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UNITED STATES COPYRIGHT ROYALTY JUDGES
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Washington, D.C.

In the Matter of: Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)	Docket No. 16-CRB-0003-PR (2018-2022)

PANDORA MEDIA, INC.'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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INTRODUCTION

Pandora Media, Inc. ("Pandora") is pleased to present its Proposed Findings of Fact and Conclusions of Law to the Copyright Royalty Judges (the "Judges"). Pandora is also pleased to present, together with Amazon Digital Services, LLC ("Amazon"), Google, Inc. ("Google"), and Spotify USA, Inc. ("Spotify") (together with Pandora, the "Services"), the Joint Services' Proposed Findings of Fact and Conclusions of Law (the "Services' Joint Proposed Findings and Conclusions"), which is submitted herewith. Pandora's Proposed Rates and Terms (As Amended), *i.e.*, the regulations proposed for 37 C.F.R. § 385, Subparts B and C, for the 2018-2022 license period, are also submitted herewith.

For the reasons discussed herein and in the Services' Joint Proposed Findings and Conclusions, and based on the extensive evidentiary record developed at trial, Pandora proposes to preserve the existing rates and terms for interactive streaming services operating under Subpart B and for "limited offerings" operating under Subpart C, subject to several adjustments. As described more specifically in Section VIII, Pandora proposes: (1) to retain the "all in" nature of the "headline" royalty right to reflect the combined value of the mechanical rights and the performance rights to use musical works in connection with interactive streaming; (2) to preserve the "headline" royalty rate of 10.5% of service revenue, subject to certain per-subscriber and other minimums, with rate differentiation between product categories; (3) to preserve the deduction for performance rights royalties to determine the relevant mechanical rights royalty pool, as performance rights royalties are paid by the services to the very same rightsholders (or their agents) for the very same musical works; and (4) to distribute the royalty pool to rightsholders based on the applicable percentage of non-fraudulent plays of more than thirty (30) seconds during the reporting period. Pandora proposes to eliminate the "mechanical-only" floor

fee from Subpart B and to eliminate the alternate computation of Subminimums I and II presently available in cases in which the record company is the Section 115 licensee. Pandora also proposes modifications to the definition of "service revenue" and certain other provisions to enhance the ability of interactive streaming services to offer student discounts and family plans, which in turn will grow service revenues and, accordingly, the royalties paid to music publishers and songwriters under Pandora's proposal.

While evidence adduced at trial reflects that existing rates are too high and significant downward adjustments are warranted, Pandora's amended proposal largely preserves the existing rates and rate structure because the evidence also reflects that at the rates proposed by Pandora:

- the marketplace for interactive streaming will continue to grow and services will continue to innovate, attracting millions of new consumers to interactive streaming in general and subscription products in particular;
- "limited offerings," ad-supported services, and other product offerings capable of reaching consumers who are unwilling or unable to pay $9.99 for a monthly subscription remain viable, avoiding the massive disruption that would ineluctably flow from adoption of the Copyright Owners' proposal;
- aggregate publisher and songwriter revenues from interactive streaming will continue to increase significantly each year, as will overall music industry revenues, and music publishing will remain an attractively profitable industry; and
- while interactive streaming services to date have struggled to achieve sustained profitability, there is reason to believe that at least some services could achieve profitability during the 2018-2022 license period.

In short, but as described in detail herein, Pandora's Proposed Rates and Terms (As Amended) satisfy the Section 801(b) policy objectives, and Pandora respectfully urges their adoption.

Pandora's Proposed Findings of Fact and Conclusions of Law are organized as follows:

Section I: Overview of Pandora's History and the Development of the Music Genome Project

This section, drawn from the testimony of Michael Herring, Pandora's President, provides a brief summary of Pandora's early history and growth into the leading U.S. music streaming service. This section also introduces the Music Genome Project—the proprietary music recommendation technology that is the heart of Pandora's service and the engine that drives music discovery across the platform to connect listeners to music they will love and artists to the audiences they deserve.

Section II: Pandora's Music Product Offerings

This section, drawn from the testimony of Christopher Phillips, Pandora's Chief Product Officer, describes the transformation of Pandora's product offering since the *Web IV* proceeding from a purely noninteractive radio-style listening experience compliant with the requirements of the compulsory license for sound recordings available under Section 114 of the Copyright Act into a three-tiered platform that offers consumers a choice between: (1) ad-supported, noninteractive listening; (2) a mid-price "limited offering" subscription product that, in addition to being free of commercial advertising, introduces a limited number of interactive features but remains a "lean-back," radio-style listening experience that does not allow on-demand listening; and (3) a premium subscription offering that combines the best of Pandora's "lean-back" listening experience with full on-demand functionality. This section also explains the extensive consumer research undertaken by Pandora in connection with the redesign of its services and the

innovative features Pandora has developed to expand the market and attract new consumers to subscriptions for interactive streaming.

Section III: Pandora's Investments in Innovation and Product Development

This section summarizes the massive investments made by Pandora to develop its interactive streaming platform, to deliver streaming to the broadest set of consumers, and to make music as widely available as possible. Drawing on Mr. Herring's testimony, Sections III.A-B describe the efforts and costs associated with the Music Genome Project and related proprietary algorithms and technology infrastructure, the ongoing maintenance and development of which are central not only to the Pandora Plus offering but also to the success of Pandora Premium. In Section III.C, we explain Pandora's efforts to make, and its central role in making, music more available to consumers when and where they want to hear it, including on mobile phones, in cars, and increasingly, through connected consumer electronics devices. Section III.D encapsulates Mr. Herring's testimony concerning Pandora's role in creating a marketplace for internet advertising, an essential component in not only monetizing the listening from consumers unwilling to pay for music—a segment that continues to include the majority of listeners—but also creating a broad pool of loyal users that can be upsold or cross-sold over time to Pandora's subscription tiers. Section III.E describes Pandora's investments in the "intelligent interruptions" technology that not only maximizes the revenues earned from Pandora's ad-supported tier but also provides the most effective means to upsell listeners to Pandora's interactive subscription tiers and to enhance connections between artists and their audience, whether by promoting concerts or delivering targeted artist messages. Section III.E also explains how publishers and songwriters benefit from the "intelligent interruptions" technology by improving royalty payments and driving other sources of rightsholder revenue. The remaining

subsections, Sections III.F-G, address Pandora's investments in sales and marketing and specific product development costs associated with its new interactive tiers of service.

Section IV: Pandora's Direct Licenses with Music Rightsholders

In connection with the introduction of its interactive product offerings, Pandora has entered into thousands of direct license agreements with music publishers, which agreements collectively cover the majority of musical works underlying sound recordings played on Pandora's service. This section explains that Pandora's direct licenses with larger music publishers accounting for the majority of publishing industry revenues contain key features proposed by Pandora for the compulsory license at issue here, including: [redacted] This section also explains that Pandora's licenses with thousands of smaller publishers, while limited to mechanical rights because the performance rights are already covered by Pandora's agreements with performing rights organizations ("PROs"), also support Pandora's rate proposal. Those agreements are structured so that the combination of mechanical rights and performance rights will never exceed 10.5% of Pandora's revenue and will never trigger a "mechanical-only" floor fee.

Section V: The Impact of Current Music Rights License Fees on Pandora's Finances and Ability to Grow

This section demonstrates that current music rights fees are already the most significant obstacle to Pandora's financial success and ability to grow. Even at existing rates for music licenses, and despite operating the most widely used streaming service in the U.S. of any kind, Pandora has been unable to achieve sustained profitability. Drawing on the testimony of Mr.

Herring, this section explains why high royalty rights—by retarding the growth of the service and the revenues Pandora could earn—actually constrict payments to rightsholders and are counter to both Pandora's and the Copyright Owners' interests.

Section VI: The Impact of the Copyright Owners' Rate Proposal on Pandora

The Services' Joint Proposed Findings of Fact and Conclusions of Law describes in detail the crippling effect that the Copyright Owners' proposal to revamp radically the rate structure of the Section 115 license and to impose significant rate increases would have on the marketplace for interactive streaming. Services' Joint Proposed Findings and Conclusions § VIII. This section focuses specifically on the absurd and massively disruptive consequences that adopting the Copyright Owners' rate proposal would have on Pandora in particular, including: (1) a [redacted] rate hike over current rates and terms for the same use of music; (2) an [redacted]; and (3) the [redacted] Pandora [redacted], as "limited offerings" under Subpart B would not be economically viable under the Copyright Owners' misguided "one size fits all" approach. As Mr. Herring testified, Pandora would never have been willing to invest in the development of an interactive service at all had it anticipated rates with the structure and levels the Copyright Owners propose.

Section VII: Pandora's Ticketfly Subsidiary

Section VII briefly describes Pandora's Ticketfly subsidiary and how it relates—and does not relate—to Pandora's music streaming service. Section VII explains that Pandora invested in Ticketfly, an electronic ticketing platform, because it saw Ticketfly as a part of its overall

strategy to connect listeners with the music they love and artists with the audiences they deserve. But the operation of Ticketfly does not implicate *any* of the exclusive rights afforded to music rightsholders under Section 106, let alone the mechanical rights for musical works at issue in this proceeding. Ticketfly is a completely separate business, with separate management teams, separate Profit & Loss statements, separate cash flows, different business models, and different customer bases. While Pandora delivers targeted messages to consumers of music service to inform them about nearby, upcoming concerts of artists they enjoy, it does so without regard to whether the concert tickets are sold through Ticketfly or any other ticketing platform. Moreover, as Mr. Herring explained, to the extent that messaging on Pandora is driving increased concert attendance, music publishers and songwriters are *already* deriving substantial benefits through increased exposure and the music performance royalties paid by concert promoters and live music venues.

Section VIII: Summary of Pandora's Proposed Rates and Terms (As Amended)

This section describes Pandora's rate proposal and, other than with respect to certain technical or conforming changes, explains the bases for the changes proposed by Pandora to the current regulations.

Section IX: Pandora's Proposed Rates and Terms (As Amended) Satisfy the Section 801(b) Objectives

This final section explains why Pandora's rate proposal best satisfies the Section 801(b) rate-setting standard and should be adopted by the Judges. Section IX.A explains the requirement set forth in 37 C.F.R. § 385.17 and 37 C.F.R. § 385.26 that royalty rates for the compulsory licenses available under Subparts B and C must be established de novo. That provision does not mean, as Mr. Israelite erroneously contended, that the agreement between music publishers, songwriters, and streaming services in 2012 to settle the *Phonorecords II*

proceeding (the "2012 Settlement") cannot be used as a benchmark to set rates here. It means only that existing rates have no binding precedential effect and proposals based upon them must be evaluated according to the policy objectives of Section 801(b) no differently than any other proposal. Section IX.A. also explains that the requirement to establish rates de novo does not apply to the license terms set forth in the current regulations. Those may be carried over absent evidence that a change is needed to satisfy the statutory objectives.

Section IX.B. sets forth the Section 801(b) policy objectives, as informed by Dr. Katz's economic interpretation of those objectives and the relevant jurisprudence. Section IX.C. explains the appropriateness of using a benchmark to determine a statutory rate, and Section IX.D. describes why the 2012 Settlement is an excellent benchmark for setting rates and terms for the 2018-2022 license period.

Section IX.E. demonstrates the reasonableness of continuing to use key features of the rate structure from the 2012 Settlement, including: (1) differentiated rate categories for different types of services; (2) the "all-in" rate structure for mechanical rights and performance rights; (3) a percentage-of-revenue rate (set at 10.5% of service revenue), subject to per-subscriber or other appropriate fee minimums. Section IX.F. shows why the adjustments to existing regulations that Pandora proposes, including elimination of the "mechanical-only" floor fee, are consistent with the Section 801(b) policy objectives.

Sections IX.G-H. show that two other potential benchmarks also support Pandora's rate proposal. Section IX.G. addresses Pandora's direct licenses with music publishers, and Section IX.H. explains that the Copyright Owners' recent settlement of Subpart A rates demonstrates that the rates proposed by Pandora here are, if anything, too high.

Appendices

In Appendix A to this filing, and for ease of reference, Pandora sets forth its proposed regulations for Subparts B and C of 37 C.F.R. § 385, which are also submitted separately. Appendix B is a comparison of its proposed regulations marked to show changes from the existing regulations. Appendix C is a comparison of its proposed regulations marked to show changes from the proposed regulations Pandora submitted with its written direct case.

PROPOSED FINDINGS OF FACT

I. OVERVIEW OF PANDORA'S HISTORY AND THE DEVELOPMENT OF THE MUSIC GENOME PROJECT

PPFF1. Pandora was founded on a vision of using the internet as a platform to deliver a smart recommendation service that could help listeners discover music that they would love and would give artists the opportunity to have their music discovered by fans who might not otherwise have learned about it. Trial Ex. 880 (Herring WDT ¶ 5).

PPFF2. The heart of Pandora is its proprietary music recommendation technology known as the Music Genome Project ("MGP"), which has been developed and refined over the past 16 years and represents an enormous and continuing investment in software, data, infrastructure, and content management. Trial Ex. 880 (Herring WDT ¶¶ 5, 13, 15). The MGP uses a combination of technology and human music expertise to map out a song's key musical characteristics (its "genes"). Trial Ex. 880 (Herring WDT ¶ 5). It then algorithmically identifies songs with similar musical "DNA" to those a user already knows and likes. *Id.* The MGP is different than other recommendation methods used by other services because it relies on musical similarity instead of popularity favoring established artists. *Id.*

PPFF3. The first attempt to build a business around the MGP began in 2000, when Tim Westergren and two colleagues started Savage Beast Technologies—the company that

would eventually become Pandora. *Id.*; 3/14/17 Tr. 846:21-25 (Herring). Savage Beast's business strategy was to market the MGP as a tool that music retailers and music websites could use to drive new music sales and consumption, including web tools that allowed customers to integrate the MGP technology into their websites as well as software for internet enabled kiosks located in "brick-and-mortar" retailers (like Tower Records, Best Buy, and Borders) that allowed consumers to discover new music. Trial Ex. 880 (Herring WDT ¶ 6); 3/14/17 Tr. 846:25-847:5 (Herring). Unfortunately, with the CD market on the decline and retailers struggling, Pandora's business customers were unwilling or unable to invest in listening kiosks. Trial Ex. 880 (Herring WDT ¶ 7). Savage Beast exhausted its initial investment and its founders took on substantial personal debt to keep the business going. *Id.*

PPFF4. In 2004, Savage Beast decided to change course away from the music retail business. *Id.* at ¶ 8; 3/14/17 Tr. 847:6-9 (Herring). The team recognized that radio was increasingly shifting to the internet, and realized that the MGP could serve as the core of an easy-to-use and compelling customized radio service. Trial Ex. 880 (Herring WDT ¶ 8). Savage Beast decided to shift into a consumer-based internet radio company. Trial Ex. 880 (Herring WDT ¶ 8); 3/14/17 Tr. 847:6-9 (Herring). It repurposed the MGP into a playlist engine, renamed the company Pandora Media, and set about creating a consumer-facing product and brand. Trial Ex. 880 (Herring WDT ¶ 8); 3/14/17 Tr. 847:6-9 (Herring).

PPFF5. The music streaming service that Pandora has created is not simply a modernized radio station, but is instead a highly promotional form of music delivery that drives discovery, which in turn leads to further paid consumption through concerts, record sales, and on-demand streaming on other music services, to the benefit of the entire music ecosystem. Trial Ex. 880 (Herring WDT ¶ 10). Pandora brings invaluable exposure to talented but lesser-known

artists—and listeners flock to Pandora precisely because it helps them make these discoveries. Trial Ex. 880 (Herring WDT ¶ 10).

PPFF6. Since launching as Pandora in 2005, the company has grown organically by word of mouth to become the leading music streaming service of any kind in the United States. Trial Ex. 880 (Herring WDT ¶ 9); 3/14/17 Tr. 847:9-13 (Herring). As of September 2016, Pandora had approximately 78 million active monthly users. Trial Ex. 880 (Herring WDT ¶ 11); see 3/14/17 Tr. 847:17-20 (Herring). Pandora listeners have created over 10 billion music stations. Trial Ex. 880 (Herring WDT ¶ 11). The MGP includes approximately [redacted] unique analyzed songs from over 150,000 artists, spanning more than 600 genres and sub-genres. Trial Ex. 880 (Herring WDT ¶ 11). Pandora has over 75 billion "thumbs up" and "thumbs down" data points of feedback on individual recordings, and collects one billion data points a day from listener behavior to improve personalization and its products. Trial Ex. 880 (Herring WDT ¶ 11); 3/14/17 Tr. 851:7-13 (Herring).

II. PANDORA'S MUSIC PRODUCT OFFERINGS

A. Pandora's Previous Noninteractive Product Offerings

PPFF7. Pandora is best known for its personalized, noninteractive radio stations that provide a "lean-back" or radio-style listening experience. Trial Ex. 877 (Phillips WDT ¶ 5); 3/9/17 Tr. 388:13-20 (Phillips). Prior to October 2016, Pandora's noninteractive, statutorily licensed service (the service at issue in the *Web IV* proceeding) included two tiers: an ad-supported tier that was free to consumers, and the subscription-based Pandora One available for $4.99 per month, which was effectively the same noninteractive radio service without advertisements. Trial Ex. 877 (Phillips WDT ¶ 5); 3/9/17 Tr. 388:9-20 (Phillips).

PPFF8. There are two ways for a new user to start listening to music on Pandora's radio-style service: seeding a station, or selecting a genre station. Trial Ex. 877 (Phillips WDT ¶ 6); *see* 3/9/17 Tr. 389:1-6 (Phillips). To create a seeded station, the listener simply types in the name of an artist, composer, or song title to serve as the starting point or "seed" for the station. Trial Ex. 877 (Phillips WDT ¶ 6); 3/9/17 Tr. 389:1-6 (Phillips). Pandora then uses its patented MGP technology and a combination of proprietary playlist algorithms to automatically create a station that will play tracks sharing musical "genes" with the seed. Trial Ex. 877 (Phillips WDT ¶ 6); 3/9/17 Tr. 389:1-6 (Phillips). Alternatively, a user can select one of Pandora's genre stations, pre-programmed collections of tracks that reflect various musical styles or preferences such as "Today's Hits" or "Todays' Country." Trial Ex. 877 (Phillips WDT ¶ 6). Pandora's music curation team hand-selects the initial track list for each genre station. Trial Ex. 877 (Phillips WDT ¶ 6).

PPFF9. Once a user starts listening to a station, he or she can then customize it by adding what Pandora calls "variety"—information like a favorite artist or song—or by "thumbing up" or "thumbing down" a song or to indicate like or dislike respectively. Trial Ex. 877 (Phillips WDT ¶ 7). Users also have the ability to skip a track. Trial Ex. 877 (Phillips WDT ¶ 7). Finally, users can typically view lyrics and an artist biography for each track they hear. Trial Ex. 877 (Phillips WDT ¶ 7). What users cannot do is choose the tracks on their station or replay a particular song. Trial Ex. 877 (Phillips WDT ¶ 7). All playlists comport with the sound recording performance complement in Section 114(j)(13) of the Copyright Act, which limits the frequency with which an artist or album can be played by a statutory webcaster. Trial Ex. 877 (Phillips WDT ¶ 7). This type of radio-style listening offers a very different user experience than

that offered by on-demand products in which listeners select the tracks or albums they wish to hear and the order in which they will hear them. Trial Ex. 877 (Phillips WDT ¶ 7).

PPFF10. In addition to music, Pandora also streams comedy routines and other spoken word content like podcasts. Pandora has developed a system called the Comedy Genome Project (similar to the MGP). Using the Comedy Genome Project, users can seed a comedian or select a comedy genre station and personalize the station with thumbs or by adding variety. Trial Ex. 877 (Phillips WDT ¶ 8).

B. Pandora's Redesign of Its Services Based on Consumer Feedback and Market Research

PPFF11. As part of its efforts to continuously improve its music service and ensure that its product offerings are meeting the needs of users, Pandora has engaged in numerous efforts to obtain feedback from listeners about their experience on Pandora. 3/9/17 Tr. 389:7-390:4 (Phillips). These efforts include collecting data regarding listener behavior, reviewing market research, analyzing consumer feedback and app reviews, commissioning surveys and studies by outside vendors to learn what listeners want in Pandora's product offerings, and reviewing third-party studies regarding the overall music landscape. Trial Ex. 877 (Phillips WDT ¶ 11); 3/9/17 Tr. 389:7-390:4 (Phillips).

PPFF12. Research commissioned by Pandora has shown that (i) time spent listening to noninteractive webcasting, like Pandora, typically has replaced other forms of noninteractive listening, such as broadcast radio, or is new listening time that would not have been spent consuming music at all; and (ii) most subscribers to on-demand music services also use noninteractive services. Trial Ex. 877 (Phillips WDT ¶ 10).

PPFF13. Further, Pandora observed that a significant portion of its user base has been using Pandora's service in conjunction with other services that offer interactive features

such as replays, offline listening, and on-demand streaming that Pandora's noninteractive radio streaming service did not offer. Trial Ex. 877 (Phillips WDT ¶ 10). In many cases, users continue to rely on Pandora as their primary source for music consumption; in others, users have been migrating away from Pandora in favor of other options. Trial Ex. 877 (Phillips WDT ¶ 10 & n.3); Trial Ex. 879.

PPFF14. Through the different research insights, Pandora came to the realization that it needed to develop interactive streaming options to satisfy the full spectrum of consumer desire for control over music selection. Trial Ex. 877 (Phillips WDT ¶ 11); 3/9/17 Tr. 391:11-393:16 (Phillips). Pandora's lack of interactive features (such as the ability to replay tracks users want to hear again, the ability to skip as many tracks as they want, the ability to save music for later listening, including offline use, the ability to hear a specific track on-demand, the ability to create playlists of their own choosing, and the ability to share music with other people) drove users to other streaming services, either temporarily or permanently. Trial Ex. 877 (Phillips WDT ¶¶ 10, 11, 13); 3/9/17 Tr. 391:11-393:16 (Phillips). Users have been most likely to leave Pandora when they reach a "pain point"—a feature limitation that prevents them listening to music in the manner they desire. Trial Ex. 877 (Phillips WDT ¶ 13); see 3/9/17 Tr. 392:1-392:19; 393:3-16 (Phillips). For example, when users run up against a pain point like reaching the Pandora-imposed skip limit, or the inability to replay a song, they often jump to another service like YouTube or Spotify to continue listening to what they want to hear. Trial Ex. 877 (Phillips WDT ¶ 13). Often they return to Pandora to continue their "lean-back" listening experience, but over time they may gradually migrate away from Pandora or simply switch providers entirely. Trial Ex. 877 (Phillips WDT ¶ 10); *see* 3/9/17 Tr. 393:3-16 (Phillips).

