 2011's rates, further compounding this problem.

22. The location of our audience base presents another catch-22. Eighty percent of our ads currently are from local businesses. As I have said, we cannot even convince those advertisers that our local streaming audience has any value. Our local listeners are the same ones who can listen to our radio stations over the air. With respect to the portion of our streaming audience that is non-local, which is a minority of our listeners, our advertisers are even less interested in reaching that audience. Why would someone from Chicago, for example, be interested in a special at a local restaurant? Yet I am required to pay SoundExchange royalties for both local and non-local listeners who I simply cannot monetize.

23. While we would like to continue offering streaming service to our listeners, we do not believe that it is essential to our existence. Like leather seats in a car, it is nice to have, but not necessary. If streaming royalties are not reduced, our losses will only continue to increase. We will have to consider dropping our streaming services and dedicating those resources to our

core business – *i.e.*, over-the-air broadcasting. Based on my review of our streaming financials in connection with preparing this testimony, I have concluded that our company should seriously consider ceasing our streaming operations, as we may already have reached the point where the costs associated with streaming, particularly for our music formatted stations that generate unsupportable SoundExchange fees, is too expensive to justify.

Bryan Broadcasting Stations Succeed for Reasons Other than Streaming Recorded Music

24. The success of Bryan Broadcasting's stations, including its music formatted stations, is the result of their close ties with the local community that come from our staff's community involvement, listener loyalty, and on-air programming. We have found, after more than a decade of streaming experience, that streaming contributes very little, if anything, to our success.

25. There are a number of elements that contribute to the success of our radio stations, most of which have little or nothing to do with music content. Recorded music has almost nothing to do with the success of our four news/talk/sports stations, as we air virtually no featured music on them (it is worth noting, however, that we still must pay SoundExchange a minimum $500 annual fee to stream these stations). Rather, these stations broadcast news, talk, teaching, and sports programming, including live sporting events. Our local sports coverage is very popular. When we broadcast Texas A&M football on WTAW, for example, we often reach on-line listening levels that far exceed those of our music formatted stations.

26. The key to the success of our music stations is their unique programming. Streaming our music stations is nice, but a song by Katy Perry sounds the same in LA as she does in College Station, Texas. The difference is presentation and what is between the songs. If

there were no unique entertainment proposition to the listener, they would not seek us out just because we are on-line. On-line music-only choices are legion. Music stations with unique College Station content are rare. This is illustrated, for example, by the spikes in Candy 95's listener volume that occur on each weekday when our most popular daily shows are broadcast, in contrast to the low level of activity for that station on weekends.

27. One of the most critical ingredients to the popularity of our stations is the people who work for them. Making the investment to have a full-time, local staff is an important driver of the success of our stations and forming listener loyalty with our brands. I believe that a full-time staff is vital to elevating our stations' identities in the marketplace. People crave friendship. A sincere voice talking about local "things" is often considered a friend who is never met. My background is programming. I sometimes will be a guest on the air of the stations because, as I tell my staff, "I didn't get into this business to read spreadsheets all day." My longevity in the market combined with these on-air appearances mean that I get to shake hands with people I've never met who believe they personally know me through on-air contact. People consider me a friend because we've laughed about some absurdity of life on the air. A jukebox never engenders that sort of connection or friendship. For that, you need people. Again: Katy Perry's music sounds the same in LA as it does back home, but in LA, they aren't talking about the new restaurant on University Drive or the excitement of the Christmas Parade on Sunday.

28. An important part of our staff – and people who contribute immensely to the success of our stations and enhance their connections with the surrounding community – is our on-air talent. These are the people that listeners keep tuning in to spend time with and with whom they form loyalties. For example, Candy 95 has morning, mid-day, afternoon, and evening local shows. The host of Candy 95's afternoon show, airing from 2-6 p.m. weekdays,

Adam Knight, has been the host for over ten years. Candy 95's morning show has been hosted by Tucker "Frito" Young for seven years. His show actually makes a point to emphasize that relational talk programming, rather than music, is its focal point, using the slogan "less music more talk." The show maintains dominance in the market by connecting to the audience every day via emails, texts, and phone calls. Receiving hundreds of text messages from listeners in a single morning is common.