PPFF15. Pandora concluded that the absence of these interactive features on any tier of its service was inhibiting growth in listener hours, contributing to a decline in monthly users, and limiting its ability to attract new customers who wanted additional functionality. Trial Ex. 877 (Phillips WDT ¶ 14); 3/9/17 Tr. 393:3-16 (Phillips).

C. Pandora's New Service Offerings

PPFF16. Pandora redesigned its product offerings to meet customer demand for interactive features. Trial Ex. 877 (Phillips WDT ¶ 15); 3/9/17 Tr. 394:16-25 (Phillips). In doing so, however, Pandora was careful to preserve the core functionality that has been key to its success: an interface that is simple to use with expert curation that makes Pandora an engine of highly personalized music discovery and enjoyment. Trial Ex. 877 (Phillips WDT ¶ 15). To that end, Pandora now offers a range of products with price points and features that accommodate the full spectrum of consumer preferences for control and willingness to pay for music. Trial Ex. 877 (Phillips WDT ¶ 16). The redesigned Pandora offers three tiers: an ad-supported free tier just called "Pandora," a subscription-based mid-tier option called "Pandora Plus," and a fully on-demand, subscription-based option called "Pandora Premium." Trial Ex. 877 (Phillips WDT ¶ 16); 3/9/17 Tr. 394:20-25 (Phillips).

PPFF17. In redesigning its new product offerings, it was important for Pandora to have diverse product offerings to appeal to the largest group of consumers possible. 3/9/17 Tr. 399:16-18 (Phillips). Pandora understands that the majority of the market is most interested in an ad-supported radio service, but that each of its subscription tiers will capture a portion of users willing to pay more for expanded features. 3/9/17 Tr. 399:18-400:9 (Phillips); 3/14/17 Tr. 852:3-18, 865:5-12; 884:21-885:16, 889:9-891:17, 892:18-22 (Herring). Additionally, Pandora expects that as consumers run up against the limits of the lower tiers of service and become

aware of the capabilities of the higher tiers, many can be "upsold" to a higher-paying tier and begin paying more money for music. 3/9/17 Tr. 400:13-401:6 (Phillips). By offering diverse product offerings, Pandora can "educate" consumers about the benefits of a paid subscription product and more successfully convert those users into paying subscribers. Trial Ex. 877 (Phillips WDT ¶ 32); 3/9/17 Tr. 400:23-401:6 (Phillips).

PPFF18. **Tier One: Pandora.** Pandora's first offering is a redesign of its free, ad-supported radio product that keeps the same "Pandora" name. Trial Ex. 877 (Phillips WDT ¶ 17). It is a noninteractive service that is not subject to the Section 115 compulsory license at issue in this proceeding. Trial Ex. 880 (Herring WDT ¶ 62). The redesigned Pandora continues to offer listeners the same "lean-back" radio powered by the Music Genome Project and Pandora's proprietary algorithms. Trial Ex. 877 (Phillips WDT ¶ 17); *see* 3/9/17 Tr. 395:3-9 (Phillips). Just as before, Pandora lets users seed stations with an artist or song, or start with a curated genre station. Trial Ex. 877 (Phillips WDT ¶ 18). Pandora users can still pause or continue to play tracks, thumb tracks up or down, and input additional variety to influence the music played on their stations. Trial Ex. 877 (Phillips WDT ¶ 18). They can also skip a limited number of songs. Trial Ex. 877 (Phillips WDT ¶ 18). However, in the new Pandora, users have the option to gain additional skips and the ability to replay [redacted] recently heard songs by watching a [redacted] ad. Trial Ex. 877 (Phillips WDT ¶ 19).

PPFF19. The purpose of this feature is to simultaneously relieve some of the pain points that cause users to leave Pandora for other services, and improve Pandora's monetization by offering advertisers an additional way to reach consumers. Trial Ex. 877 (Phillips WDT ¶ 20). The advertisements are interspersed with targeted messages encouraging users to upgrade from an ad-supported to a subscription-based tier and gain more control over their listening

experience. Trial Ex. 877 (Phillips WDT ¶ 21). These efforts have already started to bear fruit. Trial Ex. 877 (Phillips WDT ¶ 21). Pandora decided not to pursue an ad-supported on-demand interactive service to enhance the incremental value of its subscription on-demand offering. 3/14/17 Tr. 1039:14-1040:7 (Herring).

PPFF20. **Tier Two: Pandora Plus.** Pandora Plus is a subscription-based product available for $4.99 per month which was introduced in September 2016 and replaced the old Pandora One. Trial Ex. 877 (Phillips WDT ¶ 22); 3/9/17 Tr. 395:13-396:3 (Phillips). The core functionality and listener experience of Pandora Plus is the same as the ad-supported tier. Trial Ex. 877 (Phillips WDT ¶ 22); 3/9/17 Tr. 395:15-21 (Phillips). However, Pandora Plus subscribers receive ad-free music streaming, access to Pandora's replay functionality, more skips, and offline/cached listening to a limited number of stations. Trial Ex. 877 (Phillips WDT ¶ 22); 3/9/17 Tr. 395:22-25 (Phillips).

PPFF21. The cached or off-line experience stations address the pain point of the inability to use Pandora during popular listening times when users do not have internet connectivity like commuting, traveling, exercise, and work. Trial Ex. 877 (Phillips WDT ¶ 23). Cached stations (chosen by Pandora based on users' listening history) function like standard Pandora stations, but contain approximately [redacted] of unique content that can be listened to when the user does not have internet connectivity and refresh when internet connectivity is restored. Trial Ex. 877 (Phillips WDT ¶ 23); 3/9/17 Tr. 396:5-19 (Phillips).

PPFF22. Like the ad-supported Pandora tier, Pandora Plus still operates as a radio service where Pandora is the DJ and subscribers do not know which track will be played next on a station, or which tracks are upcoming. Trial Ex. 877 (Phillips WDT ¶ 24); 3/9/17 Tr. 395:15-21 (Phillips). Apart from the ability to replay a recently heard track, Pandora Plus stations abide

by the sound recording performance complement of the statutory license under Section 114, whether online or cached for offline listening. Trial Ex. 877 (Phillips WDT ¶ 24).

PPFF23. Pandora Plus is a key part of Pandora's strategy to optimize subscriber revenue. Trial Ex. 877 (Phillips WDT ¶ 25). By offering a sustainable, attractive, and unique mid-tier product at $4.99 per month, Pandora can grow its subscriber and revenue base among consumers who are not willing to pay $9.99 per month to access music. Trial Ex. 877 (Phillips WDT ¶ 25). The mix of control features included in and withheld from Pandora Plus was carefully calibrated. Trial Ex. 877 (Phillips WDT ¶ 25). Pandora believes that over time, many Pandora Plus subscribers will become willing to pay incrementally more for the complete control offered by Pandora's third tier, and can be upsold to the premium service. Trial Ex. 877 (Phillips WDT ¶ 25).

PPFF24. **Tier Three: Pandora Premium.** Pandora Premium offers Pandora's unique take on the full on-demand listening experience for $9.99 per month. Trial Ex. 877 (Phillips WDT ¶ 26); 3/9/17 Tr. 397:1-13 (Phillips). Pandora Premium includes all the features of Pandora Plus: seeded and genre stations, the ability to thumb tracks up or down, unlimited skips, replay functionality, and cached stations for offline listening. Trial Ex. 877 (Phillips WDT ¶ 26); 3/9/17 Tr. 397:7-13 (Phillips). But Pandora Premium goes far beyond Pandora Plus, offering the ability to play any song, artist, or album in Pandora's library on demand; the ability to create and manage playlists, and share them with other Pandora Premium subscribers; and the ability to listen to any song, album, station, or playlist offline. Trial Ex. 877 (Phillips WDT ¶ 27); 3/9/17 Tr. 397:1-13 (Phillips). Pandora Premium's full interactive features enable it to compete with other on-demand streaming services in the market, but Pandora's existing radio

features and its wealth of data about listener preferences make it stand out from the crowd. Trial Ex. 877 (Phillips WDT ¶ 28); 3/9/17 Tr. 398:23-399:12 (Phillips).

PPFF25. Pandora Premium brings Pandora's signature ease of use to interactive streaming. Trial Ex. 877 (Phillips WDT ¶ 29); *see* 3/9/17 Tr. 398:19-399:12 (Phillips). Pandora's recommendations are seamlessly integrated into the on-demand service. Trial Ex. 877 (Phillips WDT ¶ 29). For instance, when a user searches for a song, artist, or album, their search results will not only include their chosen song, artist, or album, but also suggested stations based on that search created using the MGP and Pandora's algorithms. Trial Ex. 877 (Phillips WDT ¶ 29). This allows users the option to listen to the music for which they searched, select a station generated by Pandora from their search, or add the selected music to a playlist of their own creation. Trial Ex. 877 (Phillips WDT ¶ 29).

PPFF26. Pandora Premium also offers two unique "auto" features to make listening to music as smooth as possible. The first is automatic play: once a user's music selection (like a song or album) finishes playing, Pandora will keep playing more music, selected based on the MGP, Pandora's algorithms, and what Pandora knows about the user and similar users. Trial Ex. 877 (Phillips WDT ¶ 30). Automatic play addresses a common pain point in interactive streaming, in which music stops playing at a time when the user cannot easily search for another selection, for example while driving. Trial Ex. 877 (Phillips WDT ¶ 30). The second is automatic playlist population, which addresses the common problem of "orphan playlists" where users begin creating a playlist, but lose steam after adding a few songs. Trial Ex. 877 (Phillips WDT ¶ 31); 3/9/17 Tr. 399:5-7 (Phillips). Pandora Premium allows users to, at the touch of a button, fill in the rest of a playlist automatically. Trial Ex. 877 (Phillips WDT ¶ 31). Pandora chooses the remaining songs based on what the user has already put in the playlist, together with

its knowledge of the user's music preferences and the preferences of similar users. Trial Ex. 877 (Phillips WDT ¶ 31). Users can then edit auto-populated playlists at their leisure. Trial Ex. 877 (Phillips WDT ¶ 31).

PPFF27. Pandora expects that the combination of its "lean-back" radio, the flexibility of on-demand streaming, and the unique music discovery features that only Pandora Premium can provide will attract new subscribers who do not currently use on-demand streaming at all. Trial Ex. 877 (Phillips WDT ¶ 32). Moreover, with its new interactive offering, Pandora will be in a better position to convert customers who use only its free, ad-supported service into paying subscribers. Trial Ex. 877 (Phillips WDT ¶ 32); 3/9/17 Tr. 400:13-401:6 (Phillips).

PPFF28. What makes Pandora Plus and Pandora Premium unique from other interactive streaming services is that they integrate Pandora's proprietary technology and the hallmark features of its noninteractive radio product. For example, Pandora Premium's "auto" features make use of the MGP, Pandora's proprietary algorithms, its "thumbs up" and "thumbs down" data, and its wealth of knowledge about listener preferences and behavior to personalize the user experience, like auto-filling playlists on behalf of our listeners or automatically playing similar songs when the users do not want to actively pick the songs they want to listen. Trial Ex. 877 (Phillips WDT ¶¶ 30-32); 3/9/17 Tr. 398:19-399:12 (Phillips); Tr. 3/14/17 852:11-18 (Herring). In fact, Pandora estimates that 70% of listening on Pandora's interactive products will take the form of noninteractive listening to radio stations or playlists. 3/14/17 Tr. 852:3-11 (Herring).

III. PANDORA'S INVESTMENTS IN INNOVATION AND PRODUCT DEVELOPMENT

A. The Music Genome Project

PPFF29. One of Pandora's most important investments is in the MGP, the taxonomy of musical styles and characteristics that powers the company's music recommendation system. Trial Ex. 880 (Herring WDT ¶ 15). The MGP is the core of Pandora's business, and it is the key feature that differentiates Pandora from its competitors. *Id.*

PPFF30. Developed and refined over 16 years, the MGP represents an enormous investment in software, data, infrastructure, and content management that continues to this day. *Id.* at ¶¶ 13, 15. The MGP currently encompasses more than 600 genres and subgenres. *Id.* at ¶ 14. Each of those genres contains hundreds of individual "genes"— traits typically present in that genre of music—including granular details of instrumentation, tempo, melody, and lyrical content. *Id.* at ¶ 14; *see* 3/14/17 Tr. 850:11-21 (Herring). Over the 16 years since the MGP's creation, Pandora's music analysts have spent hundreds of thousands of hours listening to and cataloging approximately [redacted] songs. *Id.* at ¶ 17. Pandora's team analyzes approximately [redacted] new tracks each month. *Id.* at ¶ 17.

PPFF31. Implementing the MGP requires highly skilled and very costly human effort at each step of the process. *Id.* at ¶ 15 & n.5. While many of Pandora's competitors incorporate fully computer-driven song selection models, Pandora's research has determined that computer-driven tools cannot grasp the same musical subtleties as a trained human ear, nor can they pick out lesser-known music ready for a wider audience. *Id.* The MGP therefore relies extensively on more than 80 highly-trained employees, including expert music analysts, curators, and scientists. *Id.* at ¶ 15. Pandora receives enormous amounts of new music from content owners pursuant to license agreements, but only a portion of that music can be added to the

MGP. *Id.* at ¶ 16 n.6. First, Pandora's music curation team selects the tracks to be incorporated into the MGP through research, chart tracking, and review of music publications and criticism. *Id.* at ¶ 16. Once the curators select new music, it is sent to the analysts. *Id.* at ¶ 17. Pandora employs more than thirty analysts all with deep academic training in music theory. *Id.* at ¶ 17; 3/14/17 Tr. 855:21-856:1 (Herring). An analyst evaluating a song for entry into the MGP examines it for up to 450 traits, depending on the genre. Trial Ex. 880 (Herring WDT ¶ 17); 3/14/17 Tr. 850:13-21 (Herring). The process of becoming an analyst is rigorous, and prospective hires must pass an exam to even be considered for an analyst position. Trial Ex. 880 (Herring WDT ¶ 18); 3/14/17 Tr. 856:1-19 (Herring). Once hired, analysts in training must review the same song and compare results, and repeat that process until the results are consistent. Trial Ex. 880 (Herring WDT ¶ 18). This level of qualification is necessary to ensure accurate, consistent data that can be added to the MGP. Trial Ex. 880 (Herring WDT ¶ 18).

B. <u>Algorithms and Technology Infrastructure</u>

PPFF32. In addition to the MGP, Pandora utilizes dozens of other proprietary algorithms to determine what to play as the next track on a station. Trial Ex. 880 (Herring WDT ¶ 19). Not including incremental expenses associated with the redesign of Pandora's products, the company has spent more than [redacted] creating and refining the MGP, its proprietary algorithms, and the necessary infrastructure, hardware, and software to offer a world-class radio product to nearly 78 million active users. Trial Ex. 880 (Herring WDT ¶ 27); 3/14/17 Tr. 857:4-12 (Herring).

PPFF33. Pandora's MGP algorithm uses the musical traits of recordings to find recordings with similar musical DNA. Trial Ex. 880 (Herring WDT ¶ 20); 3/14/17 Tr. 850:11-851:6 (Herring). Finding the best matches requires an extremely high-performance algorithm

that can perform complex calculations across a vast and ever-expanding database in a fraction of a second. Trial Ex. 880 (Herring WDT ¶ 20). Pandora has spent more than [redacted] developing and improving the MGP algorithm. *Id.* at ¶ 20. The MGP algorithm has two advantages that have been key to Pandora's success. *Id.* at ¶¶ 21-22. First, it does not consider a song's popularity in making recommendations, so it can introduce users to new music they would never encounter otherwise. *Id.* at ¶ 21. Second, the MGP algorithm can begin making great recommendations for a brand new user or from a single song—two common situations that cause most recommendation systems to flounder due to insufficient input. *Id.* at ¶ 22.

PPFF34. Pandora supplements the MGP algorithm with many other algorithms to improve its performance and provide a better listening experience. For instance, Pandora's "collective intelligence" algorithm harnesses user feedback to identify songs with similar musical traits that, for whatever reason, do not appeal to the same audience. *Id.* at ¶ 23. The collective intelligence algorithm ensures that these songs will not be played together even though the MGP algorithm identifies them as closely related. *Id.* Similarly, Pandora's "collaborative filtering" algorithm employs user feedback ("thumbs up" and "thumbs down") to sort users into cohorts with similar musical tastes. *Id.* at ¶ 24. This algorithm supplements the MGP with an additional strategy for identifying new tracks a user is likely to enjoy. *Id*. These are only examples. Pandora is constantly experimenting with ways to improve the mix of songs presented to listeners and creating new algorithms to assist in that process. *Id.* at ¶ 25. Pandora's scientists and engineers frequently develop new ideas for improving playlist quality, and run trials testing their techniques on small but statistically significant groups of listeners. *Id.* If the technique improves listener satisfaction, the improvement may be rolled out to all Pandora users. *Id.* At any given time, dozens of such experiments are being run simultaneously. *Id.*

PPFF35. All of Pandora's algorithms and data are used across Pandora's redesigned service. *Id.* at ¶ 26; *see* 3/14/17 Tr. 852:19-853:6 (Herring). Although these technologies, such as the MGP and other proprietary algorithms, were created before Pandora began work on its interactive service, they are critical to the development of Pandora's interactive products and enable Pandora Plus and Pandora Premium to bring new features to the interactive marketplace that are not available from any other service. 3/14/17 Tr. 854:2-855:2; 858:5-10 (Herring). Pandora's algorithms and data power Pandora Premium's "auto" features, adding seeded stations to search results, filling out playlists from a few user-submitted tracks, and selecting tracks to play when a user's selected music finishes. Trial Ex. 877 (Phillips WDT ¶¶ 29-32); 3/14/17 Tr. 858:11-24, 860:15-861:7 (Herring). Pandora Premium users also benefit from Pandora's algorithms and data when they use the service for "lean-back" radio-style listening with seeded or genre stations like those available on Pandora's lower tiers. *See* Trial Ex. 877 (Phillips WDT ¶ 26); 3/9/17 Tr. 397:7-13 (Phillips).

C. Making Music More Available

PPFF36. At launch in 2005, Pandora was available only as a website accessible from personal computers. Trial Ex. 880 (Herring WDT ¶ 29). In the intervening decade, Pandora has spent tens of millions expanding to other platforms in order to make music more accessible and available to its users. *Id.* at ¶ 34; 3/14/17 Tr. 863:24-864:4 (Herring). Pandora first expanded to mobile devices in July 2008. Trial Ex. 880 (Herring WDT ¶ 30). Rolling out mobile service in 2008 was particularly difficult because at that time, existing wireless networks lacked the signal strength and coverage to easily deliver consistent high audio quality. *Id.* Pandora has invested tens of millions in developing its mobile delivery platform. *Id.*; 3/14/17 Tr. 861:13-20 (Herring).

PPFF37. Pandora also has focused on the delivery of its service into cars, a market long dominated by terrestrial and satellite radio. Trial Ex. 880 (Herring WDT ¶ 31); 3/14/17 Tr. 861:21-862:3 (Herring). Pandora's pre-installed integrations in cars allow users to control Pandora through the same dashboard interface that controls AM/FM or satellite radio. Trial Ex. 880 (Herring WDT ¶ 31). At present, there are 25 million integrations activated in cars in the United States, and over half of all models sold in 2017 will have Pandora integrated into the dashboard. 3/14/17 Tr. 861:21-862:3 (Herring). In most integrations, the car streams Pandora from the user's smartphone. Trial Ex. 880 (Herring WDT ¶ 31). Pandora, the smartphone, and the car to talk to each other via application protocol interfaces that Pandora developed and maintains at great expense. *Id.* Pandora is also investing in the next generation of "connected car," which will have a built-in modem and enable Pandora to connect to cars without a smartphone intermediary. *Id.*

PPFF38. In addition to cars and phones, Pandora also integrates its service into other consumer electronics like smart TVs, home entertainment systems, gaming consoles, and even refrigerators. *Id.* at ¶ 33. Today, Pandora is available in approximately 1,800 third-party electronic devices from partners like Google, Apple, Amazon, Samsung, Roku, and Sonos. *Id.* at ¶ 33; 3/14/17 Tr. 862:4-17 (Herring). Finally, for its Pandora Plus and Pandora Premium offerings, Pandora has invested in enabling users to listen to its music without an internet connection. Trial Ex. 877 (Phillips WDT ¶¶ 23, 27).

D. Development of the Market for Internet Radio Advertising

PPFF39. In order to grow to the size it is today, Pandora had to expend significant resources into creating a market for internet radio advertising. Trial Ex. 880 (Herring WDT ¶ 35). Like most internet radio services, Pandora initially relied on visual ads—like banners—

for revenue. *Id.* at ¶ 36. The rise of mobile listening changed this situation dramatically. *Id.* at ¶ 36. Listening hours increased massively thanks to Pandora's mobile platform, but mobile users were not looking at their screens and could not see visual ads. *Id.* at ¶ 36. Pandora soon realized it needed to sell in-stream audio ads like traditional radio. *Id.* at ¶ 37. To do so, however, Pandora had to surmount three hurdles. First, Pandora had to demonstrate to advertisers how its reach compared to that of terrestrial radio stations. *Id.* To address this, Pandora partnered with Triton Digital, a digital audience measurement service, to provide listening metrics for Pandora streams based on listener-supplied zip codes, age, and gender. *Id.* Pandora has paid Triton more than $[redacted] to date. *Id.* at ¶ 38. Second, Pandora needed to integrate itself (along with Triton's metrics) into the ad-buying software platforms through which regional and local radio advertising purchases are made. *Id.* at ¶ 37. Finally, Pandora needed to develop the ability to use listener zip codes to track and serve local advertisements. *Id.* Pandora initially rolled out this capability in the top ten radio advertising markets, and by 2012 could sell local ads across almost all major metropolitan survey areas in the U.S. *Id.*

PPFF40. In addition to the above, Pandora has also invested heavily in growing its sales organization. *Id.* at ¶ 38. Pandora now has local sales forces in over 39 radio markets, with plans to invest more deeply in existing markets and to expand physical coverage. *Id.* at ¶ 38. Pandora has spent tens of millions on building this sales force and its supporting organization. *Id.* In 2016, the total budget for Pandora's sales organization increased to $[redacted], its marketing budget was a further $[redacted], and its sales and marketing staff together composed [redacted]% of its employees. *Id.*

PPFF41. Pandora's investment in growing the market for internet advertising is not only critical to its ad-supported tier, it also is vital to the development of Pandora's interactive

subscription products. A high-quality, ad-supported tier serves to introduce Pandora to a wide audience while still generating revenue. *Id.* at ¶ 35; 3/14/17 Tr. 865:5-22 (Herring). Additionally, this broad pool of loyal users can then be upsold or cross-sold to Pandora's paid tiers on the basis of desirable features like offline listening for Pandora Plus and on-demand functionality for Pandora Premium. 3/14/17 Tr. 865:5-22 (Herring). Pandora expects a significant number of ad-supported users will convert to a subscription tier over time. Trial Ex. 880 (Herring WDT ¶ 35). Pandora uses the knowledge it gets about user preferences from the ad-supported tier to improve service across all tiers. *Id.* Just as important, Pandora's ad-supported tier helps the company fulfill its goal of making music more accessible to everyone, including consumers who like music but are currently unable or unwilling to pay a fee. *Id.*

E. <u>Intelligent Interruptions</u>

PPFF42. [redacted] Trial Ex. 877 (Phillips WDT ¶ 33). [redacted] Trial Ex. 877 (Phillips WDT ¶ 34). [redacted] Trial Ex. 877 (Phillips WDT ¶ 34). [redacted] Trial Ex. 877 (Phillips WDT ¶ 35).

PPFF43. [redacted]

[redacted] Trial Ex. 877 (Phillips WDT ¶ 35); 3/14/17 Tr. 867:19-23 (Herring). [redacted]

[redacted] Trial Ex. 877 (Phillips WDT ¶ 35). [redacted]

F. Investments in Sales & Marketing

PPFF44. Pandora's ability to deliver personalized messages to listeners in-stream has enabled it to invest in building a platform that allows for direct, intelligently targeted connections between artists and fans. Trial Ex. 880 (Herring WDT ¶ 39). Specifically, Pandora has worked to provide a wide variety of ways for artists to promote their work with Pandora's assistance. *Id.* at ¶ 39. Since 2011, Pandora has been arranging custom sponsored events where artists perform live before an audience of fans that Pandora identifies and invites. *Id.* at ¶ 40. Pandora acts as both producer and promoter, selecting artists that will best speak to a given sponsor's target audience. *Id.* These events also promote artists both to their existing fan base and to an audience that might otherwise be unfamiliar with their music. *Id.*

PPFF45. In addition to live events, Pandora partners with artists to help live-stream their shows to viewers who cannot attend the concert in person. *Id.* at ¶ 41. These innovative efforts have included features such as custom-content stations with mixtapes of songs curated by artists, livestream stations letting listeners enjoy concerts in real time, recurring loops of livestream performances, and on-demand tracks of the performances. *Id.*

PPFF46. In October 2014, Pandora launched the Artist Marketing Platform (AMP), which provides artists with free Pandora usage metrics. *Id.* at ¶ 42; 3/14/17 Tr. 869:19-25 (Herring). AMP is designed to help artists and their teams make informed decisions about tour routing, single selection, set lists, audience targeting, and more. Trial Ex. 880 (Herring WDT ¶ 42); 3/14/17 Tr. 870:4-21 (Herring); *see* Trial Ex. 882. AMP also offers tools that artists can use to reach fans directly through Pandora. Artists can record short Artist Audio Messages to set to play before or after a certain track to fans in the markets of their choice. Trial Ex. 880 (Herring WDT ¶ 42). Pandora's testing revealed that fans do not think of Artist Audio Messages as advertisements; instead, listeners who hear Artist Audio Messages on average listen longer and come back more. 3/14/17 Tr. 868:8-15 (Herring). AMP also includes a service called AMPcast, which lets artists spontaneously communicate with fans directly through the Pandora application. Trial Ex. 880 (Herring WDT ¶ 42). These messages let artists promote songs, albums, or concerts, and thank fans for listening. 3/14/17 Tr. 868:16-869:3 (Herring). Artist Audio Messages are designed to generate exposure and more listens for artists' catalogs, and to sell live tickets. 3/14/17 Tr. 868:23-869:3 (Herring). Both AMP and Artist Audio Messages work to increase streaming and public performance royalties, which in turn benefit songwriters and publishers. 3/14/17 Tr. 869:6-18, 870:24-871:8 (Herring). Pandora provides its record label licensees with Featured Tracks, which gives them the ability to promote a new single widely on Pandora, getting real-time feedback like the track's ratio of "thumbs up" to "thumbs down," and stations created to gauge listener affinity. Trial Ex. 880 (Herring WDT ¶ 42). Pandora continues to invest in AMP, with the most recent redesign launching in October 2016. *Id.* at ¶ 43.

PPFF47. As a complement to AMP, Pandora acquired Next Big Sound (NBS) in July 2015. *Id.* at ¶ 44. NBS is an online music analytics and insights program that tracks

hundreds of thousands of artists around the world using data from Facebook, Twitter, and Youtube, along with Pandora's data on music preferences and other data from its nearly 78 million users. *Id.* Pandora provides NBS data to artists, labels and marketers. *Id.* Pandora will also use NBS data to satisfy certain reporting requirements contained in its direct licenses with sound recording and musical work copyright holders. *Id.*

PPFF48. Pandora has lately focused on helping artists sell out live shows. *Id.* at ¶ 45. Although most artists earn a significant portion of their revenue touring, an estimated 40% of concert tickets go unsold—primarily because fans do not know that a favorite artist is playing nearby. *Id.* Seeing an opportunity to facilitate the sale of tickets via targeted promotion, Pandora decided to build a music platform for connecting fans, artists, and event promoters through the Pandora service. *Id.* Pandora promotes local concert events to its listener base regardless of the event promoter or the ticketing platform responsible for ticket sales. 3/14/17 Tr. 926:21-24 (Herring).

G. <u>Development of Interactive Product Offerings</u>

PPFF49. Developing and launching Pandora's interactive service has been Pandora's most important strategic initiative over the past year. *Id.* at ¶ 46. The redesign of Pandora's product offering required massive investments. *Id.* All told, Pandora spent well over $100 million on the redesign before receiving any incremental revenue from its new products, and will have to spend more before the 2018–2022 license period begins. *Id.* These funds primarily came from Pandora's internal capital, reinvested from its earnings to help the business grow. 3/14/17 Tr. 872:19-873:1 (Herring).

PPFF50. Pandora's biggest single investment in building an interactive service was the acquisition of IP and technology assets from Rdio, a preexisting interactive music service.

See Trial Ex. 880 (Herring WDT ¶ 47). The Rdio acquisition cost Pandora $[redacted]. *Id.* at ¶ 47. Putting Rdio's assets to use in Pandora's interactive product offerings required spending millions more on engineering and development. *Id.* Pandora spent another $[redacted] acquiring NBS, described above. *Id.*

PPFF51. The transition from a noninteractive service that operated under Section 114 of the Copyright Act to a service with interactive tiers has been very expensive for Pandora, not simply because of the higher royalties paid to sound recording rightsholders and the need to license mechanical rights from musical work rightsholders, but also because of the costs of negotiating and securing grants of sound recording rights not available under a statutory license. *Id.* at ¶ 48. In 2016, Pandora negotiated for and secured expanded grants of rights from ASCAP, BMI, SESAC, and Global Music Rights, the four U.S. performing rights organizations, because the mechanical rights at issue in this proceeding have no value to Pandora without the accompanying public performance rights to stream the compositions. *Id.* at ¶ 49; Trial Ex. 888 (Herring WRT ¶ 21); 3/14/17 Tr. 882:17-883:2 (Herring); Services' Joint Proposed Findings and Conclusions § VII.C. These licenses now authorize the public performance of the many millions of musical works in their collective repertories in connection with both Pandora's "lean-back" offerings and as part of its on-demand streaming tier. Trial Ex. 880 (Herring WDT ¶ 49). Since November 2015, Pandora has entered into direct licenses with thousands of music publishers that cover the mechanical rights at issue in this proceeding. *Id.* Pandora's direct licenses with many of the largest and most prominent music publishers, including Sony/ATV Music Publishing LLC, EMI Entertainment World, Inc., Warner-Chappell Music, Inc., Kobalt Music Publishing America, Inc., SONGS Music Publishing, LLC, and Downtown Music Publishing LLC, also include performance rights. *Id.* Together, these direct licenses cover millions of musical works.

Id. Pandora would have had no need to acquire mechanical rights if it continued to operate exclusively as a noninteractive service. *Id.* Pandora also has had to secure direct licenses from record labels in order to acquire the rights necessary to operate outside the confines of the statutory license under Section 114. *Id.* at ¶ 50; Services' Joint Proposed Findings and Conclusions § VI.A. (discussing licensing of sound recording rights necessary to operate an interactive streaming service). Because Pandora does not have the in-house capacity required to administer the royalty payments required from an interactive service, and to ensure that rightsholders are paid accurately and on time, Pandora has contracted with Music Reports, Inc., a leading provider of royalty administration services, at considerable expense. Trial Ex. 880 (Herring WDT ¶ 51).

PPFF52. The redesign of Pandora's service and the development of new interactive features has also required a massive investment of time and effort from employees across the company. Trial Ex. 877 (Phillips WDT ¶ 36). Hundreds of Pandora employees have spent the majority of their time on product development since this initiative began. Trial Ex. 877 (Phillips WDT ¶ 36). This team includes members of Pandora's product development, product insight, product management, project management, product marketing, engineering, design, and programming departments. Trial Ex. 877 (Phillips WDT ¶ 36). The project required data scientists, software engineers, quality assurance engineers, project managers, product analysts, lead product designers, researchers, and more. Trial Ex. 877 (Phillips WDT ¶ 36). Even with the launch of Pandora Premium, their work will continue, as Pandora is continuously engaged in efforts to improve its service and promote a healthy music ecosystem. Trial Ex. 877 (Phillips WDT ¶ 37).

IV. PANDORA'S DIRECT LICENSES WITH MUSIC RIGHTSHOLDERS

PPFF53. In connection with the introduction of its interactive product offerings, Pandora has entered into thousands of direct licenses with music publishers covering the mechanical rights at issue in this proceeding, and in some cases, public performance rights as well. Trial Ex. 880 (Herring WDT ¶ 49).

PPFF54. Broadly speaking, Pandora has entered into two different types of license agreements with music publishers. *See, e.g.*, Trial Ex. 974 (compendium of Pandora Agreements); *see also* PPFF ¶¶ 55-57, *infra*. The first category of agreements are those with some of the larger music publishers that specify the payments for all of the performance and mechanical rights that Pandora needs to offer interactive streaming, limited downloads, and its noninteractive streaming service. *Id.* The second category of agreements that Pandora has entered into are those with other publishers (including thousands of smaller publishers through Music Reports, Inc.) that specify the payments only for mechanical rights. *Id.*; Trial Ex. 880 (Herring WDT ¶ 49). Collectively, these agreements support maintaining the structure of the 2012 Settlement with the one modification discussed above—elimination of the mechanical-only floor. Trial Ex. 885 (Katz WDT ¶ 99).

PPFF55. [redacted][1] [redacted] Trial Ex. 974-31 [redacted] Trial Ex. 974-35 [redacted] Trial Ex.

[1] Sony/ATV, Warner/Chappell, BMG, and SONGS account for approximately 59 percent of publisher share of top-100 Billboard songs in 2016-Q2. When Kobalt and UMPG are included, the total increases to nearly 83 percent in the same period. Katz WDT ¶ 100 n.142).

974-25 [redacted] Trial Ex. 974- 33 [redacted] Trial Ex. 974-09 [redacted] Trial Ex. 974-10 [redacted] Trial Ex. 974-16 [redacted]; Trial Ex. 974-26 [redacted]; Trial Ex. 885 (Katz WDT ¶ 100); 3/13/17 Tr. 623:21-624:12 (Katz). [redacted] Trial Ex. 885 (Katz WDT ¶ 100). [redacted] Trial Ex. 885 (Katz WDT ¶¶ 100-102); 3/13/17 Tr. 624:7-12 (Katz).

PPFF56. [redacted] Trial Ex. 974-01 [redacted] Trial Ex. 974- 20 [redacted]

PPFF57. [redacted] Trial Exs. 974-12, 974-14, 974-15, 974-19, 974-21–24, 974-26, 974-28, 974-29, 974-34, 974-84; Trial Ex. 885 (Katz WDT ¶ 104); 3/13/17 Tr. 624:13-23 (Katz). [redacted]

[redacted]

[redacted] Trial Exs. 974-12, 974-14, 974-15, 974-19, 974-21–24, 974-26, 974-28, 974-29, 974-34, 974-84; Trial Ex. 885 (Katz WDT ¶ 104); 3/13/17 Tr. 624:13-23 (Katz).

V. THE IMPACT OF CURRENT MUSIC RIGHTS LICENSE FEES ON PANDORA'S FINANCES AND ABILITY TO GROW

PPFF58. Despite being one of the most successful streaming services in the country, Pandora has yet to have a profitable year according to generally accepted accounting principles ("GAAP"). Trial Ex. 880 (Herring WDT ¶ 54); 3/14/17 Tr. 876:15-17 (Herring). The enormous cost of music royalties is the greatest obstacle to Pandora's ability to operate a sustainable, profitable business. Trial Ex. 880 (Herring WDT ¶ 54); 3/14/17 Tr. 876:18-21 (Herring). To date, Pandora has paid more than two billion dollars in music rights royalties. Trial Ex. 880 (Herring WDT ¶ 53). It paid more than $588 million, over half its revenues, in licensing fees to the music industry in 2015 alone. Trial Ex. 880 (Herring WDT ¶ 53). That was for a noninteractive service. Trial Ex. 880 (Herring WDT ¶ 53). With the higher royalty rates Pandora will incur from its interactive service, Pandora expects to pay more than [redacted] in 2017, an increase of [redacted] from 2015. Trial Ex. 880 (Herring WDT ¶ 53).

PPFF59. Pandora's analyses and its decision to enter the market for on-demand streaming assumed no increase in the current statutory rates for the license at issue in this proceeding. Trial Ex. 880 (Herring WDT ¶ 55); 3/14/17 Tr. 876:22-877:2 (Herring). In making this assumption, Pandora considered that mechanical rates for interactive streaming services had been stable for a long time, that numerous music publishers were willing to enter into direct licenses with Pandora at those rates. 3/14/17 Tr. 876:22-877:8 (Herring). Pandora also

considered industry trends and practice more generally and foresaw no basis to expect an increase in rates. 3/14/17 Tr. 874:16-875:1 (Herring).

PPFF60. Even at current rates for interactive streaming services, Pandora will not be profitable according to GAAP at the start of the 2018–2022 license period. Trial Ex. 880 (Herring WDT ¶ 55); Trial Ex. 890. However, Pandora is hopeful that if it is able to meet its growth targets—which contemplate attracting millions of new paid subscribers to on-demand streaming (not just new to Pandora), Pandora could be profitable during the license period if the Copyright Royalty Board were to adopt Pandora's Proposed Rates and Terms (As Amended). *See* Trial Ex. 880 (Herring WDT ¶ 55).

PPFF61. High royalty rates divert Pandora's resources away from investing in its business, and ultimately constrict its revenues and thus its payments to music rightsholders. Trial Ex. 880 (Herring WDT ¶ 56); *see generally* Trial Ex. 696 (Pakman ¶¶ WDT 28-29). With lower royalty rates, Pandora could put more resources into sales, marketing and product development. Trial Ex. 880 (Herring WDT ¶ 56); 3/14/17 Tr. 1045:14-1046:2 (Herring). These investments drive user growth and retention and attract more users to subscription on-demand streaming, which in turn enlarge the pool of money that Pandora shares with songwriters. Trial Ex. 880 (Herring WDT ¶ 56); 3/14/17 Tr. 1045:14-1046:2 (Herring). Through investing in its business in these ways, Pandora estimates that, assuming there is no increase in mechanical royalty rates, it will go from paying [redacted] a year in royalties in 2016 to [redacted] a year in 2020. 3/14/17 Tr. 1046:11-16 (Herring).

VI. THE IMPACT OF THE COPRYIGHT OWNERS' RATE PROPOSAL ON PANDORA

PPFF62. The Copyright Owners' rate proposal, if it were adopted, would have a devastating impact on Pandora and cripple the market for interactive streaming services. The

effect would be particularly pronounced with respect to "limited offerings" such as Pandora Plus and other efforts aimed at consumers unwilling to pay current rates for subscription on-demand services. Trial Ex. 888 (Herring WRT ¶¶ 7-10); 3/14/17 Tr. 911:8-21 (Herring); Trial Ex. 889.

PPFF63. As noted above, when making the decision to enter the interactive streaming market, Pandora assumed that there would be no increase in the current statutory rates for the license at issue in this proceeding. *See* Paragraph 59 *supra*. Even with aggressive targets for subscriber growth and no increase in rates, Pandora did not expect that either Pandora Plus or Pandora Premium [redacted]. Herring WRT ¶¶ 9, 12).

PPFF64. As Mr. Herring explained, holding all else equal, the Copyright Owners' proposal would require the company to pay over [redacted] dollars more in royalties than it would pay if current rates and terms continue. Trial Ex. 888 (Herring WRT ¶ 14); 3/14/17 Tr. 912:6-11 (Herring); Trial Ex. 889. If the Judges were to accept the Copyright Owners' proposal, Pandora would pay [redacted] more for mechanical rights for Pandora Premium during the 2018-2022 license period than it would if current rates and terms were extended. Trial Ex. 888 (Herring WRT ¶ 11); 3/14/17 Tr. 911:22-912:1 (Herring); Trial Ex. 889. For Pandora Plus, the increase is even greater: Pandora would pay [redacted] more for mechanical rights under the Copyright Owners' proposal than it would pay if current rates and terms continue. Trial Ex. 888 (Herring WRT ¶ 8); 3/14/17 Tr. 911:8-14 (Herring); Trial Ex. 889.

PPFF65. The massive increase in royalties proposed by the Copyright Owners, however, would [redacted] Trial Ex. 888 (Herring WRT ¶¶ 12, 14); 3/14/17 Tr. 911:15-18, 912:2-5 (Herring). If the Copyright Owners'

rate proposal were adopted, [redacted] Trial Ex. 888 (Herring WRT ¶ 12); 3/14/17 Tr. 912:2-5 (Herring); Trial Ex. 889. The situation for Pandora Plus is even more dire. If the Copyright Owners' proposal were adopted, Pandora Plus [redacted]. Trial Ex. 888 (Herring WRT ¶ 9); 3/14/17 Tr. 911:15-18 (Herring); Trial Ex. 889.

PPFF66. If the Copyright Owners' proposal were adopted, Pandora would have no [redacted]. Trial Ex. 888 (Herring WRT ¶¶ 8-10); 3/14/17 Tr. 911:19-21 (Herring).

PPFF67. Under current rates and terms, the per-subscriber minimum royalty for "limited offerings" such as Pandora Plus is $0.18 per month, *before* deducting [redacted] rights royalties. Trial Ex. 888 (Herring WRT ¶ 7 (citing 37 C.F.R. § 385.23(a)(3))). The Copyright Owners propose to raise this to $1.06 per end user per month, *without* any deduction for performance rights royalties. Trial Ex. 888 (Herring WRT ¶ 7). This would be a sixfold increase in the minimum rate even if performance rights royalties were zero. Trial Ex. 888 (Herring WRT ¶ 7). Factoring in the actual performance rights royalties paid for Pandora Plus, the new minimum would be more than [redacted] times the current minimum rate. Trial Ex. 888 (Herring WRT ¶ 7).

PPFF68. The royalty increase is also striking for Pandora Plus and other "limited offerings" currently paying royalties under the "percentage of revenue" prong. Trial Ex. 888 (Herring WRT ¶ 7). The minimum payment for mechanical rights for Pandora Plus required under the Copyright Owner's proposal is [redacted] what Pandora [redacted] pays for both mechanical *and* performance rights for the product under the revenue prong—and the required payments

could rise even higher depending on the number of plays subject to the Copyright Owners' proposed royalty. Trial Ex. 888 (Herring WRT ¶ 7).

PPFF69. These rate increases would transform a "limited offering" at the $4.99 per month price point of Pandora Plus into a sure-fire money-losing proposition. *See* Trial Ex. 888 (Herring WRT ¶¶ 7, 9); 3/14/17 Tr. 911:15-18 (Herring). At a minimum, the Copyright Owners' proposal would result in Pandora paying over [redacted] more than the standard retail price of Pandora Plus for mechanical royalties alone, and over [redacted] more when performance royalties are included at their current rates. Trial Ex. 888 (Herring WRT ¶ 7). Those economics are unsustainable and [redacted]. Trial Ex. 888 (Herring WRT ¶¶ 8-10); 3/14/17 Tr. 911:19-21 (Herring).

PPFF70. Although Pandora would likely continue to offer some version of Pandora Premium even if the Copyright Owners' proposal were adopted, this is only because its [redacted] investment in creating the product is a sunk cost. *See* 3/14/17 Tr. 951:17-953:1 (Herring). If Pandora had known that rates would escalate in the manner the Copyright Owners have proposed, it would not have invested in the development of Pandora Premium in the first place. 3/14/17 Tr. 951:17-953:1 (Herring). This situation is symptomatic of a broader problem facing interactive services: investors are reluctant to put capital into interactive services because the high royalty rates make profits virtually impossible and create a major risk of business failure. Trial Ex. 696 (Pakman WDT ¶¶ 18, 31); 3/22/17 Tr. 2301:16-2302:3 (Pakman). The unprofitability of investment constrains the development of innovative services, the growth of the market, and ultimately the royalties paid to copyright owners. Trial Ex. 696 (Pakman WDT ¶¶ 29- 33, 37).