29. We expect our personnel to connect with the communities that our stations serve and to promote our stations throughout those communities. To that end, our employees engage in a variety of activities to strengthen those community ties, including participating in charity events and performing volunteer work. For example, each year, KNDE and WTAW sponsor the Christmas Angels toy drive, which provides toys and clothing to 700 needy area children. Katy Dempsey raises money for the local Special Olympics athletes with a touch football tournament. Tucker Young adopts and fosters pets from the Humane Society; regular guests on his morning show. Mary Hatcher raises money for cancer research. Scott DeLucia is working to rebuild the Bryan Downtown area and to encourage local artists to locate there. Everybody works on fundraising for area charities and speaking to classes. We also send our staff to major community and fundraising events. For example, three of our staff recently attended a ribbon cutting ceremony for a local bank, which donated $100,000 to the United Way. It was on the news the next morning. This connection to the community means that members of that community are comfortable calling us when they need assistance.

30. Another important ingredient of our stations – including our music-formatted stations – is the news, local weather, and other community information that they broadcast. It is valuable for our stations to have people in the local market talking about stories we covered and

the topics we brought forward. Our music stations, Candy 95, Maverick, and Peace, feature non-music related content that enhances listener loyalty. For example, Peace107 will often open the lines to callers on a topic like "the best advice Mother ever gave you." One of Candy 95's secret weapons is to solicit listener opinion about national – and especially local – issues (would you eat what the new lunchroom standards for kids mandates?). Maverick, being new, is still developing its relationship with listeners by taking on-air listener phone calls for requests, comments, and exploring what attracted listeners to the station. All three of our broadcast music stations feature local public service announcements every hour, provide morning local news updates, and make traffic announcements whenever traffic flow is slowed.

31. Our stations also broadcast many special features that enable our listeners to interact with us and thus further increase our ties with them. For example, we announce contests over the air that listeners can enter online, by calling in, or by texting. One example of such contests is a contest we recently ran on Candy 95**,** where we gave away movie tickets to the Twilight marathon to the 95th texter to respond. We received 4,000 texts in response to this contest within less than fifteen minutes, showing how engaged our listeners are in interacting with us. The on-air staff at Candy 95, Maverick, and Peace frequently take calls and invite discussion of topics of local interest.

32. In addition to our broadcast programming and on-air talent, the content that we display on our websites is another important tool in increasing our brand loyalty. For example, Peace107.com includes postings of upcoming community events of interest to listeners, allows listeners to submit calendar events, includes uplifting blog posts and daily scripture readings, as well as a link to an order form for obtaining free copies of our publication "Peace Magazine." Candy 95's website, Candy95.com, includes a web page that provides information about various

contests that listeners can enter on-line and/or listen for. Maverickradio.com features local news as well as music and local performance venue information. Our non-music stations post extensive news, sports, weather, and community interest information. The stations share a common “My Photo” site. Whenever we’re involved in a large event, we take many photos and upload them onto this site and encourage attendees to download them for free.

33. We further strengthen our listeners’ connections with many of our on-air personalities by providing more information about them on our station web pages. The Candy 95 web page, candy95.com, contains links to web pages for our on-air staff and for our Morning Candy show and its co-hosts, Frito (Tucker Young) and Katy. For example, Adam Knight posts the answers and winners of his daily “Road Warrior Trivia” contest on his web page. Peace107.com contains self-descriptions of Peace 107’s on-air staff as well as frequent postings by the station’s DJs, such as short articles, recipes, and life lessons. Our recently-launched Maverick 102.7 website, maverickradio.com, includes web pages featuring our show “The Morning Mavericks with Drake & Mel” and our afternoon show “Drew Williams,” along with a blog site with postings by Drew.