PPFF71. In addition to wreaking havoc on Pandora's balance sheet, the Copyright Owners' proposal also would cripple the service's growth. Trial Ex. 888 (Herring WRT ¶ 13). In calculating the projected royalty spike discussed above, Pandora assumed for illustrative purposes that retail prices for subscription offerings, number of subscribers, number of streams, and performance rights royalties as a percentage of revenue would remain the same regardless of changes in rates and terms, and that no late fees would apply. Trial Ex. 888 (Herring WRT ¶ 6); 3/14/17 Tr. 910:19-911:7 (Herring). In reality, however, Pandora's growth and user retention would be reduced under the Copyright Owners' proposal versus current rates and terms. Trial Ex. 888 (Herring WRT ¶ 13); *see* 3/14/17 Tr. 894:15-896:13, 914:4-921:1 (Herring). If the Copyright Owners' proposal were adopted, Pandora would spend far more money on licensing costs, and have less money available to invest in marketing and product development. Trial Ex. 888 (Herring WRT ¶ 13); 3/14/17 Tr. 894:15-896:13, 913:6-20, 915:7-916:25 (Herring). Pandora would not be able to invest further in growing the Pandora Premium service, because the return on the investment would be too low. 3/14/17 Tr. 913:1-20 (Herring). Pandora Premium would also likely need to be modified in ways that increase prices or reduce listening hours (*e.g.* listening caps), which in turn would reduce demand for the product and create user retention problems. Trial Ex. 888 (Herring WRT ¶¶ 13, 17); 3/14/17 Tr. 894:15-896:12, 914:4-921:1 (Herring).

PPFF72. Furthermore, the [redacted] would significantly impede Pandora's ability to monetize subscribers unwilling to pay $9.99 per month for interactive features, and to upsell existing Pandora users to Pandora Premium. Trial Ex. 888 (Herring WRT ¶ 10); *see also* Trial Ex. 877 (Phillips WDT ¶ 25); 3/14/17 Tr. 1012:24-1013:8. Even though subscription rates for Pandora Premium are higher than for Pandora Plus, these dynamics would

substantially erode the total royalties that Pandora expects to pay to Copyright Owners during the license period. Trial Ex. 888 (Herring WRT ¶ 10).

VII. PANDORA'S TICKETFLY SUBSIDIARY

PPFF73. While most artists earn a significant portion of their revenue through touring, an estimated 40% of concert tickets generally go unsold, mainly due to lack of awareness—fans find out too late (or not at all) that a favorite artist is playing a concert nearby. Pandora has perceived a significant opportunity to sell more tickets via targeted promotion on its service to the benefit of consumers, artists, music publishers, and songwriters alike. Trial Ex. 880 (Herring WDT ¶ 45).

PPFF74. Accordingly, in October 2015, Pandora acquired Ticketfly, Inc., a leading live events technology company, to create a platform for connecting fans, artists, and event promoters through the Pandora service. Ticketfly provides ticketing and marketing software for approximately 1,200 leading venues and event promoters across North America and makes it easy for fans to find and purchase tickets to events. The acquisition of Ticketfly was another step toward achieving Pandora's mission not only to help listeners find music they love but also to help artists connect with their fans and potential broader audience and drive greater artist income. Trial Ex. 880 (Herring WDT ¶ 45).

PPFF75. Ticketfly, however, does not engage in any activity that implicates a music copyright holder's exclusive rights. It does not perform, reproduce, or distribute either sound recordings or musical works. Rather, Ticketfly generates revenues by charging the venues and promoters that utilize its electronic ticketing platform a processing fee. You do not need to be a Pandora user in order to buy tickets to a concert through Ticketfly, and a Pandora user cannot purchase a concert ticket without separately logging in to Ticketfly. The concert notifications

that Pandora provides to listeners in order to help drive greater connections between artists and their fans and a healthier music ecosystem are not limited to concerts for which the venue or promoter is a Ticketfly client; to the contrary, the vast majority of concert notifications delivered on Pandora's music services are for concerts for which tickets are sold through competing platforms. Trial Ex. 888 (Herring WRT ¶ 31); 3/14/17 Tr. 926:8-927:9 (Herring).

PPFF76. Ticketfly and Pandora are operated as completely separate businesses. They have separate Profit & Loss statements, separate cash flows, separate management teams, different business models, and different customer bases. Trial Ex. 888 (Herring WRT ¶ 32); 3/14/17 Tr. 926:8-927:17 (Herring). Pandora's ownership of Ticketfly does not enable it to operate its music service unprofitably or to defer music service revenues. Trial Ex. 888 (Herring WRT ¶ 33); 3/14/17 Tr. 927:18-928:10 (Herring).

PPFF77. Moreover, to the extent that Pandora is driving incremental attendance at concerts and other live events by notifying its listeners about nearby shows with music they enjoy, music publishers and songwriters *already* benefit directly. Concert venues and concert promoters pay performance rights royalties to music publishers and songwriters, typically as a percentage of revenues on gross ticket sales through licenses from PROs. Trial Ex. 888 (Herring WRT ¶ 34). Accordingly, incremental concert attendance provides incremental performance rights royalties to music publishers and songwriters. Songwriters who are also performing artists receive even greater direct economic benefits from the additional concert attendance, as they receive incremental income not only through musical work royalties, but also from the performing artist's share of ticket sales and merchandising. Trial Ex. 888 (Herring WRT ¶ 34); 3/14/17 Tr. 928:17-929:2 (Herring).

VIII. SUMMARY OF PANDORA'S PROPOSED RATES AND TERMS (AS AMENDED)

PPFF78. Pandora's proposed regulations for Subparts B and C of the statutory license provided by 17 U.S.C. § 115 during the period January, 1, 2018 through December 31, 2022 and a comparison of Pandora's proposed regulations to the current regulations with proposed changes marked are annexed as Appendices A and B. The differences between Pandora's Proposed Rates and Terms (As Amended) and the Proposed Rates and Terms submitted with Pandora's written direct case are shown in Appendix C. The key elements of Pandora's rate proposal and proposed changes to the regulations are described below. Additional technical or conforming changes proposed by Pandora are shown in Appendix B.

A. Proposed Rates

PPFF79. As to rates for interactive streaming and limited downloads governed by 37 C.F.R. § 385 Subpart B, Pandora proposes to preserve the current rates and rate structure, in which statutory licensees pay the greater of 10.5% of service revenue and certain minima that vary by type of service, less applicable performance royalties paid in connection with the licensed activity, except that Pandora proposes: (1) to eliminate the per subscriber royalty "floors" in § 385.13 for the reasons discussed in Section IX.F.1 below; and (2) to eliminate as unnecessary the alternate computation of Subminimums I and II presently available in cases in which the record company is the Section 115 licensee.

PPFF80. As to rates for "limited offerings" governed by 37 C.F.R. § 385 Subpart C, Pandora proposes to preserve the current rates and rate structure, subject to the same elimination of the alternate subminimum computation. Pandora takes no position as to rates for types of services licensed under Subpart C other than limited offerings.

B. Proposed Terms

PPFF81. In addition to certain technical or conforming changes shown in Appendix B, Pandora proposes the following changes to the terms set forth in the current regulations:

PPFF82. **Clarification of relationship to voluntary agreements:** Pandora proposes the addition of a new subsection 385.10(d) to Subpart B and a new subsection 385.20(d) to Subpart C to clarify in the regulations that rates and terms of direct license agreements entered into by rightsholders and interactive streaming services concerning rights within the scope of Section 115 apply in lieu of the rates and terms of the compulsory license to the use of musical works within the scope of such agreements. This proposed clarification would not change existing law or industry practice. It would merely incorporate the import of Section 115(c)(3)(E) of the Copyright Act into the regulations.

PPFF83. **Accommodation of family plans and student discounts:** Pandora proposes to add definitions of "family plan" and "student plan" to 37 C.F.R. § 385.11 and a provision for discounts for student plans as 37 C.F.R. § 385.15. As Mr. Herring explained, student plans and family plans enable subscription streaming services to earn incremental revenue from consumers who would not otherwise subscribe and are extremely hard to monetize through an ad-supported service. 3/14/17 Tr. 892:14-894:8 (Herring). The incremental revenues in turn result in higher royalties under Pandora's proposal, and accordingly, a rate structure that encourages their use is in the best interests of both the Copyright Owners and licensees. *Id*; *see also* Services' Joint Proposed Findings and Conclusions § 2.D.

PPFF84. **Amendments to the definitions of "service revenue" and "Subpart C service revenue" to clearly exclude revenue from products and services outside the scope of the licensed activity:** Pandora proposes to clarify the definitions of "service revenue" and

"Subpart C service revenues" to exclude revenues from products and services and outside the scope of the licensed activity. Many licensees, including Pandora, offer not only interactive streaming products and services, but also products and services that do not implicate the rights covered by the Section 115 license. *See, e.g.*, Section VII *supra* (describing Ticketfly electronic ticketing platform). If a business would not require mechanical rights, and therefore would not pay royalties to Copyright Owners, if it were owned by a non-licensee, there is no reason for its revenues to be included in "service revenue" or "Subpart C service revenues" merely because that business is owned by a licensee.

PPFF85. **Amendments to the definitions of "service revenue" and "Subpart C service revenue" concerning the exclusion of certain costs of acquiring revenue:** Pandora proposes to amend the definition of service revenue to provide for more consistent treatment of various costs of acquiring revenue. Specifically, Pandora proposes to treat carrier billing, credit card transaction, and app-store fees in a manner consistent with advertising agency deductions and subject to the same 15% cap on the amount of the exclusion. Trial Ex. 887 (Herring WDT ¶ 63).

PPFF86. **Amendment to the definition of "limited offering":** Pandora proposes a modest amendment of the definition of "limited offering" in 37 C.F.R. § 385.20 to make clear that offering replay functionality does not prevent a subscription service that otherwise qualifies as a "limited offering" from taking the compulsory licenses available for "limited offerings." Thousands of music publishers have agreed in direct licenses with Pandora to treat Pandora Plus as a "limited offering" for purposes of royalty rates, notwithstanding the replay functionality of Pandora Plus. Trial Ex. 974 (compendium of Pandora direct license agreements). The proposed amendment merely codifies what the marketplace uniformly has accepted.

PPFF87. **Additional definitions of a "Play" and a "Fraudulent Stream"**: Pandora proposes to add definitions of "play" and "fraudulent stream" to 37 C.F.R. § 385.11 and 37 C.F.R. § 385.20 for the reasons explained in Section XVIII of the Services' Joint Proposed Findings and Conclusions.

PROPOSED CONCLUSIONS OF LAW

IX. PANDORA'S PROPOSED RATES AND TERMS (AS AMENDED) SATISFY THE SECTION 801(b) RATE-SETTING OBJECTIVES

PPCL1. The Services' Joint Proposed Findings and Conclusions address the Section 801(b) policy objectives and the legal framework that governs rate-setting here. Joint Proposed Findings and Conclusions § XIII. That joint filing also explains why the Copyright Owners' rate proposal does not satisfy the Section 801(b) objectives. *Id.* at § XIV. In this section, Pandora briefly encapsulates the rate-setting standard and explains why Pandora's Proposed Rates and Terms (As Amended) do satisfy those objectives and should be adopted by the Judges.

A. The Requirement That Royalty Rates Shall Be Established De Novo

PPCL2. In this proceeding, the royalty rates payable for the compulsory license available under Section 115 shall be established de novo. 37 C.F.R. §§ 385.17, 385.26. Mr. Israelite has baselessly attempted to claim that the Judges are precluded from continuing the current rates or using them as a benchmark to determine new rates. 3/28/17 3586-3587:5 (Israelite); 3/29/17 Tr. 3777:17-25 (Israelite); Services' Joint Proposed Findings and Conclusions § V.E.2. They are incorrect.

PPCL3. The requirement that the Judges establish the royalty rates de novo does *not* prevent the Judges from considering the existing rates, or the settlement agreement that led to their adoption, as a benchmark. The requirement, a version of which appears in Section

115(c)(3)(D) of the Copyright Act, simply means that the existing rates do not have binding precedential effect and the Judges should evaluate proposals based on current rates (and any proposed adjustments) according to whether they satisfy the policy objectives of Section 801(b). *See, e.g.*, *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 46 Fed. Reg. 10466, 10486 (Feb. 3, 1981) ("The Tribunal recognizes that Congress intended that the rates in the Act should not be regarded as precedents in future proceedings of this Tribunal. We have not in our determination, considered the rates established by Congress as precedential but we have taken them into consideration as a 'benchmark of reasonableness.'").

PPCL4. Moreover, the requirement that rates be established de novo does not apply to the non-rate license terms. The regulations expressly distinguish between "rates" and "terms," and those terms are not used interchangeably. *Compare* 37 C.F.R. §§ 385.17, 385.26 (requiring "rates" to be established de novo) *with* 37 C.F.R. § 385.10 ("This subpart establishes rate *and terms* of royalty payments for interactive streams . . .) (emphasis added). Where the regulations are intended to require that particular terms be subject to de novo review, they do so in carefully limited and express fashion. *See* 37 C.F.R. §§ 385.14(a)(4), 385.24(d) (providing with respect to promotional streams that "[t]he terms of this section shall be subject to de novo review and consideration (or elimination) in future proceedings . . ."). Thus, according to basic tenets of statutory and regulatory construction, there is no requirement that license terms generally be established de novo here. *See, e.g.*, *Qwest Corp. v. Colorado Pub. Utilities Comm'n*, 656 F.3d 1093, 1099 (10th Cir. 2011) ("If an agency includes a term in one provision of a regulation but excludes it in another, this court will not presume that the term applies to the provision from which it is omitted.") (citing *Atlas Tel. Co. v. Okla. Corp. Comm'n*, 400 F.3d

1256, 1265 (10th Cir.2005)); *see also Cremeens v. City of Montgomery*, 602 F.3d 1224, 1227 (11th Cir. 2010) ("We apply the canons of construction to regulations as well as to statutes.").

B. The Section 801(b) Policy Objectives for Rate-Setting as Informed by Dr. Katz's Economic Interpretation and the Relevant Jurisprudence

1. The Royalty Rate Must Maximize the Availability of Creative Works to the Public

PPCL5. Section 801(b)(1)(A) requires rates to be calculated to "maximize the availability of creative works to the public." 17 U.S.C. § 801(b)(1)(A). This objective is intended to encourage both the creation and the dissemination of musical works. *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 Fed. Reg. 10466, 10479 (Feb. 3, 1981). The policy objective of furthering availability matches the utilitarian concept of copyright codified in the Constitution. *See Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., Inc.*, 499 U.S. 340, 349 (1991) (U.S. copyright exists "not to reward the labor of authors, but '[t]o promote the Progress of Science and useful Arts.'") (quoting U.S. Const. Art. I, §8, cl. 8)); *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) ("[c]reative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting *broad public availability* of literature, music, and the other arts.") (emphasis added).

PPCL6. The availability of creative works to the public depends on the economic incentives and financial returns that motivate content creators (*e.g.*, songwriters, publishers, performing artists, and record labels) to create and publish such works and content distributors (*e.g.*, streaming services) to distribute such works. Trial Ex. 885 (Katz WDT ¶¶ 10, 13); 3/13/17 Tr. 552:10-553:3 (Katz). Neither set of parties will be willing to incur the costs of creating and distributing creative works—including investment costs—without the prospect of being

adequately and sufficiently compensated. Trial Ex. 885 (Katz WDT ¶ 13). Thus, the statutory objective of maximizing the availability of creative works can be achieved in this proceeding only if the statutory royalties give *both* writers/publishers *and* streaming services the opportunity to earn adequate financial returns if they are able to create offerings that are attractive relative to those of their competitors. Trial Ex. 885 (Katz WDT ¶¶ 13-14); 3/13/17 Tr. 552:10-553:3 (Katz).

PPCL7. Given the increasingly important role played by streaming services in how music is distributed to the public, *see* Section III.C., *supra*, the availability of musical works to the public depends, now more than ever, on streaming services' ability to earn adequate financial returns on their investments. Trial Ex. 885 (Katz WDT ¶ 14). If streaming services are unable to earn sufficient financial returns, they will be less incentivized to make additional investment and could cease operations altogether (as several have done). Trial Ex. 885 (Katz WDT ¶ 15). Even if streaming services remain in business, availability of musical works will not be maximized if streaming services are forced to raise prices to the point that they discourage consumers from subscribing or to induce services to provide less attractive products, leading to reduced use. Trial Ex. 885 (Katz WDT ¶ 15). Indeed, the price charged to consumers is relevant to the objective of maximizing availability because availability depends on consumers getting access to musical works at prices that they are actually willing to pay. 3/13/17 Tr. 553:4-21 (Katz). Availability of musical works also depends on songwriters' and publishers' ability to earn sufficient monetary and non-monetary rewards to incentivize the continued production of content. Trial Ex. 885 (Katz WDT ¶ 16). However, royalties from the streaming services at issue in this proceeding are only one revenue stream for songwriters and publishers and the many other sources of revenue streams must be considered when evaluating the songwriters' and

publishers' economic (and non-economic) incentives for continuing to create musical works. Trial Ex. 885 (Katz WDT ¶ 16); *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (SDARS I)*, 73 Fed. Reg. 4080, 4090 (Jan. 24, 2008) (copyright owners' "incentives to produce new music are based on revenues from *all* available sources") (emphasis added).

2. The Royalty Rate Must Afford the Copyright Owner a Fair Return and the Copyright User a Fair Income

PPCL8. The second objective requires that the rate "afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions." 17 U.S.C. § 801(b)(1)(B). The mechanical license "regulates the price of music to lower the entry barriers for the potential users of music," *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25409 (May 8, 1998), and it derives from "Congress' decision to permit entry into the music market by a potential copyright user. . . . at will." *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 Fed. Reg. 10466, 10480 (Feb. 3, 1981). The goal of this objective is to "balance[] the owners' right to compensation against the users' need for access to the works at a price that would not hamper their growth." 63 Fed. Reg. at 25409. The statutory rate therefore must be "a royalty of reasonable resort." 46 Fed. Reg. at 10480.

PPCL9. Economics interprets the concept of fairness invoked in Section 801(b)(1)(B) in many different ways. Trial Ex. 885 (Katz WDT ¶ 17); 3/13/17 Tr. 554:20-555:10 (Katz). One could evaluate the concept of fairness by assessing whether a particular outcome is in itself fair or whether the outcome is the result of a fair process or procedure. Trial Ex. 885 (Katz WDT ¶ 18); 3/13/17 Tr. 554:20-555:10 (Katz). Rather than focusing solely on the

outcome itself, it is more appropriate in the context of this proceeding to interpret the concept of fairness based on the notion that an outcome is fair if it is the result of a fair process—namely, a process that would have occurred in an effectively competitive market. Trial Ex. 885 (Katz WDT ¶¶ 19-20); 3/13/17 Tr. 554:20-555:10 (Katz). A competitive market does not need to be characterized by perfect competition; effective competition is sufficient but requires multiple independent suppliers and that consumers have the choice among the different suppliers in response to differences in prices or product quality. 3/13/17 Tr. 555:11-25 (Katz).

PPCL10. Economists consider a bargain in an effectively competitive marketplace to be fair because it represents a fair process, one in which each party has equal knowledge, sophistication, and bargaining power and there is equality of opportunity even if outcomes differ. Trial Ex. 885 (Katz WDT ¶¶ 18, 20). Many economic policies, including antitrust, are predicated on the idea that outcomes corresponding to what would have happened in an effectively competitive marketplace are fair. Trial Ex. 885 (Katz WDT ¶ 20). Under this conception of fairness, a fair return to a copyright owner and fair income to a copyright user are the return and income that would arise in an effectively competitive market in the absence of a mandatory licensing requirement. Trial Ex. 885 (Katz WDT ¶ 20).

PPCL11. In applying a competitive market approach to fairness, it is important to account for sunk costs, meaning costs a firm has already incurred and cannot recover. Trial Ex. 885 (Katz WDT ¶ 21). Although some costs (like investments in launching a streaming service or writing songs) may be considered sunk in the short run, most costs are variable over long time horizons and would affect the competitive outcome. Trial Ex. 885 (Katz WDT ¶ 21). In other words, it is important to consider bargaining over the proper time frame. Trial Ex. 885 (Katz WDT ¶ 21). If a party expects that once it has incurred a sunk cost, it will never be compensated

for such cost again in the future, that party will not be willing to invest in creating a song or building the infrastructure for a music streaming service. 3/13/17 Tr. 556:24-556:22 (Katz)

PPCL12. It is also important to note that ensuring a fair *opportunity* to earn incomes and returns does not imply that any party is entitled to guaranteed incomes or returns. Trial Ex. 885 (Katz WDT ¶ 21). Some parties will compete more successfully than others in effectively competitive markets, and both entry and exit are normal and expected. Trial Ex. 885 (Katz WDT ¶ 21).

3. The Royalty Rate Must Reflect the Relative Roles of the Copyright Owner and the Copyright User in the Product Made Available to the Public

PPCL13. The third statutory objective requires the rate to "reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication." 17 U.S.C. § 801(b)(1)(C). The "product made available to the public" refers not to the underlying musical works, but to the entire digital music service. *See Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25408 (May 8, 1998). Together with Section 801(b)(1)(B), this objective indicates that rates should "achieve an equitable division of music industry profits between the copyright owners and users." *Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal*, 662 F.2d 1, 8-9 (D.C. Cir. 1981).

PPCL14. From an economic perspective, this objective raises considerations that overlap with the first two statutory objectives. Trial Ex. 885 (Katz WDT ¶ 25); 3/13/17 Tr. 556:1-10 (Katz). For example, a failure to reflect the parties' investments, costs, and risks,

would reduce availability because it would diminish the incentives driving creators or distributors to make copyrighted works available to the public. Trial Ex. 885 (Katz WDT ¶ 26); 3/13/17 Tr. 556:1-10 (Katz). Similarly, the relative creative and technological contributions and contributions to opening up new markets capture the extent to which investments and other activities contribute to maximizing availability. Trial Ex. 885 (Katz WDT ¶ 26).

PPCL15. The objective of reflecting relative roles is also similar to the fair income/fair return objective. Trial Ex. 885 (Katz WDT ¶ 27). Under effective competition or bargaining by parties with comparable market power, any agreement reached would reflect relative contributions to the creation of benefits and relative costs, including investment costs, incurred to make those contributions. Trial Ex. 885 (Katz WDT ¶ 27); 3/13/17 Tr. 556:11-16 (Katz). If a fair outcome is one that reflects the outcome of an effectively competitive marketplace, failure to reflect relative contributions and costs would produce an unfair result. Trial Ex. 885 (Katz WDT ¶ 27).

PPCL16. From an economic perspective, stating a separate objective of reflecting relative capital investment and risk highlights the desirability of taking return on investments, including sunk costs, into account in determining statutory royalties. Trial Ex. 885 (Katz WDT ¶ 28); 3/13/17 Tr. 556:17-23 (Katz). In other words, this objective counsels in favor of considering price-setting in the context of a forward-looking process, *i.e.* one that considers the effects of the proceeding on future investments. Trial Ex. 885 (Katz WDT ¶ 28). The importance of accounting for sunk costs becomes clear when one considers what would happen if they were ignored. Trial Ex. 885 (Katz WDT ¶ 28 n.26). Not only would the streaming services' investments be disregarded, but so would the sunk costs incurred by songwriters to

produce existing songs—and those songwriters would therefore not be entitled to compensation. Trial Ex. 885 (Katz WDT ¶ 28, n.26).

4. The Royalty Rate Must Be Set So as to Minimize Any Disruptive Impact on the Industry

PPCL17. The final statutory objective requires that any rate must be calculated to "minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices." 17 U.S.C. § 801(b)(1)(D). This objective codifies Congressional intent "not to hamper the arrival of new technologies." *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25408 (May 8, 1998). A royalty rate that would cause interactive streaming services to cease operating or to dramatically change the nature of their products is disruptive. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (SDARS I)*, 73 Fed. Reg. 4080, 4097 (Jan. 24, 2008). In evaluating disruptiveness, the Judges must consider "the effect of the royalty rate on the future of the music industry." *Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal*, 662 F.2d 1, 8 (D.C. Cir. 1981). The Judges therefore examine the financial health of the parties. *See* 63 Fed. Reg. at 25408, 25410.

PPCL18. From the perspective of economics, minimizing disruption requires analyzing the impact of any change in the royalty rate on the music publishing and streaming industries. Trial Ex. 885 (Katz WDT ¶ 29. Logically, the action that would cause the least disruption to the industries involved would be to maintain the same licensing terms and conditions as before. Trial Ex. 885 (Katz WDT ¶ 29). On the other hand, analysis of the disruptive impact from an economic perspective should not be viewed as binary but more on a continuum view. In other words, it is not always the case that disruption is minimized by preserving the status quo, especially when the status quo is unsustainable. Trial Ex. 885 (Katz

WDT ¶ 29); 3/13/17 Tr. 558:14-559:6 (Katz). For example, maintaining the status quo would be disruptive if the current terms were creating, or are expected to create, financial conditions making business as usual with respect to the licensed activities unsustainable over the 2018-2022 license period. Trial Ex. 885 (Katz WDT ¶ 29). However, this has not been the case. Since the implementation of the 2012 Settlement, content creators have continued to produce new, high-quality music, and streaming services have become an increasingly popular and important source of content distribution. Trial Ex. 885 (Katz WDT ¶ 30). Despite the threat of ongoing economic challenges like piracy, these industries are likely to remain sustainable over the coming years. Trial Ex. 885 (Katz WDT ¶ 30). The objective of minimizing disruption therefore indicates that it would be desirable to avoid making major changes to the statutory royalty scheme. Trial Ex. 885 (Katz WDT ¶ 30). Thus, if an industry is economically healthy—as it is here—maintaining the status quo is what minimizes disruption. Trial Ex. 885 (Katz WDT ¶ 28); 3/13/17 Tr. 559:7-9 (Katz).

PPCL19. The issue of disruption is also important because of how it affects incentives to invest, tying back to the objectives of maximizing availability and affording the parties fair incomes and returns. Trial Ex. 885 (Katz WDT ¶ 31). A significant increase in the royalty rate would negatively affect all three of these objectives. First, availability would be harmed because the higher royalties mean a lower return on any investment, and thus would reduce the incentive to make new investments in interactive streaming services. Trial Ex. 885 (Katz WDT ¶ 31). Second, a major change in royalty rates would be disruptive and create uncertainty going forward. Trial Ex. 885 (Katz WDT ¶ 31). Perceived instability in royalty rates could make both current interactive streaming services and potential entrants reluctant to invest. Trial Ex. 885 (Katz WDT ¶ 31). Finally, if past investments were made with expectations

regarding future royalties, and those investments have not yet covered their costs, an increase in royalty rates would implicate the issues of fair income and fair return. Trial Ex. 885 (Katz WDT ¶ 31).

C. The Use of Benchmarks for Determining a Reasonable Rate

PPCL20. One approach to determining a reasonable statutory rate structure and levels is to rely on private agreements between industry participants who have identified rate structures and levels that they have found to be reasonable and promote attainment of statutory objectives. Trial Ex. 885 (Katz WDT ¶ 68). This approach is set forth in Section 115, which states that "in establishing . . . rates and terms, the Copyright Royalty Judges may consider rates and terms under voluntary license agreements." 17 U.S.C. § 115(c)(3)(D). The Judges may also consider a benchmark not explicitly contemplated by the statute if it is probative. *See Determination of Royalty Rates for Digital Performance Right in Sound Recordings and Ephemeral Recordings (Web III)*, 79 Fed. Reg. 23102, 23110 (Apr. 25, 2014). Accordingly, the Judges have consulted and relied on benchmarks in prior proceedings, including *Phonorecords II*. *See* Trial Ex. 885 (Katz WDT ¶ 68); *Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings (Web IV)*, 81 Fed. Reg. 26316, 26326 (May 2, 2016) ("[T]he Judges have relied upon certain marketplace agreements as benchmarks for the setting of the statutory rates."); *Web III*, 79 Fed. Reg. at 23110 ("[I]t is appropriate to rely on benchmarks to establish rates in this section 114 proceeding."); *Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal*, 676 F.2d 1144, 1157 (7th Cir. 1982) ("[T]he Tribunal could properly take cognizance of the marketplace analogies while appraising them to reflect the differences in both the respective markets . . . and the regulatory environment.").

PPCL21. However, not all private agreements will be helpful in achieving statutory objectives, such as those that were negotiated in the presence of distortionary differences in bargaining power, or by parties in very different situations than those subject to the statutory license regime. Trial Ex. 885 (Katz WDT ¶ 69); *SDARS I*, 73 Fed. Reg. at 4088 ("[P]otential benchmarks are confined to a zone of reasonableness that excludes clearly noncomparable market situations."). Thus, some potential benchmarks must be discarded, while others must be adjusted to account for differences between the benchmark market and the target market. Trial Ex. 885 (Katz WDT ¶ 69); *Web III*, 79 Fed. Reg. at 23110 (Judges may rely on benchmarks if they "find them to be sufficiently comparable, perhaps after any appropriate adjustments"). Adjusting benchmarks is often complicated and prone to error. Trial Ex. 885 (Katz WDT ¶ 70). The best benchmarks are therefore those requiring minimal adjustment. Trial Ex. 885 (Katz WDT ¶ 70).

D. The 2012 Settlement is an Economically Sound Benchmark for Setting Statutory Rates for the 2018-2022 License Period

1. Overview of the 2012 Settlement and the Current Statutory Rates and Terms

PPCL22. As explained in detail in the Services' joint filing, the current statutory rates and terms were adopted in the prior Section 115 rate-setting proceeding and are based on the 2012 Settlement. Services' Joint Proposed Findings and Conclusions § V.D.–E. The 2012 Settlement has several key elements:

- *Accounts for Different Categories of Services.* The 2012 Settlement consists of Subpart B and Subpart C. Subpart B of the regulations establishes rates and terms for interactive streams and limited downloads by subscription and non-subscription digital music services. 37 CFR § 385.10(a). Subpart C establishes

rates and terms of royalty payments for limited offerings, mixed service bundles, music bundles, paid locker services and purchased content locker services. 37 CFR § 385.20(a).

- *Headline Percentage-of-Revenue Rates*. Under the revenue prong, a headline royalty rate is applied to applicable service revenue: 10.5 percent for interactive streaming services licensed under Subpart B and for "limited offerings" such as Pandora Plus licensed under Subpart C. 37 C.F.R. §§ 385.12(b), 385.23(a)(3).[3] The headline rate covers both mechanical royalties and public performance royalties. 37 C.F.R. § 385.23(a); Trial Ex. 885 (Katz WDT ¶ 75).
- *Per-subscriber or Alternate Minimums*. There is a set of per-subscriber or alternate minimums that apply to the sum of mechanical and public performance royalties and which vary depending on the type of service (*e.g.*, $.80 per subscriber per month for a portable subscription service under Subpart B like Pandora Premium and $0.18 per subscriber per month for a "limited offering" under Subpart C like Pandora Plus). 37 C.F.R. § 385.13 and 37 C.F.R. § 385.23. These minimums also cover both mechanical royalties and public performance royalties.
- *Deduction for Performance Rights Royalties*. In order to determine the incremental payment due under the statutory license, a licensee may subtract the amounts paid for public performance rights from the total royalty payment. 37 C.F.R. §§ 385.12(b), 385.22(b).

[3] The headline rates for services operating under Subpart C vary by service type. Pandora takes no position as to the appropriate headline rate for any Subpart C category other than "limited offerings."

- *A Mechanical-Only Floor*. For certain types of services operating under Subpart B, the mechanical royalty payment due after deduction of the performance rights payments is subject to a per-subscriber, mechanical-only floor. These floors vary by service, and free non-subscription/ad-supported services have no mechanical-only floor at all. 37 C.F.R. §§ 385.13(a). There are no mechanical-only floors for any service operating under Subpart C. 37 C.F.R. §§ 385.22(b).

PPCL23. Tables summarizing current rates for each type of service are set forth in Dr. Katz's written direct testimony. Trial Ex. 885 (Katz WDT ¶ 76 & Tables 2, 3). For any given service, the smaller of the two applicable subminimum percentages in the tables is used to calculate that component of the royalty formula when "the record company is the licensee," and the larger of the two when it is not. 37 C.F.R. §§ 385.13(b)(1)-(2), 385.13(c)(1)-(2), 385.23(b)(1)-(2).

2. Advantages of Using the 2012 Settlement as Benchmark

PPCL24. The 2012 Settlement is an excellent benchmark to use in setting royalties because it requires very little adjustment to match the conditions of this proceeding. Trial Ex. 885 (Katz WDT ¶ 71); 3/13/17 Tr. 550:25-551:7 (Katz). This is so for many reasons. It involved similar (in some cases identical) parties, and an identical set of rights. Trial Ex. 885 (Katz WDT ¶ 71); 3/13/17 Tr. 567:14-25 (Katz). Unlike other potential benchmark agreements that cover other services and products, or were negotiated concurrently with agreements covering other services or products, the 2012 Settlement covered only the rights at issue here. Trial Ex. 885 (Katz WDT ¶ 71); 63 Fed. Reg. at 25402 ("Courts recognize that complex transactions encourage tradeoffs among the various provisions and lead to results that most likely differ from those that would result from a separately negotiated transaction."); *see also Am. Soc. of*

Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc., 912 F.2d 563, 590 (2d Cir. 1990). The 2012 Settlement is also relatively recent, and an examination of how the industry has changed demonstrates that it is not an outdated benchmark. Trial Ex. 885 (Katz WDT ¶ 71). No asymmetries in market power or bargaining positions distorted the outcome in favor of the interactive streaming services. Trial Ex. 885 (Katz WDT ¶ 71); 3/13/17 Tr. 567:3-9 (Katz); *see generally* Services' Joint Proposed Findings and Conclusions § V (discussing negotiation of 2012 Settlement and prior 2008 agreement on reasonable royalty rates for the Section 115 license).

PPCL25. Critically, the settlement was negotiated in the shadow of a Section 801(b)(1) rate-setting proceeding that both sides were fully capable of litigating. Trial Ex. 885 (Katz WDT ¶ 72); 3/13/17 Tr. 567:2-13, 568:21-570:13 (Katz). Since any party could have chosen to abandon settlement discussions and litigate, neither side would have accepted a deal worse than what they expected to get in a rate-making proceeding under the Section 801(b)(1) objectives. Trial Ex. 885 (Katz WDT ¶ 72); 3/13/17 Tr. 570:21-571:15 (Katz). In other words, the parties' view of how the Section 801(b)(1) objectives would likely be interpreted by the Judges at trial put a lower bound on what terms the parties would accept in the settlement. Trial Ex. 885 (Katz WDT ¶ 72).

PPCL26. Even beyond this negotiating floor, the combination of the shadow of a rate-making proceeding and the parties' incentives mean that they would have tended to converge on a settlement that fulfills the Section 801(b)(1) objectives. Trial Ex. 885 (Katz WDT ¶ 73); 3/13/17 Tr. 570:6-13, 575:13-576:6 (Katz). First, economically rational parties negotiating a licensing agreement will seek to maximize availability, all else being equal, in order to maximize their profits from consumers enjoying that availability. *See* Trial Ex. 885

(Katz WDT ¶ 73); 3/13/17 Tr. 571:25-573:2 (Katz). Second, the fact that settlement resulted from industry-wide negotiations in the shadow of a rate-making proceeding prevented music publishers from exploiting asymmetries in bargaining power. 3/13/17 Tr. 568:15-569:8 (Katz). As a result, the 2012 Settlement can be seen as the outcome of effective competition, and thus provides a fair income and return on investment. Trial Ex. 885 (Katz WDT ¶ 73); 3/13/17 Tr. 576:10-577:24 (Katz). Third, economic principles indicate that, in the absence of excessive bargaining power or distortionary government policy strengthening one side, negotiated settlements will reflect relative contributions. Trial Ex. 885 (Katz WDT ¶ 73). Last, in assessing the costs and benefits of an agreement, the parties have economic incentives to account for disruption and to minimize their collective costs of disruption from the agreement. Trial Ex. 885 (Katz WDT ¶ 73).

E. The Reasonableness of Continuing the 2012 Settlement Royalty Structure for the 2018-2022 License Period

PPCL27. Trends in the music industry since 2012 show the music industry is thriving, and that current rates and terms are therefore reasonable and sustainable. 3/13/17 Tr. 559:10-560:18 (Katz); *see also* Trial Ex. 885 (Katz WDT ¶ 53). The decline in music industry revenues since 1999 has finally levelled off thanks to rapidly growing revenues from streaming over the past five years and is now increasing again. Trial Ex. 885 (Katz WDT ¶ 56); Trial Ex. 2727 at 13; 3/13/17 Tr. 611:15-612:2 (Katz); *see* Trial Ex. 1070 (Zmijewski WRT ¶¶ 17, 43); Trial Ex. 306. Since the 2012 Settlement, overall album consumption has increased by 23%. Trial Ex. 885 (Katz WDT ¶ 57). This increase was driven by a 370% increase in streaming music, and occurred in spite of a 28% decline in physical sales and digital downloads. Trial Ex. 885 (Katz WDT ¶ 57). Publishing revenues have started to increase again, with the NMPA's own estimate showing an increase of [redacted] between 2014 and 2015 alone, the most recent year

for which the NMPA collected the data. Trial Ex. 885 (Katz WDT ¶ 58); Trial Ex. 306, 3/29/17 Tr. 3724:4-17, 3728:5-16 (Israelite); *see* 4/12/17 Tr. 5783:9-12 (Zmijewski) ("[O]nce you include the performance of streaming revenues, for most of the companies, they had over this period and over the longer period an increase. They had growth."). The three largest publishers, Sony/ATV, UMPG, and Warner/Chappell, collectively earned over [redacted] in profits from U.S. music in 2015. Trial Ex. 885 (Katz WDT ¶ 59). ASCAP and BMI, the largest U.S. PROs, have added hundreds of thousands of new songwriter members and millions of new musical works to their repertories between 2012 and 2015. Trial Ex. 885 (Katz WDT ¶¶ 60-61); 3/13/17 Tr. 617:9-618:19 (Katz); Trial Ex. 695 (Leonard AWDT ¶ 96). As a result, both PROs announced record-breaking billion-dollar revenues this year. Trial Ex. 885 (Katz WDT ¶ 61). Analysts, including those at the RIAA, recognize these trends as driven by streaming music, and expect them to continue into the future. Trial Ex. 885 (Katz WDT ¶ 62); 3/13/17 Tr. 612:3-11 (Katz); *see generally* Trial Ex. 2727.

PPCL28. Unlike the publishers, however, stand-alone interactive streaming services are generally unprofitable. Trial Ex. 885 (Katz WDT ¶¶ 64-65); *see also* Trial Ex. 695 (Leonard AWDT ¶¶ 98-100). Indeed, there is no evidence in the record that any interactive streaming service has ever achieved sustained profitability. Accordingly, the current rates, if anything, are too high and too favorable to copyright owners. Trial Ex. 695 (Leonard AWDT ¶ 101); 3/13/17 Tr. 619:9-620:16 (Katz); *see Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal*, 662 F.2d 1, 8-9 (D.C. Cir. 1981) ("fair income" and "relative roles" provisions in Section 801(b)(1) indicate that rates should "achieve an equitable division of music industry profits between the copyright owners and users"); *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394, 25409 (May 8, 1998) (rates must

"balance[] the owners' right to compensation against the users' need for access to the works at a price that would not hamper their growth.").

PPCL29. Although Pandora has proposed some alterations to account for changes in the market for interactive streaming, the three key features of the 2012 Settlement are still reasonable today: (1) a flexible rate structure that accommodates different business models, encourages innovation, and allows services to try to reach all parts of the demand curve; (2) an "all-in" rate covering both mechanical and performance rights, with a deduction for performance royalties; and (3) a royalty structure consisting of a percentage of service revenues supplemented by a per-subscriber minimum (with the latter differentiated by service type). *See* Trial Ex. 885 (Katz WDT ¶¶ 43, 78-86, 95-96).

1. The Royalty Rate Should Retain Differentiated Rate Categories for Different Types of Services

PPCL30. The 2012 Settlement's structure of different headline rates and minimums for different categories of services is still reasonable today and should be continued. Trial Ex. 885 (Katz WDT ¶¶ 85-86); 3/13/17 Tr. 586:21-587:7 (Katz); 3/14/17 Tr. 884:21-885:16 (Herring). As described above, both the percentage of revenue and per-subscriber minimum royalties vary across services depending on their characteristics (*e.g.*, portable or not; locker service or streaming service; limited offering or full-service offering). Trial Ex. 885 (Katz WDT ¶ 85); Trial Ex. 22 (Hubbard WDT ¶ 4.5). These differentiated rates are desirable because they reflect differences in the underlying commercial economics of different types of services. Trial Ex. 885 (Katz WDT ¶ 85); Trial Ex. 22 (Hubbard WDT ¶¶ 4.4, 4.7); 3/13/17 Tr. 586:21-587:7 (Katz). For instance, consumers are generally less willing to pay for a non-portable, limited service than for a portable, unlimited service. Trial Ex. 885 (Katz WDT ¶ 85). A one-size-fits-all royalty rate cannot reflect these differences, and could render some types of services

unprofitable—even though they may be profitable under an appropriate royalty rate. Trial Ex. 885 (Katz WDT ¶ 85); *see* Trial Ex. 22 (Hubbard WDT ¶ 4.7); 3/14/17 Tr. 884:21-885:16 (Herring). Similarly, a uniform per-subscriber minimum cannot accommodate reasonable promotional efforts like free trials without triggering an unwarranted increase in the effective percentage of revenue paid. Trial Ex. 880 (Herring WDT ¶ 61).

PPCL31. This artificial constriction of business models leaves money on the table because consumers vary in terms of what features they care about and how much they are willing to spend on music. *See* Trial Ex. 885 (Katz WDT ¶ 85); Trial Ex. 880 (Herring WDT ¶ 35); Trial Ex. 877 (Phillips WDT ¶ 9, 25); 3/14/17 Tr. 884:21-885:16 (Herring). Furthermore, accommodating users who are initially interested in only an ad-supported, inexpensive, or promotional service tier provides later opportunities to upsell them to a more expensive premium service. Trial Ex. 880 (Herring WDT ¶ 35); Trial Ex. 877 (Phillips WDT ¶ 25); 3/14/17 Tr. 865:1-25 (Herring). In sum, economic analysis indicates that a rate structure that promotes differentiation of product offerings should be maintained to facilitate continuing innovation, experimentation, and differentiation in means of making music accessible to all types of consumers. Trial Ex. 885 (Katz WDT ¶ 85); 3/14/17 Tr. 884:21-885:16 (Herring); *see* Trial Ex. 22 (Hubbard WDT ¶ 4.7).

PPCL32. The importance of preserving rate differentiation for different types of services is seen clearly in Pandora's decision to offer both a mid-tier product, Pandora Plus, and a premium-tier product, Pandora Premium. Pandora Plus has only a modicum of interactivity and makes minimal use of the mechanical rights at issue here: there is no on-demand listening and less than [redacted] of the streams will involve interactive features of any kind. *See* Paragraphs 20-22, *supra*. It is designed to appeal to consumers who are currently either unwilling or unable to

pay the $9.99 per month rate for a premier subscription product, and to provide a means for Pandora to upsell listeners from its ad-supported, noninteractive radio service to a subscription on-demand product over time. Trial Ex. 877 (Phillips WDT ¶ 25).

PPCL33. Pandora Premium, on the other hand, has full on-demand functionality, sells for twice the price of Pandora Plus, and makes much greater use of the mechanical rights at issue. There is no basis *whatsoever* for rates to be set in a way such that Pandora would have to pay the same amount in royalties for Pandora Plus and Pandora Premium, as the industry has broadly acknowledged. Pandora has entered into thousands of direct licenses with music rightsholders, [redacted] *See, e.g.*, Trial Ex. 974.