34. We also maintain Facebook and Twitter pages for many of our stations and include links to those pages on our station websites so that listeners can more easily find them and communicate with us. For example, Candy 95’s website has links to its Facebook page, Twitter page, and You Tube page, as well as a link to the Facebook page for the Morning Candy show. The level of activity on these media fluctuates from week to week, but is always significant. As of October 2, 2014, Candy 95 had generated over 15,000 Facebook “Likes” and had a weekly reach of over 37,000. Interest generated by our Facebook posts involving issues of local interest far exceeds interest in our postings related to music. For example, some recent

Facebook postings by the station show that while new music posts reached about 1500 Facebook users (NAB Ex. 22), the station's posts about lost dogs have reached more than 10 times that amount – reaching over 15,000, or even 80,000. (NAB Ex. 23) Candy 95 currently has over 4,600 Twitter followers. As discussed above, our stations also make extensive use of texting to strengthen the bond between the station and its listeners. Candy 95 consistently receives thousands of texts each month.

<u>Our Stations Promote Artists</u>

35. Our music formatted stations are recognized as a means for artists to increase their exposure and become better known. For example, Maverick is a very new station but already has been sought out by musicians who are performing locally. Our studio is not even completely finished, yet last week, I watched an up and coming group put all five members, guitars, and a drum kit in the room to provide a demo to the audience. Radio is a particular friend to Country Music. Country artists, whether charted or not, recognize the promotional value that over-the-air radio provides – Maverick 102.7 has only been on the air for a couple of months, and, so far, these artists have visited or are scheduled to visit our small town station: Roger Creager, Aaron Watson, Josh Abbott, William Clark Green, Granger Smith, Kyle Park, Wade Bowen, Sean McConnell, JB and the Moonshine Band, Sam Riggs, Jason Eady, and Texas Tenors. These artists could simply put their music on YouTube and be in the digital, streaming world. But they choose to make appearances on our station and its stream.

Before the
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In The Matter Of: **Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)**	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF BEN DOWNS

I, Ben Downs, declare under penalty of perjury under the laws of the United States that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed on October 6, 2014.

Ben Downs

G

Before the
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LIBRARY OF CONGRESS
Washington, D.C.

In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF
JULIE KOEHN
(On behalf of the National Association of Broadcasters)

INTRODUCTION

1. My name is Julie Koehn. I am the President and General Manager of Lenawee Broadcasting Company, the licensee of WLEN Radio, in Adrian, Michigan. I have held that position since 1990.

2. I offer this testimony to discuss why radio broadcasters and the programming they transmit are so important to the communities they serve. At any moment, we may be charged with keeping our community and the public at large safe in storms and power outages. At any moment, we may be charged with broadcasting an Amber Alert to help find a lost child, or helping find an adult who wanders off from a care facility. At any moment, we may be charged with broadcasting critical information regarding a local or national emergency.

3. I discuss below the ways in which WLEN fulfills this important role in the Lenawee County, Michigan community by providing local news, political coverage, weather, and community information, keeping our citizens safe during storms and power outages, providing tens of thousands of public service announcements each year, volunteering for various

causes, and supporting fundraising events. We also play music, but that is not the primary reason people listen to us, and it is not what makes us unique or important in the lives of the people in our community.

4. WLEN would like to simulcast its broadcast programming over the Internet in order to serve Lenawee County even more effectively, but we do not. Other than local sporting events, political debates, and government meetings of community interest, we do not stream. Our main reason for this is that we would be required to pay royalties to SoundExchange for the least unique part of our programming, and these royalties are much too variable and unpredictable to be able to design a stable business plan for streaming.

PROFESSIONAL BACKGROUND

5. I began my broadcasting career in 1985 after graduating from Michigan State University with a Bachelor of Science degree in both industrial and labor relations and political science. I have served as President of Lenawee Broadcasting Company for the past 24 years.

6. I currently serve on the Radio Board of Directors for the National Association of Broadcasters ("NAB"). I also have served on the Michigan Association of Broadcasters ("MAB") Board of Directors, including service as chairman in 2005-2006. In addition, I have served on the Board of Directors for the MAB Foundation, serving as chairman in 2012-2013. I serve on the Radio Advertising Bureau Small Market Advisory Committee and have been a featured and panel speaker on small market radio at multiple NAB and Radio Advertising Bureau annual conferences as well as at MAB and the Illinois Broadcasters Association events.