PPCL34. As Mr. Herring explained, Pandora [redacted] Trial Ex. 888 (Herring WRT ¶¶ 8-10); 3/14/17 Tr. 911:19-21 (Herring).

2. The Royalty Rate Should Preserve the "All-in" Rate Structure

PPCL35. Another important feature of the 2012 Settlement is the inclusion of an "all-in" rate covering both mechanical and public performance rights. An interactive streaming service must acquire both mechanical and public performance rights for any music it wishes to provide to listeners. Trial Ex. 885 (Katz WDT ¶ 43). From the perspective of interactive streaming services, the two rights are perfect complements: neither has any value without the other. Trial Ex. 885 (Katz WDT ¶¶ 43, 92); Trial Ex. 880 (Herring WDT ¶ 59); 3/13/17 Tr. 561:22-563:7, 587:8-20 (Katz); 3/14/17 Tr. 882:23-883:2 (Herring). When making business

decisions, a streaming service views the two rights as inextricably linked. Trial Ex. 885 (Katz WDT ¶ 43); Trial Ex. 880 (Herring WDT ¶ 59); *see* 3/14/17 Tr. 883:3-16, 892:2-13 (Herring). The cost of adding music to a service's product is the sum of the two licenses, and all else equal, any increase in the royalty charged for one type of license will lower a service's willingness to pay for the other. Trial Ex. 885 (Katz WDT ¶ 43). The reverse is also true. The same sellers (songwriters and publishers) control both sets of rights, and the revenue they gain from licensing a composition to an interactive streaming service is the sum of the two licenses. Trial Ex. 885 (Katz WDT ¶ 43); Trial Ex. 880 (Herring WDT ¶ 59. As a result of this complementarity, economic logic dictates that the reasonable outcome would be to jointly determine the two royalty rates. Trial Ex. 885 (Katz WDT ¶¶ 43, 88); 3/13/17 Tr. 561:21-562:9, 587:8-588:9 (Katz).

PPCL36. Uncontroverted evidence reflects that the all-in rate structure was a key element of the willingness of streaming services to agree to pay mechanical rates at the levels reflected in the current regulations, both in 2008 when the rate was originally set and again in 2012 when the rate was continued. Trial Ex. 875 (Parness WDT ¶¶ 7, 13); 3/8/17 Tr. 170:3-171:5 (Levine); 3/8/17 Tr. 299:2-20, 300:12-301:1, 308:13-309:2 (Parness) ("[T]hat was the reason from the Services point of view about why we were willing to agree to a mechanical rate and interactive streaming because it specifically encompassed an all-in rate where you get a credit for the public performance royalties that you pay."); 3/8/17 Tr. 170:3-171:5 (Levine).

3. The Royalty Rate Should Be Set as a Percentage of Applicable Service Revenues Royalties Subject to a Per-Subscriber or Other Appropriate Minimum Fee

PPCL37. The 2012 Settlement's method of calculating royalties as a percentage of total revenues, supplemented by a per-subscriber minimum, also remains reasonable. Trial Ex.

885 (Katz WDT ¶ 80); 3/13/17 Tr. 588:10-13 (Katz). The percentage of revenue method for calculating royalties is widely accepted by industry participants. *See* Trial Ex. 880 (Herring WDT ¶ 60); Trial Ex. 888 (Herring WRT ¶ 18); 3/13/17 Tr. 588:14-24 (Katz). The percentage of revenue rate structure is also used in a wide variety of private agreements between digital music services (as well as terrestrial radio broadcasters) and music publishers and PROs, and in the licensing of intellectual property more generally. Trial Ex. 888 (Herring WRT ¶ 18); Trial Ex. 695 (Leonard AWDT ¶¶ 54, 57-59, 66, 68, 69, 71, 74). For example, Pandora has historically paid performance rights royalties to music publishers on this basis (whether directly or via PROs), and it remains the basis of Pandora's performance royalties to ASCAP and BMI for its interactive tiers of service. Trial Ex. 888 (Herring WRT ¶ 18). Pandora's agreements with PROs also provide for the payment of royalties on a percentage of the revenue basis. 3/13/17 Tr. 767:23-768:3 (Katz). [redacted] Trial Ex. 692 (Levine WDT ¶¶ 51, 54, 55); *see* Trial Ex. 695 (Leonard AWDT ¶¶ 53, 57-58). [redacted] Trial Ex. 695 (Leonard AWDT ¶¶ 66, 68, 69, 71).

PPCL38. Nor is there any concern that continuing to structure royalty rates around a percentage of interactive service revenue would create uncertainty or disruption. Trial Ex. 885 (Katz WDT ¶ 84); 3/13/17 Tr. 590:5-15 (Katz). Royalties assessed as a percentage of revenue result in streaming services that are more successful at monetization paying more than services that are less successful. Trial Ex. 885 (Katz WDT ¶ 84). In theory, the incentives generated by this structure could inefficiently suppress innovation, run counter to the statutory objective of

having the license fees reflect relative contributions, and have adverse implications for risk-sharing. Trial Ex. 885 (Katz WDT ¶ 84). In reality, however, there is substantial evidence that interactive streaming services have continued to innovate under revenue-based royalties, indicating that the theoretical concern does not apply to this market. Trial Ex. 885 (Katz WDT ¶ 84); 3/13/17 Tr. 590:16-21 (Katz); Services' Joint Proposed Findings and Conclusions § II (describing extensive innovation by streaming services under current rates).

PPCL39. Although the percentage of revenue method is reasonable and widely adopted, there are good reasons to supplement it with per-subscriber minimum royalties. First, some business models make measuring revenues difficult. Trial Ex. 885 (Katz WDT ¶ 82); 3/13/17 Tr. 598:5-21 (Katz). Determining applicable revenues is straightforward for a stand-alone, subscription-based interactive music streaming business. Trial Ex. 885 (Katz WDT ¶ 82). Determining applicable revenues could be more complicated when a streaming service is operated at least in part to generate economic benefits for a parent company's other lines of business, or incorporates significant non-music offerings, or when a streaming service is part of larger bundle of services offered by the same provider. Trial Ex. 885 (Katz WDT ¶ 82). When such situations make calculating revenues contentious, the per-subscriber minimum offers a solution to ensure that songwriters and publishers are adequately compensated. Trial Ex. 885 (Katz WDT ¶ 83); 3/13/17 Tr. 598:22-599:13 (Katz). Indeed, these types of situations have long been present in the interactive streaming services marketplace, and the negotiation of the current rate structure explicitly sought to account for them. Trial Ex. 697 (Levine WRT ¶ 6); 3/8/17 Tr. 161:25-164:11 (Levine); 3/28/17 Tr. 3394:21-3395:15, 3397:22-3399:2 (Timmins); 3/29/17 Tr. 3833:10-3836:20, 3838:9-3839:22, 3843:7-384:23 (Israelite). .

F. Pandora's Proposed Adjustments Are Reasonable and Consistent With the Section 801(b) Objectives

PPCL40. Even though the 2012 Settlement generally serves as an excellent benchmark for determining a reasonable royalty rate structure and term, there are certain elements of the 2012 Settlement have led to problems achieving the statutory objectives and need some adjustments. Pandora's Proposed Rates and Terms (As Amended) recommend the following modifications:

1. The Mechanical-Only Floor Should Be Eliminated

PPCL41. Pandora's proposal includes elimination of the mechanical royalty floor. As the result of past and potential future fragmentation of the licensing of public performance rights since 2012 (*see* Services' Joint Proposed Findings and Conclusions § VI.B.), a separate floor on mechanical royalties does not promote the statutory objectives. Trial Ex. 885 (Katz WDT ¶ 87); 3/13/17 Tr. 601:20-602:12 (Katz).

PPCL42. Mechanical rights and public performance rights are perfect complements from the perspective of an interactive streaming service, and there is no economic rationale for setting the two rates separately. *See* Services' Joint Proposed Findings and Conclusions § VIII.C.; Trial Ex. 885 (Katz WDT ¶ 88); 3/13/17 Tr. 561:24-563:7, 587:8-20 (Katz). Under the current framework, if public performance rights increase enough, then the total payment for public performance and mechanical rights will increase above the current headline rate. Trial Ex. 885 (Katz WDT ¶ 88); 3/13/17 Tr. 604:19-25 (Katz).

PPCL43. The repertories of PROs and major publishers are also complementary to each other. *See* Services' Joint Proposed Findings and Conclusions § VIII.C.; Trial Ex. 885 (Katz WDT ¶ 92); 3/13/17 Tr. 603:11-21 (Katz); Trial Ex. 875 (Parness WDT ¶ 19). An interactive streaming service needs all major repertories to offer an attractive product and, due to

lack of transparency about which entities control which rights, to insulate itself from copyright infringement suits. Trial Ex. 885 (Katz WDT ¶ 92); 3/13/17 Tr. 603:11-21 (Katz); Trial Ex. 875 (Parness WDT ¶ 19); 3/23/17 Tr. 2959:1-10, 2693:3-2964:1 (Herbison) (acknowledging that transparency of ownership is a problem and that he previously stated the industry's ownership "data is crap").

PPCL44. As the number of licensing entities with "must have" repertories increases, the cost of performance rights will go up for streaming services. Well known in economics as the Cournot Complements problem, firms offering complementary products tend to set higher prices than even a monopoly seller of the same products. Trial Ex. 885 (Katz WDT ¶ 93); 3/13/17 Tr. 603:33-604:8 (Katz); *see also Web IV*, 81 Fed. Reg. at 26342 (stating that "the reason for the absence of price competition in the upstream interactive market is that the repertoires of each Major are 'complements' for each other."). This occurs because a monopoly seller of two complementary products would internalize the fact that lowering the price of one product would increase sales of both products, whereas a seller that internalizes the benefits of only one of the products has less incentive to lower the price. Trial Ex. 885 (Katz WDT ¶ 93); 3/13/17 Tr. 603:22-604:8 (Katz). As a result, fragmentation and the associated necessity to separately negotiate with increasing numbers of complementary rightsholders will remain a problem unless and until rightsholders become so fragmented that no one is a "must have." Trial Ex. 885 (Katz WDT ¶ 93).

PPCL45. If fragmentation increases the cost of public performance rights to the point that the mechanical royalty floor triggers, interactive streaming services will be forced to pay an unreasonably high royalty rate. Trial Ex. 885 (Katz WDT ¶¶ 88, 94); 3/13/17 Tr. 604:19-25 (Katz). The rate would be unreasonable because such a triggering of the mechanical floor

would have nothing to do with an increase in the intrinsic value of performance rights or mechanical rights. Trial Ex. 885 (Katz WDT ¶ 94); 3/13/17 Tr. 604:19-25 (Katz). Instead, it would reflect the ability of copyright holders to exert market power over interactive services in the form of supra-competitive performance rights license fees. Trial Ex. 885 (Katz WDT ¶ 94); 3/13/17 Tr. 604:19-25 (Katz). Allowing the publishers to benefit from this sort of exercise of market power is contrary to the Section 801(b)(1) objectives. Trial Ex. 885 (Katz WDT ¶ 94). To eliminate this possibility, the 2012 Settlement benchmark should be adjusted by eliminating the mechanical-only floor. Trial Ex. 885 (Katz WDT ¶ 94).

2. The Alternate Computation of the Subminimums I and II Rates for Cases in Which the Record Company Is the Licensee Should Be Eliminated

PPCL46. There is no evidence in the record to suggest that record companies will be the Section 115 licensee for interactive streaming during the 2018-2022 license period, and it appears this alternate computation has become obsolete.[4]

3. Pandora's Proposed Changes to the License Terms Are Reasonable

PPCL47. In addition to its recommended simplification of the existing rate structure, Pandora also recommends certain changes to the existing license terms. First, the definition of "service revenue" should be adjusted to exclude carrier billing, credit card transaction, and app store fees, as these expenses for subscription services are analogous to the ad agency commissions that are permitted deductions for ad-supported services under the current regulations. Trial Ex. 880 (Herring WDT ¶ 63). This change is consistent with treatment of

[4] In opposing the subsequently withdrawn Petition to Participate of Sony Music Entertainment, the Copyright Owners observed that digital streaming services are the licensees under Subparts B and C, not record labels. *See* Copyright Owners' Motion to Deny, in Part, the Petition to Participate of Sony Music Entertainment, *In re Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, Docket No. 16-CRB-0003-PR (2018-2022) at 5-6.

those categories of expense in numerous direct licenses between Pandora and music rightsholders. Trial Ex. 974-77 [redacted]; Trial Ex. 974-67 [redacted]; Trial Ex. 974-58 [redacted].

PPCL48. Second, Pandora proposes changes in the definition of "subscriber" to accommodate reasonable promotional efforts like student discounts and family plans. These programs benefit both the Services and the Copyright Owners because they target monetize users who would not purchase the product at full price. Student discounts enable services to get business from students on a tight budget and introduce them to paying for music, while family plans are a way to obtain revenue from customers who likely would not buy personal subscriptions, including children and the elderly. 3/21/17 Tr. 2020: 11-16 (Marx) ("And so having additional price discrimination such as student discounts, family discounts, ad-supported streaming, that allows you to try to chip away at that deadweight loss and to bring those consumers who still have positive value into music consumption."); 3/22/17 Tr. at 2457:10-2458:22 (Dorn) (describing how the family and student plans exist for younger consumers with lower willingness to pay); Trial Ex. 880 (Herring WDT ¶ 61); Trial Ex. 1 (Mirchandani WDT ¶¶ 82-83); 3/14/17 Tr. 892:14-894:8 (Herring) (Pandora's student discount targets customers with low budget and willingness to pay, and family plans "target[] those incremental subscribers

out of pools that are hard to monetize . . . with advertising" like adolescents and seniors); 3/15/17 Tr. 1321:11-1323:12, 1324:6-16 (Mirchandani).

PPCL49. Third, Pandora proposes that the final terms of the regulation should make clear that for services that offer multiple product tiers, only some of which will rely on the statutory license, revenue from or subscribers to product tiers that do not utilize the statutory license are properly excluded from any royalty calculations. Trial Ex. 880 (Herring WDT ¶ 62). For example, Pandora will not be using the statutory license for its ad-supported tier, and its revenues from that tier should have no bearing on the royalties for mechanical rights licensed for other product tiers. Trial Ex. 880 (Herring WDT ¶ 62).

PPCL50. Fourth, Pandora proposes that the regulations state expressly that the statutory rates will be superseded by direct licenses between copyright owners and statutory licensees covering activity otherwise subject to the statutory license. Trial Ex. 880 (Herring WDT ¶ 62). This clarification is not a change from existing law, but rather, would conform the regulations to what is already provided in Section 115(c)(3)(E) of the Copyright Act. 17 U.S.C. § 115(c)(3)(E).

PPCL51. Fifth, Pandora proposes that the regulations clarify what constitutes a "play" as a stream of thirty (30) seconds or more. *See* Services' Joint Proposed Findings and Conclusions § XVIII.

G. Direct Licenses Between Pandora and Publishers Confirm the Reasonableness of Pandora's Proposed Rates and Terms (As Amended)

PPCL52. Examining licensing deals between interactive streaming services and music publishers makes clear that Pandora's Proposed Rates and Terms (As Amended) are reasonable. Trial Ex. 885 (Katz WDT ¶ 97); *see* 3/13/17 Tr. 623:12-625:10 (Katz). These direct deals are useful resources for benchmarking because they are very recent. Trial Ex. 885 (Katz

WDT ¶ 97). However, there are important differences in the rights being negotiated, so they must be interpreted carefully. Trial Ex. 885 (Katz WDT ¶ 97). The direct deals indicate that a slightly modified version of the 2012 Settlement would promote achievement of the four Section 801(b)(1) policy objectives going forward. Trial Ex. 885 (Katz WDT ¶ 97). Specifically, they provide support for the propositions that (a) the overall structure of the 2012 Settlement remains reasonable, but the fragmentation of the licensing of public performance rights has rendered the floors on mechanical royalties inappropriate; and (b) there is no justification for increasing the headline (or "all-in") statutory rates. *See* Trial Ex. 885 (Katz WDT ¶ 97); 3/13/17 Tr. 623:12-625:10 (Katz).

PPCL53. As described in Section V above, a key feature of Pandora's direct license deals with the largest music publishers is that they specify a single, all-in rate for both mechanical rights and performance rights. This is true for both Pandora Plus and Pandora Premium. Trial Ex. 974-31 [redacted]; Trial Ex. 974-35 [redacted]; Trial Ex. 974-25 [redacted]; Trial Ex. 974- 33 [redacted]; Trial Ex. 974-09 [redacted]; Trial Ex. 974-10 [redacted]; Trial Ex. 974-16 [redacted]; Trial Ex. 974-26 [redacted]; Trial Ex. 885 (Katz WDT ¶ 100) Trial Ex. 885 (Katz WDT ¶ 100); 3/13/17 Tr. 623:21-624:12 (Katz). [redacted] Trial Ex. 885 (Katz WDT ¶ 100). [redacted]

[redacted] Trial Ex. 885 (Katz WDT ¶¶ 100-102); 3/13/17 Tr. 624:7-12 (Katz).

PPCL54. [redacted] Trial Ex.974-01 [redacted]

PPCL55. [redacted] Trial Exs. 974-12, 974-14, 974-15, 974-19, 974-21–24, 974-26, 974-28, 974-29, 974-34, 974-84; Trial Ex. 885 (Katz WDT ¶ 104); 3/13/17 Tr. 624:13-23 (Katz). [redacted] Trial Exs. 974-12, 974-14, 974-15, 974-19, 974-21–24, 974-26, 974-28, 974-29, 974-34, 974-84; Trial Ex. 885 (Katz WDT ¶ 104); 3/13/17 Tr. 624:13-23 (Katz).

PPCL56. [redacted] that the mechanical only floor of the 2012 Settlement is no longer appropriate. *See* Trial Ex. 885 (Katz WDT ¶¶ 99-104); 3/13/17 Tr. 625:6-18 (Katz).

H. The Subpart A Settlement Confirms the Reasonableness of Pandora's Proposed Rates

PPCL57. During the course of this proceeding, the NMPA, NSAI, the Church Music Publishers Association, Songwriters of North America, and the Harry Fox Agency reached a partial settlement with the three major record labels, Universal Music Group, Warner Music Group, and Sony Music Entertainment regarding royalties for physical phonorecords (CDs, cassettes, vinyl, etc.) and permanent digital downloads under Subpart A of the regulation. On July 2016, the Judges published the proposed settlement as a proposed rulemaking and solicited comments from interested parties. *See Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, 81 Fed. Reg. 48371 (July 25, 2016); Trial Ex. 695 (Leonard AWDT ¶¶ 40-41).

PPCL58. Under the terms of the proposed settlement, the mechanical royalties for phonorecords and permanent digital downloads would remain unchanged from the current rate of either $.091 per song or $0.0175 cents per minute of playing time or fraction thereof, whichever is amount is larger. *See* 81 Fed. Reg. 48371; *see also* 37 C.F.R. 385.3(a).

PPCL59. Comparing these rates to the current rates for interactive services reveals that interactive services are paying much more. Trial Ex. 885 (Katz WDT ¶¶ 109-12). When measured against an average retail price of approximately one dollar per track for a digital download, the $.091 payment corresponds to a royalty rate of 9.2 percent, less than the 10.5 percent paid by interactive streaming services. Trial Ex. 885 (Katz WDT ¶ 109); *see* Trial Ex. 695 (Leonard AWDT ¶ 44). In fact, there has been a gradual increase in the average price of single digital downloads, from $0.99 in 2006 to $1.20 in 2016. Trial Ex. 885 (Katz WDT ¶ 109); *see* Trial Ex. 695 (Leonard AWDT ¶¶ 42, 45). Measured against the current $1.20 average price,

the mechanical rate as a share of the price has declined from the 9.2 percent to 7.6 percent. Trial Ex. 885 (Katz WDT ¶ 109); *see* Trial Ex. 695 (Leonard AWDT ¶ 42).

PPCL60. A second way to compare royalties between digital downloads and interactive streaming is to apply a conversion ratio treating a certain number of streams as the equivalent of a sale of a track. Trial Ex. 885 (Katz WDT ¶ 110); *see* Trial Ex. 698 (Leonard WRT ¶¶ 178-181). Doing so leads to the same conclusion as the previous method: the royalty rates from the 2012 Settlement are, if anything, too high. Trial Ex. 885 (Katz WDT ¶ 111); Trial Ex. 698 (Leonard WRT ¶ 181). Nielsen uses a ratio of 150 streams per track sale for purposes of compiling the Billboard lists. Trial Ex. 885 (Katz WDT ¶ 109); 3/13/17 Tr. 632:6-8 (Katz). Other industry participants also follow the rule that 150 streams equal one track sale. Trial Ex. 885 (Katz WDT ¶ 110); Trial Ex. 698 (Leonard WRT ¶ 180); Trial Ex. 1095 (admission of exhibit subject to pending motion). For instance, the RIAA uses it to determine whether an album has gone gold or platinum. Trial Ex. 885 (Katz WDT ¶ 110); 3/13/17 Tr. 631:17-632:4 (Katz).

PPCL61. Using the 150:1 ratio, Dr. Katz calculated the implied mechanical rate based on the permanent digital download rate as a function of hypothetical subscription services with a subscriber fee of $10 per subscriber per month:

Table 5: All-in Royalty Rate based on Permanent Digital Downloads Royalty and Conversion Ratio of 150-to-1

Streams per Subscriber per Month	Royalty per Sub per Month	Royalty as a Share of $10 Subscription
100	$0.061	0.61%
200	$0.121	1.21%
300	$0.182	1.82%
400	$0.243	2.43%
500	$0.303	3.03%
600	$0.364	3.64%
700	$0.425	4.25%
800	$0.485	4.85%
900	$0.546	5.46%
1000	$0.607	6.07%

Trial Ex. 885 (Katz WDT ¶ 111, Table 5); *see* 3/13/17 Tr. 627:16-629:13 (Katz).

PPCL62. At 500 streams per month, the implied mechanical royalty would be only 3.03 percent. Trial Ex. 885 (Katz WDT ¶ 111). The average streams per user per month for Spotify's premium ($10/month) service is approximately [redacted]. Trial Ex. 885 (Katz WDT ¶ 111). Based on this usage rate, the implied mechanical royalty revenue would be [redacted] percent. Trial Ex. 885 (Katz WDT ¶ 111); 3/13/17 Tr. 629:16-630:1 (Katz). Even if users streamed an average of 1000 plays per month, the implied mechanical royalty rate would still be only 6.07 percent, much less than what streaming services pay now. Trial Ex. 885 (Katz WDT ¶ 111, Table 5).

PPCL63. Accordingly, the rates agreed upon under the Section A Settlement are significantly lower than the statutory royalty rates currently in effect for interactive streaming, and suggest, if anything, that the current headline rate in the 2012 Settlement is too high. Trial Ex. 885 (Katz WDT ¶ 106); 3/13/17 Tr. 630:7-631:1 (Katz); Trial Ex. 695 (Leonard AWDT ¶¶ 42-46); Trial Ex. 698 (Leonard WRT ¶ 181).

CONCLUSION

For the reasons set forth above and in the Services' Joint Proposed Findings and Conclusions, the Judges should adopt Pandora's Proposed Rates and Terms (As Amended).

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Respectfully submitted,

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APPENDIX A

Subpart B—Interactive Streaming and Limited Downloads

§385.10 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for interactive streams and limited downloads of musical works by subscription and nonsubscription digital music services in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes interactive streams or limited downloads of musical works through subscription or nonsubscription digital music services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a musical work copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

§385.11 Definitions.

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

Affiliate means an entity controlling, controlled by, or under common control with another entity, except that an affiliate of a record company shall not include a copyright owner of musical works to the extent it is engaging in business as to musical works.

Applicable consideration means anything of value given for the identified rights to undertake the licensed activity, including, without limitation, ownership equity, monetary advances, barter or any other monetary and/or nonmonetary consideration, whether such consideration is conveyed via a single agreement, multiple agreements and/or agreements that do not themselves authorize the licensed activity but nevertheless provide consideration for the identified rights to undertake the licensed activity, and including any such value given to an affiliate of a record company for such rights to undertake the licensed activity. For the avoidance of doubt, value given to a copyright owner of musical works that is controlling, controlled by, or

under common control with a record company for rights to undertake the licensed activity shall not be considered value given to the record company. Notwithstanding the foregoing, applicable consideration shall not include in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings embodying musical works or the paid use of music services through which sound recordings embodying musical works are available where such in-kind promotional consideration is given in connection with a use that qualifies for licensing under 17 U.S.C. 115.

Family plan means a single subscription account that authorizes access to a digital music service for up to six listener profiles for a single discounted fee payable via one form of payment.

Fraudulent stream means a stream that a Service has determined was either not directly initiated or requested by a human user of the service or otherwise initiated to artificially increase play count. Without limiting the foregoing, if a single end user plays the same track more than 50 straight times, all plays after play 50 shall be deemed fraudulent.

GAAP means U.S. Generally Accepted Accounting Principles, except that if the U.S. Securities and Exchange Commission permits or requires entities with securities that are publicly traded in the U.S. to employ International Financial Reporting Standards, as issued by the International Accounting Standards Board, or as accepted by the Securities and Exchange Commission if different from that issued by the International Accounting Standards Board, in lieu of Generally Accepted Accounting Principles, then an entity may employ International Financial Reporting Standards as "GAAP" for purposes of this subpart.

Interactive stream means a stream of a sound recording of a musical work, where the performance of the sound recording by means of the stream is not exempt under 17 U.S.C. 114(d)(1) and does not in itself or as a result of a program in which it is included qualify for statutory licensing under 17 U.S.C. 114(d)(2).

Licensee means a person that has obtained a compulsory license under 17 U.S.C. 115 and its implementing regulations.

Licensed activity means interactive streams or limited downloads of musical works, as applicable, licensed pursuant to this subpart B.

Limited download means a digital transmission of a sound recording of a musical work to an end user, other than a stream, that results in a specifically identifiable reproduction of that sound recording that is only accessible for listening for—

(1) An amount of time not to exceed 1 month from the time of the transmission (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use for another time period not to exceed 1 month), or in the case of a subscription transmission, a period of time following the end of the applicable subscription no longer than a subscription renewal period or 3 months, whichever is shorter; or

(2) A specified number of times not to exceed 12 (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use of another series of 12 or fewer plays), or in the case of a subscription transmission, 12 times after the end of the applicable subscription.

(3) A limited download is a general digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D).

Offering means a service provider's offering of licensed activity that is subject to a particular rate set forth in §385.13(a) (e.g., a particular subscription plan available through the service provider).

Play means an interactive stream or limited download play of 30 seconds or more, except a sound recording of a musical work that is, in its entirety, under 30 seconds shall constitute a "play" if it is streamed by the end user for the entire duration of such sound recording. A Fraudulent Streams does not constitute a Play.

Promotional royalty rate means the statutory royalty rate of zero in the case of certain promotional interactive streams and certain promotional limited downloads, as provided in §385.14.

Record company means a person or entity that

(1) Is a copyright owner of a sound recording of a musical work;

(2) In the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under the common law or statutes of any State, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under title 17, United States Code;

(3) Is an exclusive licensee of the rights to reproduce and distribute a sound recording of a musical work; or

(4) Performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the copyright owner of the sound recording.

Relevant page means a page (including a Web page, screen or display) from which licensed activity offered by a service provider is directly available to end users, but only where the offering of licensed activity and content that directly relates to the offering of licensed activity (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed activity is directly available to end users from a page if sound recordings of musical works can

be accessed by end users for licensed activity from such page (in most cases this will be the page where the limited download or interactive stream takes place).

Service provider means that entity (which may or may not be the licensee) that, with respect to the licensed activity,

(1) Contracts with or has a direct relationship with end users in a case where a contract or relationship exists, or otherwise controls the content made available to end users;

(2) Is able to report fully on service revenue from the provision of the licensed activity to the public, and to the extent applicable, verify service revenue through an audit; and

(3) Is able to report fully on usage of musical works by the service, or procure such reporting, and to the extent applicable, verify usage through an audit.

Service revenue. (1) Subject to paragraphs (2) through (5) of the definition of "Service revenue," and subject to GAAP, *service revenue* shall mean the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed activity;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed activity (*i.e.*, advertising placed immediately at the start, end or during the actual delivery, by way of interactive streaming or limited downloads, as applicable, of a musical work); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a relevant page of the service or on any page that directly follows such relevant page leading up to and including the limited download or interactive streaming, as applicable, of a musical work; provided that, in the case where more than one service is actually available to end users from a relevant page, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, include:

(i) Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) The value of any barter or other nonmonetary consideration; and

(iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed activity that they were

unable to use due to technical faults in the licensed activity or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, exclude:

(i) Revenue derived in connection with services and activities other than licensed activity, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Service revenue." By way of example, and not limitation, the following kinds of revenue shall be excluded:

(A) Revenue derived from predominantly non-music voice, content and text services such as, by way of example and not limitation, news, talk, sports, weather, traffic, and comedy programming, or podcasts of any of the foregoing;

(B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions); and

(C) Revenue derived from music or music-related products and services that are not or do not include licensed activity.

(4) For purposes of paragraph (1) of the definition of "Service revenue":

(i) Advertising, sponsorship, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) Where the licensed activity is provided to end users as part of the same transaction with one or more other products or services that are not a music service engaged in licensed activity, then the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Service revenue" shall be the revenue recognized from end users for the bundle less the standalone published price for end users for each of the other component(s) of the bundle; provided that, if there is no such standalone published price for a component of the bundle, then the average standalone published price for end users for the most closely comparable product or service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

Stream means the digital transmission of a sound recording of a musical work to an end user—

(1) To allow the end user to listen to the sound recording, while maintaining a live network connection to the transmitting service, substantially at the time of transmission, except

to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction;

(2) Using technology that is designed such that the sound recording does not remain accessible for future listening, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction; and

(3) That is also subject to licensing as a public performance of the musical work.

Streaming cache reproduction means a reproduction of a sound recording of a musical work made on a computer or other receiving device by a service solely for the purpose of permitting an end user who has previously received a stream of such sound recording to play such sound recording again from local storage on such computer or other device rather than by means of a transmission; provided that the user is only able to do so while maintaining a live network connection to the service, and such reproduction is encrypted or otherwise protected consistent with prevailing industry standards to prevent it from being played in any other manner or on any device other than the computer or other device on which it was originally made.

Student plan means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college or university geographically located in the United States or in its possessions or territories.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.14(b).

§385.12 Calculation of royalty payments in general.

(a) *Applicable royalty*. Licensees that make or authorize licensed activity pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the minimum royalties and subscriber-based royalty floors for specific types of services provided in §385.13, except as provided under §385.10(d) and for certain promotional uses in §385.14.

(b) *Rate calculation methodology*. Royalty payments for licensed activity in subpart B shall be calculated as provided in paragraph (b) of this section. If a service includes different offerings, royalties must be separately calculated with respect to each such offering taking into consideration service revenue and expenses associated with such offering. Uses subject to the promotional royalty rate shall be excluded from the calculation of royalties due, as further described in this section and the following §385.13.

(1) *Step 1:* Calculate the All-In Royalty for the Offering. For each accounting period, the all-in royalty for each offering of the service provider is the greater of

(i) The applicable percentage of service revenue associated with the relevant offering as set forth in paragraph (c) of this section (excluding any service revenue derived solely from licensed activity uses subject to the promotional royalty rate), and

(ii) The minimum specified in §385.13 of the offering involved.

(2) *Step 2:* Determine the Payable Royalty Pool by Subtracting Applicable Performance Royalties. From the amount determined in step 1 in paragraph (b)(1) of this section, for each offering of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such offering during the accounting period that constitute licensed activity (other than licensed activity subject to the promotional royalty rate). Although this amount may be the total of the service's payments for that offering for the accounting period, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed activity. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed activity, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering. If the payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering are not readily distinguishable from payments for public performances not allocable to licensed activity uses, then the payments allocated to licensed activity uses (other than promotional royalty uses) for the accounting period shall be made on the basis of plays of musical works for licensed activity uses (other than promotional royalty uses) in relation to all uses of musical works for which the public performance payments are made or, where per-play information is unavailable due to bona fide technical limitations as described in step 3 in paragraph (b)(3) of this section, using the same alternative methodology as provided in step 3.

(3) *Step 3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed activity through a particular offering during the accounting period. To determine this amount, the result determined in step 2 in paragraph (b)(2) of this section must be allocated to each musical work used through the offering. The allocation shall be accomplished by dividing the payable royalty pool determined in step 2 for such offering by the total number of plays of all musical works through such offering during the accounting period (other than promotional royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than promotional royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step 3 only (*i.e.*, after the payable royalty pool has been determined), for sound recordings of musical works with a playing time of over 5 minutes, each play shall be counted as provided in paragraph (d) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices useable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(c) *Percentage of service revenue.* The percentage of service revenue applicable under paragraph (b) of this section is 10.5%.

(d) *Overtime adjustment.* For purposes of the calculations in step 3 in paragraph (b)(3) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 for each additional minute or fraction thereof.

(e) *Accounting.* The calculations required by paragraph (b) of this section shall be made in good faith and on the basis of the best knowledge, information and belief of the licensee at the time payment is due, and subject to the additional accounting and certification requirements of 17 U.S.C. 115(c)(5) and §201.19 of this title. Without limitation, a licensee's statements of account shall set forth each step of its calculations with sufficient information to allow the copyright owner to assess the accuracy and manner in which the licensee determined the payable royalty pool and per-play allocations (including information sufficient to demonstrate whether and how a minimum royalty pursuant to §385.13 does or does not apply) and, for each offering reported, also indicate the type of licensed activity involved and the number of plays of each musical work (including an indication of any overtime adjustment applied) that is the basis of the per-work royalty allocation being paid.

§385.13 Minimum royalty rates for specific types of services.

(a) *In general.* The following minimum royalty rates shall apply to the following types of licensed activity:

(1) *Standalone non-portable subscription—streaming only.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings only in the form of interactive streams and only from a non-portable device to which such streams are originally transmitted while the device has a live network connection, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum II as described in paragraph (c) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month.

(2) *Standalone non-portable subscription—mixed.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings either in the form of interactive streams or limited downloads but only from a non-portable device to which such streams or downloads are originally transmitted, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of the subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month.

(3) *Standalone portable subscription service.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings in the form of interactive streams or limited downloads from a portable device, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 80 cents per subscriber per month.

(4) *Bundled subscription services.* In the case of a subscription service providing licensed activity that is made available to end users with one or more other products or services (including products or services subject to other subparts) as part of a single transaction without pricing for the subscription service providing licensed activity separate from the product(s) or service(s) with which it is made available (e.g., a case in which a user can buy a portable device and one-year access to a subscription service providing licensed activity for a single price), the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum I as described in paragraph (b) of this section for the accounting period.

(5) *Free nonsubscription/ad-supported services.* In the case of a service offering licensed activity free of any charge to the end user, the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum II described in paragraph (c) of this section for the accounting period.

(b) *Computation of subminimum I.* For purposes of paragraphs (a)(2), (3), and (4) of this section, subminimum I for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period: in cases in which the record company-has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, 21% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(c) *Computation of subminimum II.* For purposes of paragraphs (a)(1) and (5) of this section, subminimum II for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period: in cases in which the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein,

22% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(d) *Payments made by third parties.* If a record company providing sound recording rights to the service provider for a licensed activity—

(1) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed activity and its affiliates, and

(2) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(3) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraphs (b) or (c) of this section, as applicable, if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(e) *Computation of subscriber-based royalty rates.* For purposes of paragraph (a) of this section, to determine the minimum applicable to any particular offering, the total number of subscriber-months for the accounting period, shall be calculated taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the promotional royalty rate as described in §385.14(b)(2), except that in the case of a bundled subscription service, subscriber-months shall instead be determined with respect to active subscribers as defined in paragraph (a)(4) of this section. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber (or active subscriber, as the case may be) shall be used as the subscriber-based component of the minimum or subscriber-based royalty floor, as applicable, for the accounting period. A family plan shall be treated as 1.5 subscribers per month, prorated in the case of a family plan end user who subscribed for only part of a calendar month.

§385.14 Promotional royalty rate.

(a) *General provisions.* (1) This section establishes a royalty rate of zero in the case of certain promotional interactive streaming activities, and of certain promotional limited downloads offered in the context of a free trial period for a digital music subscription service under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the promotional royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission of interactive streams or limited downloads of a sound recording that embodies such musical work, only if—

(i) The primary purpose of the record company in making or authorizing the interactive streams or limited downloads is to promote the sale or other paid use of sound recordings by the relevant artists, including such sound recording, through established retail channels or the paid use of one or more established retail music services through which the sound recording is available, and not to promote any other good or service;

(ii) Either—

(A) The sound recording (or a different version of the sound recording embodying the same musical work) is being lawfully distributed and offered to consumers through the established retail channels or services described in paragraph (a)(1)(i) of this section; or

(B) In the case of a sound recording of a musical work being prepared for commercial release but not yet released, the record company has a good faith intention of lawfully distributing and offering to consumers the sound recording (or a different version of the sound recording embodying the same musical work) through the established retail channels or services described in paragraph (a)(1)(i) of this section within 90 days after the commencement of the first promotional use authorized under this section (and in fact does so, unless it can demonstrate that notwithstanding its bona fide intention, it unexpectedly did not meet the scheduled release date);

(iii) In connection with authorizing the promotional interactive streams or limited downloads, the record company has obtained from the service provider it authorizes a written representation that—

(A) In the case of a promotional use other than interactive streaming subject to paragraph (d) of this section, the service provider agrees to maintain for a period of no less than 5 years from the conclusion of the promotional activity complete and accurate records of the relevant authorization and dates on which the promotion was conducted, and identifying each sound recording of a musical work made available through the promotion, the licensed activity involved, and the number of plays of such recording;

(B) The service provider is in all material respects operating with appropriate license authority with respect to the musical works it is using for promotional and other purposes; and

(C) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(iv) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the promotional royalty rate by that service;

(v) The interactive streams or limited downloads are offered free of any charge to the end user and, except in the case of interactive streaming subject to paragraph (d) of this section in the case of a free trial period for a digital music subscription service, no more than 5 sound recordings at a time are streamed in response to any individual request of an end user;

(vi) The interactive streams and limited downloads are offered in a manner such that the user is at the same time (e.g., on the same Web page) presented with a purchase opportunity for the relevant sound recording or an opportunity to subscribe to a paid service offering the sound recording, or a link to such a purchase or subscription opportunity, except—

(A) In the case of interactive streaming of a sound recording being prepared for commercial release but not yet released, certain mobile applications or other circumstances in which the foregoing is impracticable in view of the current state of the relevant technology; and

(B) In the case of a free trial period for a digital music subscription service, if end users are periodically offered an opportunity to subscribe to the service during such free trial period; and

(vii) The interactive streams and limited downloads are not provided in a manner that is likely to cause mistake, to confuse or to deceive, reasonable end users as to the endorsement or association of the author of the musical work with any product, service or activity other than the sale or paid use of sound recordings or paid use of a music service through which sound recordings are available. Without limiting the foregoing, upon receipt of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular use of such work under this section violates the limitation set forth in this paragraph (a)(1)(vii), the record company shall promptly cease such use of that work, and within 5 business days withdraw by written notice its authorization of such use by all relevant third parties it has authorized under this section.

(2) To rely upon the promotional royalty rate, a record company making or authorizing interactive streams or limited downloads shall keep complete and accurate contemporaneous written records of such uses, including the sound recordings and musical works involved, the artists, the release dates of the sound recordings, a brief statement of the promotional activities authorized, the identity of the service or services where each promotion is authorized (including the Internet address if applicable), the beginning and end date of each

period of promotional activity authorized, and the representation required by paragraph (a)(1)(iii) of this section; provided that, in the case of trial subscription uses, such records shall instead consist of the contractual terms that bear upon promotional uses by the particular digital music subscription services it authorizes; and further provided that, if the record company itself is conducting the promotion, it shall also maintain any additional records described in paragraph (a)(1)(iii)(A) of this section. The records required by this paragraph (a)(2) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed activity in the ordinary course of business, but in no event for less than 5 years from the conclusion of the promotional activity to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (a)(2) with respect to a specific promotion or relating to a particular sound recording of a musical work, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(1)(iii)(A) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(3) If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(1)(iii)(A) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(4) The promotional royalty rate is exclusively for audio-only interactive streaming and limited downloads of musical works subject to licensing under 17 U.S.C. 115. The promotional royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the promotional royalty rate (including without limitation interactive streaming or limited downloads of a musical work beyond the time limitations applicable to the promotional royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices

and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101 *et seq.*

(b) *Interactive streaming and limited downloads of full-length musical works through third-party services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (b) apply to interactive streaming, and limited downloads (in the context of a free trial period for a digital music subscription service), authorized by record companies under the promotional royalty rate through third-party services (including Web sites) that is not subject to paragraphs (c) or (d) of this section. Such interactive streams and limited downloads may be made or authorized by a record company under the promotional royalty rate only if—

(1) No applicable consideration for making or authorizing the relevant interactive streams or limited downloads is received by the record company, any of its affiliates, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings or the paid use of music services through which sound recordings are available;

(2) In the case of interactive streaming and limited downloads offered in the context of a free trial period for a digital music subscription service, the free trial period does not exceed 30 consecutive days per subscriber per two-year period; and

(3) In contexts other than a free trial period for a digital music subscription service, interactive streaming subject to paragraph (b) of this section of a particular sound recording is authorized by the record company on no more than 60 days total for all services (*i.e.*, interactive streaming under paragraph (b) of this section of a particular sound recording may be authorized on no more than a total of 60 days, which need not be consecutive, and on any one such day, interactive streams may be offered on one or more services); provided, however, that an additional 60 days shall be available each time the sound recording is re-released by the record company in a remastered form or as a part of a compilation with a different set of sound recordings than the original release or any prior compilation including such sound recording.

(4) In the event that a record company authorizes promotional uses in excess of the time limitations of paragraph (b) of this section, the record company, and not the third-party service it has authorized, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved. In the event that a third-party service exceeds the scope of any authorization by a record company, the service provider, and not the record company, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Interactive streaming of full-length musical works through record company and artist services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (c) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate through a service (e.g., a Web site) directly owned or operated by the record company, or directly owned or operated by a recording artist under the authorization of the record company, and that is not subject to paragraph (d) of this section. For the avoidance of doubt and without limitation, an artist page or site on a third-party service (e.g., a social networking service) shall not be considered a service operated by the record company or artist. Such interactive streams may be made or authorized by a record company under the promotional royalty rate only if—

(1) The interactive streaming subject to this paragraph (c) of a particular sound recording is offered or authorized by the record company on no more than 90 days total for all services (*i.e.*, interactive streaming under this paragraph (c) of a particular sound recording may be authorized on no more than a total of 90 days, which need not be consecutive, and on any such day, interactive streams may be offered on one or more services operated by the record company or artist, subject to the provisions of paragraph (b)(2) of this section); provided, however, that an additional 90 days shall be available each time the sound recording is re-released by the record company in a remastered form or as part of a compilation with a different set of sound recordings than prior compilations that include that sound recording;

(2) In the case of interactive streaming through a service devoted to one featured artist, the interactive streams subject to this paragraph (c) of this section of a particular sound recording are made or authorized by the record company on no more than one official artist site per artist and are recordings of that artist; and

(3) In the case of interactive streaming through a service that is not limited to a single featured artist, all interactive streaming on such service (whether eligible for the promotional royalty rate or not) is limited to sound recordings of a single record company and its affiliates and the service would not reasonably be considered to be a meaningful substitute for a paid music service.

(d) *Interactive streaming of clips.* In addition to those in paragraph (a) of this section, the provisions of this paragraph (d) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate of segments of sound recordings of musical works with a playing time that does not exceed 90 seconds. Such interactive streams may be made or authorized by a record company under the promotional royalty rate without any of the temporal limitations set forth in paragraphs (b) and (c) of this section (but subject to the other conditions of paragraphs (b) and (c) of this section, as applicable). For clarity, this paragraph (d) is strictly limited to the uses described herein and shall not be construed as permitting the creation or use of an excerpt of a musical work in violation of 17 U.S.C. 106(2) or 115(a)(2) or any other right of a musical work owner.