WLEN RADIO AND ITS DISTINCTIVE PROGRAMMING

7. Lenawee Broadcasting, the licensee of WLEN, has always been a family company. My father put WLEN on the air in June 1965 at a time when few people had FM

radios. The station's first promotion was to give away FM radios so that people could hear the transmission. Unfortunately for many in our listening area, we went on the air two months too late, as devastating tornados swept a nearby community on Palm Sunday in April of that year. WLEN was not yet broadcasting to be able to warn the community of the danger, and two tornados in the same path on the same day killed many local citizens.

8. Our company is unique. We believe that "if you build it, they will come." WLEN has received national, regional, and state recognition for news, public service, and promotions. It has won many awards – including five NAB Crystal Radio Awards in 1998, 2001, 2005, 2010, and 2014 for excellence in community service, three NAB Education Foundation Service to America Awards, Service to Children Awards, one NAB Marconi Award for AC Station of the Year, and seven MAB Station of the Year Awards in 2002, 2003, 2005, 2006, 2008, 2009, and 2011. WLEN also was named the 2010 NAB Small Market Station of the Year and has been recognized by the University Press Club.

9. WLEN offers unique programming. We are located on a very crowded dial, with fifty-six small, medium, and major market signals coming into the community, so to distinguish ourselves, we have to offer programming that is different and relevant to the citizens of Lenawee County. We focus on local news and local community information, employing a full time news department and the services of a meteorologist. Our county has no local television stations and only one daily newspaper, so the public depends on us for local news and information. We aired nearly 4,000 newscasts and nearly 17,000 weather programs in 2013 alone and do over 100 remote broadcasts from the community each year. We have a weather line with the latest forecast available 24/7 as well as the local forecast from the National Oceanic and Atmospheric Administration ("NOAA") available on our website, and have even donated tower space for

NOAA's use. We broadcast a four-minute community calendar five times a day, a fifteen-minute local information program called "Community Conversation" four to five times weekly hosted by our Program Director, and "Partyline Now," a three-and-a-half hour talk show that serves as a citizens' public forum. We also cover city/village, township, and county government meetings each month as well as eleven local school districts. In addition, we air Radio Picoso, the county's only live and local Hispanic radio show each week connecting to the large Spanish speaking population in our community.

10. While we do play music and are considered an Adult Contemporary format station, music is not the number one reason why people listen to WLEN, and it is not what makes us unique. If listeners were only interested in hearing wall-to-wall music, there are many other ways for them to do so. Rather, it is our local community focus that makes us stand out in the crowd. Even our music programming is live and local, with the exception of two weekend specialty shows.

11. WLEN carries more local sports than any other local station in our area. In the fall, we carry Adrian High School Maple football and football from two of our colleges, Siena Heights University and the Adrian College Bulldogs. Our basketball schedule includes an all-county schedule of high school and college games. WLEN's coverage includes live play-by-play commentary on these events. A listing of the programming that we offer is included as NAB Ex. 24.

12. Our staff consists of fourteen full-time and three part-time broadcast professionals. This is a very large staff for a station in our size community. The reason we employ such a large staff is to be able to provide the citizens in our coverage area with the

information they want and need, with live announcers nineteen hours each day, Sunday through Friday, and eleven hours on Saturdays.

13. Our on-air talent and the loyalty our listeners develop towards those personalities is another reason WLEN stands out in a crowded market. Our morning show host, Steve Barkway, has been with the station for over thirty years. Our night shift DJ from 6 p.m. until midnight weekdays, Mike Reynolds, has been with WLEN for sixteen years. We have about 150 years of combined experience under our roof.

WLEN'S STRONG COMMITMENT TO COMMUNITY SERVICE

14. A core part of who we are is our service to the Lenawee County community in which we broadcast. WLEN takes community service very seriously. This is yet another attribute that makes radio broadcasters and their programming so different from online music services that simply play wall-to-wall music and have no real connection to the communities where their listeners are.

15. WLEN listeners are very loyal to the station because WLEN is loyal to its listeners. We donate over $800,000 in cash and in-kind advertising and promotion to local nonprofits each and every year. Our announcers and staff volunteer hundreds of hours, both on and off the clock, sitting on nonprofit boards, emceeing local fundraising auctions, running coat and blanket drives, and collecting funds for homeless veterans and socks and pjs for our unattended youth. In 2012, we launched a public service announcement ("PSA") contest for youth to bring awareness to bullying in our schools. WLEN also has participated in community events such as walking in the "Walk for Warmth" to help needy families pay their utility bills and has participated in "learn to read month," reading to kids in schools. In 2013 alone, WLEN broadcast over 54,000 public service announcements and generated more than 400 hours of community affairs programming.

16. As I mentioned above, we also keep our listeners safe during weather emergencies. We are the only local station in our area to have auxiliary power at both our studio and transmitter sites, which keeps us on the air during power outages and storms.

17. Homelessness, hunger, and unemployment are priority needs in our community. WLEN has especially worked to meet those needs. While we have always served, we saw a much greater need when the great recession hit Michigan and the pool of those able to help greatly diminished with our population decline. People left the state to find work, and those who couldn't now needed services they never dreamed they would ever need. And those that needed services before the recession needed more services than ever before. Our focus was helping those in need and promoting ways to achieve self-sufficiency. As a 3,000-watt single FM station in a community of 20,000, we reach over 100 organizations; from local food banks to education and housing programs. In 2013, we assisted local non-profit organizations in raising over $2,000,000 in community by giving through donations of cash, advertising, and promotion.

18. Several years ago, we implemented our "Hometown Hope" program because we saw a critical need in the non-profit community. Organizations needed help getting information out to the population that could help them. Each month, we donate a $3,500 marketing grant to a different local non-profit organization. These organizations receive a two-hour live broadcast, a fifteen-minute interview on our "Community Conversation" program, and a live interview on our morning show, as well as a bank of 150 commercial/PSA announcements for their use during the month. We also featured these charities on our website. WLEN's 2013 Report to the Community describes the twelve charities that we helped in that year and many of the other ways in which we served the Lenawee County community in 2013. *See* NAB Ex. 25. We will always

work to continue to strengthen our local community and help people and organizations help themselves and help each other.

19. As a result of these strong community ties and the ways that we differentiate ourselves in the market, WLEN maintains a very large portion of the over-the-air radio audience in Lenawee County, Michigan.

WLEN'S DECISION NOT TO STREAM

20. We have considered whether to stream WLEN as another means of reaching our listeners. Other than local sporting events, political debates, and some governmental meetings of community interest, however, we decided against it because we are concerned with the unpredictable cost of SoundExchange royalties. These costs can rapidly spiral out of control under the current per-performance structure because they increase with increased listenership.

21. We are particularly concerned about incurring expensive and unpredictable SoundExchange royalties if our stream were to become popular among our listeners. To help me assess the potential financial impact on our station of SoundExchange royalties, I calculated what those fees would be if we had 100 listeners on average to our stream. At the 2014 rate of $0.0023 per performance, and assuming that eleven recordings per hour are transmitted, those fees would be $61 per day, or over $22,000 per year. We do not believe that streaming would generate additional revenues sufficient to cover these significant royalties, let alone the other costs that would be incurred if we began to stream, which reinforces our decision not to stream. The more popular we become, the more unpredictable and expensive the costs would be, and we would be paying those costs for the least unique part of our programming; not for the programmatic reasons that listeners tune in to us. This is an unstable and unpredictable business model, and we cannot just roll the dice.

22. I am not aware of any small broadcasters who are streaming their broadcast programming and making a profit from it.

23. It would be possible for me to impose listener caps on online listening, but I do not believe that this makes business sense. I do not believe that it would be good for our brand, our reputation, or our service to our community if we offered streaming but then barred people from listening to it if it becomes too popular. How would you like to be listener number 101, who could not listen to the stream when you were trying to hear your daughter's name announced as our Student of the Day or as our 4-H member of the week? Or how would you like to be working in an area where you could not receive our terrestrial signal and you needed information because your child's school was just placed in lockdown, or where there was a chemical spill in your neighborhood and your kids were home alone? We would be doing a disservice to our community by limiting our stream.

24. We would reconsider our decision not to stream if the formula for streaming royalties becomes predictable, stable, and reasonable.

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In The Matter Of:	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

DECLARATION OF JULIE KOEHN

I, Julie Koehn, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed on 10/6/14

Julie Koehn

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Before the
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In The Matter Of:	)	
	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)	**14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT TESTIMONY OF JEAN-FRANCOIS GADOURY
(On behalf of the National Association of Broadcasters)

Summary

1. My name is Jean-Francois Gadoury. I am the Chief Technology Officer of Triton Digital ("Triton"). My primary role at Triton is to oversee the strategic direction of our company in terms of technology. I began my career as a programmer analyst and consultant for Cesart International, a Bell Canada company, where I was involved in VOIP and fax over IP, among other technologies. I later went on to work at CESCOM, Tata Communications (formerly Teleglobe) and Atlas Telecom Mobile. I am a computer and networking expert with extensive software, hardware, and networking experience.

2. Triton Digital provides to many prominent audio broadcasters and webcasters a technology that allows them to stream over the Internet. Our customers include Cumulus, CBS Radio, Cox, NPR Digital Services and many others. I am providing this witness statement to describe some of the technological issues an audio

webcaster could face with respect to counting and identifying the number of listeners for streamed sound recordings.

3. To meet its reporting requirements, an audio webcaster may seek to count the number of performances of each sound recording, where the count represents the number of sound recordings streamed within a certain time period, and multiply each sound recording by the number of individuals who have listened to the applicable sound recording. When a service counts performances of sound recordings in a digital Internet stream, several situations may lead to counts that may not represent the true count. That is because there can be connections made to the stream that do not objectively represent an actual human listener.

4. Within the process of using technology to hear a digital Internet stream, a human must rely on hardware and software designed to render the digital content audible. These hardware and software components need to perform multiple operations to obtain content and play it for the human listener. In counting the number of listener sessions to an Internet stream, situations arise that could cause performances to be counted where they should not. I describe here two potential scenarios that illustrate the issues an audio webcaster seeking to count performances for reporting purposes could face.

Scenario 1 – Discovery Connection by a Media Application

5. In this case, the listener's media application will initiate a connection to a given stream and only seek to receive the header information returned by the streaming server software to which it is connecting. Upon receiving this information the media application might then proceed in connecting a second time to the streaming server. This

second connection will be the one that will be used to receive the actual audio content and playback to the listener will occur. This scenario occurs because of the way certain third party application developers have designed their applications.

6. This situation demonstrates one scenario in which, although two connections occurred, only one connection is valid for counting of sound recording performances. If each connection is used to count sound recording performances, the count of a performance for the sound recording playing during those two connections will result in a count of two even if only one of those two connections actually served to play content to the listener.

Scenario 2 - Disconnection of a user due to stream instability

7. The Internet is a network that is generally stable. At the same time it is also a dynamic environment in which network conditions can vary day by day or even second by second. When disruptions do occur, some applications that are using the Internet to send and receive data may be affected. Streaming of music is one such application and is therefore subject to those varying conditions.

8. When network conditions become unfavorable, it is possible that a media application playing back content to a user may get disconnected from the streaming server for various reasons.

9. When a disconnection occurs, the media application will automatically attempt to reconnect to the stream it was connected to. In this situation, the media application will usually reconnect very quickly, and a listener may not even notice the disconnection.

10. However this disconnection will result in a new session being generated and therefore there will now be two sessions spanning the same song performance. If the two sessions are used as is, the sound recording performance would be counted twice for the same sound recording.

11. On an individual basis this typically does not present a large problem for an audio webcaster seeking to count performances for reporting purposes. However, if the instability is sufficiently widespread enough, thousands, or tens of thousands, of media applications might be affected at the same time, and there can conceivably be a significant number of extra performances counted if each connection is counted as a performance, and corrections are not made to account for multiple connections being attributable to the same person.

12. The above can result in a count of performances that is high. That is, an audio webcaster seeking to count performances for reporting purposes may count connections or sessions during which a human heard one performance of a sound recording but the sessions reflect two performances of the sound recording.

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DECLARATION OF JEAN-FRANCOIS GADOURY

I, Jean-Francois Gadoury, declare under penalty of perjury that the matters set forth in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information and belief.

Executed this 7th day of October 2014.

[SIGNATURE FORTHCOMING]

Executed on ___________________

____
Jean-Francois Gadoury