§385.15 Discounts for Student Plans

In calculating the royalty payments for licensed activity in §385.12, for each student plan, a service provider may discount the minimum royalty rate(s) as set forth in §385.13 commensurate with the discount off the retail price offered to student plan subscribers, not to exceed 50%.

§385.16 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed activity, solely for the purpose of providing such licensed activity (and no other purpose).

§385.17 Effect of rates. In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

Subpart C—Limited Offerings, Mixed Service Bundles, Music Bundles, Paid Locker Services and Purchased Content Locker Services

§385.20 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for certain reproductions or distributions of musical works through limited offerings, mixed service bundles, music bundles, paid locker services and purchased content locker services provided in accordance with the provisions of 17 U.S.C. 115. For the avoidance of doubt, to the extent that product configurations for which rates are specified in subpart A of this part are included within licensed subpart C activity, as defined in §385.21, the rates specified in subpart A of this part shall not apply, except that in the case of a music bundle the compulsory licensee may elect to pay royalties for the music bundle pursuant to subpart C of this part or for the components of the bundle pursuant to subpart A of this part.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes reproduction or distribution of musical works in limited offerings, mixed service bundles, music bundles, paid locker services or purchased content locker services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

§385.21 Definitions.

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

Affiliate shall have the meaning given in §385.11.

Applicable consideration shall have the meaning given in §385.11, except that for purposes of this subpart C, references in the definition of "Applicable consideration" in §385.11 to licensed activity shall mean licensed subpart C activity, as defined in this section.

Free trial royalty rate means the statutory royalty rate of zero in the case of certain free trial periods, as provided in §385.24.

Fraudulent stream shall have the meaning given in §385.11.

GAAP shall have the meaning given in §385.11.

Interactive stream shall have the meaning given in §385.11.

Licensee shall have the meaning given in §385.11.

Licensed subpart C activity means, referring to subpart C of this part—

(1) In the case of a limited offering, the applicable interactive streams or limited downloads;

(2) In the case of a locker service, the applicable interactive streams, permanent digital downloads, restricted downloads or ringtones;

(3) In the case of a music bundle, the applicable reproduction or distribution of a physical phonorecord, permanent digital download or ringtone; and

(4) In the case of a mixed service bundle, the applicable—

(i) Permanent digital downloads;

(ii) Ringtones;

(iii) To the extent a limited offering is included in a mixed service bundle, interactive streams or limited downloads; or

(iv) To the extent a locker service is included in a mixed service bundle, interactive streams, permanent digital downloads, restricted downloads or ringtones.

Limited download shall have the meaning given in §385.11.

Limited offering means a subscription service providing interactive streams or limited downloads where—

(1) An end user is not provided the opportunity to listen initially to a particular sound recording chosen by the end user at a time chosen by the end user (i.e., the service does not provide interactive streams of individual recordings that are on-demand, and any limited downloads are rendered only as part of programs rather than as individual recordings that are on-demand); provided that the ability of an end user to replay a sound recording previously and recently provided to the end user on a noninteractive basis shall not be deemed for the purposes of this subparagraph (1) to be a sound recording chosen by the end user at a time chosen by the end user; or

(2) The particular sound recordings available to the end user over a period of time are substantially limited relative to services in the marketplace providing access to a comprehensive catalog of recordings (e.g., a service limited to a particular genre, or permitting interactive streaming only from a monthly playlist consisting of a limited set of recordings).

Locker service means a service providing access to sound recordings of musical works in the form of interactive streams, permanent digital downloads, restricted downloads or ringtones, where the service has reasonably determined that phonorecords of the applicable sound recordings have been purchased by the end user or are otherwise in the possession of the end user prior to the end user's first request to access such sound recordings by means of the service. The term locker service does not extend to any part of a service otherwise meeting this definition as to which a license is not obtained for the applicable reproductions and distributions of musical works.

Mixed service bundle means an offering of one or more of permanent digital downloads, ringtones, locker services or limited offerings, together with one or more of non-music services (e.g., Internet access service, mobile phone service) or non-music products (e.g., a device such as a phone) of more than token value, that is provided to users as part of one transaction without pricing for the music services or music products separate from the whole offering.

Music bundle means an offering of two or more of physical phonorecords, permanent digital downloads or ringtones provided to users as part of one transaction (e.g., download plus ringtone, CD plus downloads). A music bundle must contain at least two different product configurations and cannot be combined with any other offering containing licensed activity under subpart B of this part or subpart C of this part.

(1) In the case of music bundles containing one or more physical phonorecords, the physical phonorecord component of the music bundle must be sold under a single catalog number, and the musical works embodied in the digital phonorecord delivery configurations in the music bundle must be the same as, or a subset of, the musical works embodied in the physical phonorecords; provided that when the music bundle contains a set of digital phonorecord deliveries sold by the same record company under substantially the same title as the physical phonorecord (e.g., a corresponding digital album), up to 5 sound recordings of musical works that are included in the stand-alone version of such set of digital phonorecord deliveries but are not included on the physical phonorecord may be included among the digital phonorecord deliveries in the music bundle. In addition, the seller must permanently part with possession of the physical phonorecord or phonorecords sold as part of the music bundle.

(2) In the case of music bundles composed solely of digital phonorecord deliveries, the number of digital phonorecord deliveries in either configuration cannot exceed 20, and the musical works embodied in each configuration in the music bundle must be the same as, or a subset of, the musical works embodied in the configuration containing the most musical works.

Paid locker service means a locker service that is a subscription service.

Permanent digital download shall have the meaning given in §385.2.

Play shall have the meaning given in §385.11.

Purchased content locker service means a locker service made available to end-user purchasers of permanent digital downloads, ringtones or physical phonorecords at no incremental charge above the otherwise applicable purchase price of the permanent digital downloads, ringtones or physical phonorecords, with respect to the sound recordings embodied in permanent digital downloads or ringtones or physical phonorecords purchased from a qualifying seller as described in paragraph (1) of this definition of "Purchased content locker service," whereby the locker service enables the purchaser to engage in one or both of the qualifying activities identified in paragraph (2) of this definition of "Purchased content locker service." In addition, in the case of a locker service made available to end-user purchasers of physical phonorecords, the seller must permanently part with possession of the physical phonorecords.

(1) A qualifying seller for purposes of this definition of "purchased content locker service" is the same entity operating such locker service, one of its affiliates or predecessors, or—

(i) In the case of permanent digital downloads or ringtones, a seller having another legitimate connection to the locker service provider set forth in one or more written agreements (including that the locker service and permanent digital downloads or ringtones are offered through the same third party); or

(ii) In the case of physical phonorecords, a seller having an agreement with—

(A) The locker service provider whereby such parties establish an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service; or

(B) A service provider that also has an agreement with the entity offering the locker service, where pursuant to those agreements the service provider has established an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service.

(2) Qualifying activity for purposes of this definition of "purchased content locker service" is enabling the purchaser to—

(i) Receive one or more additional phonorecords of such purchased sound recordings of musical works in the form of permanent digital downloads or ringtones at the time of purchase, or

(ii) Subsequently access such purchased sound recordings of musical works in the form of interactive streams, additional permanent digital downloads, restricted downloads or ringtones.

Record company shall have the meaning given in §385.11.

Restricted download means a digital phonorecord delivery distributed in the form of a download that may not be retained and played on a permanent basis. The term restricted download includes a limited download.

Ringtone shall have the meaning given in §385.2.

Service provider shall have the meaning given in §385.11, except that for purposes of this subpart references in the definition of "Service provider" in §385.11 to licensed activity and service revenue shall mean licensed subpart C activity, as defined in this section, and subpart C service revenue, as defined in this section, respectively.

Subpart C offering means, referring to subpart C of this part, a service provider's offering of licensed subpart C activity, as defined in this section, that is subject to a particular rate set forth in §385.23(a) (e.g., a particular subscription plan available through the service provider).

Subpart C relevant page means, referring to subpart C of this part, a page (including a Web page, screen or display) from which licensed subpart C activity, as defined in this section, offered by a service provider is directly available to end users, but only where the offering of licensed subpart C activity, as defined in this section, and content that directly relates to the offering of licensed subpart C activity, as defined in this section, (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed subpart C activity, as defined in this section, is directly available to end users from a page if sound recordings of musical works can be accessed by end users for licensed subpart C activity, as defined in this section, from such page (in most cases this will be the page where the transmission takes place).

Subpart C service revenue. (1) Subject to paragraphs (2) through (6) of the definition of "Subpart C service revenue," as defined in this section, and subject to GAAP, subpart C service revenue shall mean, referring to subpart C of this part, the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed subpart C activity, as defined in this section;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed subpart C activity, as defined in this section, (i.e., advertising placed immediately at the start, end or during the actual delivery, by way of transmissions of a musical work that constitute licensed subpart C activity, as defined in this section); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a subpart C relevant page, as defined in this section, of the service or on any page that directly follows such subpart C relevant page, as defined in this section, leading up to and including the

transmission of a musical work that constitutes licensed subpart C activity, as defined in this section; provided that, in the case where more than one service is actually available to end users from a subpart C relevant page, as defined in this section, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue," of this section such revenue shall, for the avoidance of doubt, include:

(i) Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) The value of any barter or other nonmonetary consideration; and

(iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed subpart C activity, as defined in this section, that they were unable to use due to technical faults in the licensed subpart C activity, as defined in this section, or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue" of this section, such revenue shall, for the avoidance of doubt, exclude:

(i) Revenue derived in connection with services and activities other than licensed subpart C activity, as defined in this section, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Subpart C service revenue" of this section. By way of example, and not limitation, the following kinds of revenue shall be excluded:

(A) Revenue derived from predominantly non-music voice, content and text services, such as, by way of example and not limitation, news, talk, sports, weather, traffic and comedy programming, or podcasts of any of the foregoing;

(B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions);

(C) Revenue generated from the sale of actual locker service storage space to the extent that such storage space is sold at a separate retail price;

(D) In the case of a locker service, revenue derived from the sale of permanent digital downloads or ringtones; and

(ii) Revenue derived from other music or music-related products and services that are not or do not include licensed subpart C activity, as defined in this section.

(4) For purposes of paragraph (1) of the definition of "Subpart C service revenue" of this section:

(i) Advertising, sponsorship, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) In the case of a mixed service bundle, the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Subpart C service revenue" of this section shall be the greater of—

(i) The revenue recognized from end users for the mixed service bundle less the standalone published price for end users for each of the non-music product or non-music service components of the bundle; provided that, if there is no such standalone published price for a non-music component of the bundle, then the average standalone published price for end users for the most closely comparable non-music product or non-music service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(ii) Either—

(A) In the case of a mixed service bundle that either has 750,000 subscribers or other registered users, or is reasonably expected to have 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle, 40% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and further provided that in any case in which royalties were paid based on this paragraph due to a reasonable expectation of reaching 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle and that does not actually happen, applicable payments shall, in the accounting period next following the end of such 1-year period, retroactively be adjusted as if paragraph (5)(ii)(B) of the definition of "Subpart C service revenue" of this section applied; or

(B) Otherwise, 50% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

(6) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee—

(i) Service revenue shall be 150% of the record company's wholesale revenue from the music bundle; and

(ii) The times at which distribution and revenue recognition are deemed to occur shall be in accordance with §201.19 of this title.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.24.

§385.22 Calculation of royalty payments in general.

(a) *Applicable royalty.* Licensees that make or authorize licensed subpart C activity, as defined in §385.21, pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the royalty rates and subscriber-based royalty floors for specific types of services provided in §385.23, except as provided for certain free trial periods in §385.24.

(b) *Rate calculation methodology.* Royalty payments for licensed subpart C activity, as defined in §385.21, shall be calculated as provided in this paragraph (b). If a service provides different subpart C offerings, as defined in §385.21, royalties must be separately calculated with respect to each such subpart C offering, as defined in §385.21, taking into consideration service revenue and expenses associated with such offering. Uses subject to the free trial royalty rate shall be excluded from the calculation of royalties due, as further described in this section and §385.23.

(1) *Step 1:* Calculate the All-In Royalty for the Subpart C Offering, as Defined in §385.21. For each accounting period, the all-in royalty for each subpart C offering, as defined in §385.21, of the service provider is the greater of:

(i) The applicable percentage of subpart C service revenue, as defined in §385.21, associated with the relevant offering as set forth in §385.23(a) (excluding any subpart C service revenue, as defined in §385.21, derived solely from licensed subpart C activity, as defined in §385.21, uses subject to the free trial royalty rate); and

(ii) The minimum specified in §385.23(a) for the subpart C offering, as defined in §385.21, involved.

(2) *Step 2:* Subtract applicable performance royalties to determine the payable royalty pool, which is the amount payable for the reproduction and distribution of all musical works used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, for a particular subpart C offering, as defined in §385.21, during the accounting period. From the amount determined in step 1 in paragraph (b)(1) of this section, for each subpart C offering, as defined in §385.21, of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such subpart C offering, as defined in §385.21, during the accounting period that constitute licensed subpart C activity, as defined in §385.21, (other than licensed subpart C activity, as defined in §385.21, subject to the free trial royalty rate), or in connection with previewing of such subpart C offering, as defined in §385.21, during the accounting period. Although this amount may be the total of the payments with respect to the service for that subpart C offering, as defined in §385.21, for the accounting period, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, or previewing of such licensed subpart C activity, as defined in §385.21. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed subpart C activity, as defined in §385.21, uses (other than free trial royalty rate uses), and previewing of such uses, in connection with the relevant subpart C offering, as defined in §385.21, as determined in relation to all uses of musical works for which the public performance payments are made for the accounting period. Such allocation shall be made on the basis of plays of musical works or, where per-play information is unavailable due to bona fide technical limitations as described in step 3 in paragraph (b)(3) of this section, using the same alternative methodology as provided in step 3 in paragraph (b)(3) of this section.

(3) *Step 3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, through a particular subpart C offering, as defined in §385.21, during the accounting period. To determine this amount, the result determined in step 2 in paragraph (b)(2) of this section must be allocated to each musical work used through the subpart C offering, as defined in §385.21. The allocation shall be accomplished as follows:

(i) In the case of limited offerings (but not limited offerings that are part of mixed service bundles), by dividing the payable royalty pool determined in step 2 in paragraph (b)(2) of this section for such offering by the total number of plays of all musical works through such offering during the accounting period (other than free trial royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than free trial royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step 3 only (i.e., after the payable royalty pool has been determined), for sound recordings of musical works with a playing time of over 5 minutes, each play shall be counted as provided in paragraph (c) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or

of devices usable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(ii) In the case of mixed service bundles and locker services, by—

(A) Determining a constructive number of plays of all licensed musical works that is the sum of the total number of interactive streams of all licensed musical works made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads);

(B) Determining a constructive per-play allocation that is the payable royalty pool determined in step 2 of paragraph (b)(2) of this section for such offering divided by the constructive number of plays of all licensed musical works determined in paragraph (b)(3)(ii)(A) of this section;

(C) For each licensed musical work, determining a constructive number of plays of that musical work that is the sum of the total number of interactive streams of such licensed musical work made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of such licensed musical work made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of such licensed musical work made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads); and

(D) For each licensed musical work, determining the per-work royalty allocation by multiplying the constructive per-play allocation determined in paragraph (b)(3)(ii)(B) of this section by the constructive number of plays of that musical work determined in paragraph (b)(3)(ii)(C) of this section.

(E) Notwithstanding the foregoing, if a service provider offers both a paid locker service and a purchased content locker service, and with respect to the purchased content locker service there is no subpart C service revenue, as defined in §385.21, and the applicable subminimum is zero dollars, then the service provider shall be permitted to include within the calculation of constructive plays under paragraphs (b)(3)(ii)(A) and (C) of this section for the paid locker service, the licensed subpart C activity, as defined in §385.21, made through the purchased content locker service (i.e., the total number of interactive streams of all licensed musical works made through the purchased content locker service during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through the purchased content locker service

during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through the purchased content locker service during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads)); provided that the relevant licensed subpart C activity, as defined in §385.21, made through the purchased content locker service is similarly included within the play calculation for the paid locker service for the corresponding sound recording rights.

(iii) In the case of music bundles, by—

(A) Allocating the payable royalty pool determined in step 2 of paragraph (b)(2) of this section to separate pools for each type of product configuration included in the music bundle (e.g., CD, permanent digital download, ringtone) in accordance with the ratios that the standalone published prices of the products that are included in the music bundle bear to each other; provided that, if there is no such standalone published price for such a product, then the average standalone published price for end users for the most closely comparable product in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(B) Allocating the product configuration pools determined in paragraph (b)(3)(iii)(A) of this section to individual musical works by dividing each such pool by the total number of sound recordings of musical works included in products of that configuration in the music bundle.

(c) *Overtime adjustment.* For purposes of the calculations in step 3 of paragraph (b)(3)(i) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 plays for each additional minute or fraction thereof.

§385.23 Royalty rates and subscriber-based royalty floors for specific types of services.

(a) *In general.* The following royalty rates and subscriber-based royalty floors shall apply to the following types of licensed subpart C activity, as defined in §385.21:

(1) *Mixed service bundle.* In the case of a mixed service bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b) is 21%.

(2) *Music bundle.* In the case of a music bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is 21%.

(3) *Limited offering.* In the case of a limited offering, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 10.5%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is 21%; and

(ii) The aggregate amount of 18 cents per subscriber per month.

(4) *Paid locker service.* In the case of a paid locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1)-is 20.65%; and

(ii) The aggregate amount of 17 cents per subscriber per month.

(5) *Purchased content locker service.* In the case of a purchased content locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. For the avoidance of doubt, paragraph (1)(i) of the definition of "Subpart C service revenue," as defined in §385.21, shall not apply. The minimum for use in step 1 in §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is 22%, except that for purposes of paragraph (b) of this section the applicable consideration expensed by the service for the relevant rights shall consist only of applicable consideration expensed by the service, if any, that is incremental to the applicable consideration expensed for the rights to make the relevant permanent digital downloads and ringtones.

(b) *Computation of subminima.* For purposes of paragraph (a) of this section, the subminimum for an accounting period is the aggregate of the following with respect to all sound

recordings of musical works used in the relevant subpart C offering, as defined in §385.21, of the service provider during the accounting period:

(1) In cases in which the record company has granted the rights to engage in licensed subpart C activity, as defined in §385.21, with respect to a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, the appropriate sound recording-only percentage from paragraph (a) of this section of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(2) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee, the appropriate all-in percentage from paragraph (a) of this section of the record company's total wholesale revenue from the music bundle in accordance with GAAP for the accounting period, which amount shall equal the applicable consideration for such music bundle at the time such applicable consideration is properly recognized as revenue under GAAP, subject to the provisions of §201.19 of this title concerning the times at which distribution and revenue recognition are deemed to occur.

(3) If a record company providing sound recording rights to the service provider for a licensed subpart C activity, as defined in §385.21—

(i) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed subpart C activity, as defined in §385.21, and its affiliates, and

(ii) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(iii) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraph (b)(1) of this section if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(c) *Computation of subscriber-based royalty rates.* For purposes of paragraphs (a)(3) and (4) of this section, to determine the subscriber-based minimum applicable to any particular subpart C offering, as defined in §385.21, the total number of subscriber-months for the accounting period shall be calculated, taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the free trial royalty rate as described in §385.24. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber shall be used as the subscriber-based component of the minimum for the accounting period.

§385.24 Free trial periods.

(a) *General provisions.* This section establishes a royalty rate of zero in the case of certain free trial periods for mixed service bundles, paid locker services and limited offerings under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the free trial royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission, as part of a mixed service bundle, paid locker service or limited offering, of a sound recording that embodies such musical work, only if—

(1) The primary purpose of the record company in providing or authorizing the free trial period is to promote the applicable subpart C offering, as defined in §385.21;

(2) No applicable consideration for making or authorizing the transmissions is received by the record company, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration used to promote the sale or paid use of sound recordings or audiovisual works embodying musical works or the paid use of music services through which sound recordings or audiovisual works embodying musical works are available;

(3) The free trial period does not exceed 30 consecutive days per subscriber per two-year period;

(4) In connection with authorizing the transmissions, the record company has obtained from the service provider it authorizes a written representation that—

(i) The service provider agrees to maintain for a period of no less than 5 years from the end of each relevant accounting period complete and accurate records of the relevant authorization, and identifying each sound recording of a musical work made available through the free trial period, the licensed subpart C activity, as defined in §385.21, involved, and the number of plays or downloads, as applicable, of such recording;

(ii) The service is in all material respects operating with appropriate license authority with respect to the musical works it is using; and

(iii) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(5) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the free trial royalty rate by that service;

(6) The free trial period is offered free of any charge to the end user; and

(7) End users are periodically offered an opportunity to subscribe to the service during such free trial period.

(b) *Recordkeeping by record companies.* To rely upon the free trial royalty rate for a free trial period, a record company making or authorizing the free trial period shall keep complete and accurate contemporaneous written records of the contractual terms that bear upon the free trial period; and further provided that, if the record company itself is conducting the free trial period, it shall also maintain any additional records described in paragraph (a)(4)(i) of this section. The records required by this paragraph (b) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed subpart C activity, as defined in §385.21, in the ordinary course of business, but in no event for less than 5 years from the conclusion of the licensed subpart C activity, as defined in §385.21, to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (b) with respect to a specific free trial period, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(4)(i) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Recordkeeping by services.* If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(4)(i) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If

the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(d) *Interpretation.* The free trial royalty rate is exclusively for audio-only licensed subpart C activity, as defined in §385.21, involving musical works subject to licensing under 17 U.S.C. 115. The free trial royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the free trial royalty rate (including without limitation licensed subpart C activity, as defined in §385.21, beyond the time limitations applicable to the free trial royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101, *et seq.*

§385.25 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed subpart C activity, as defined in §385.21, solely for the purpose of providing such licensed subpart C activity, as defined in §385.21 (and no other purpose).

§385.26 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

APPENDIX B

Subpart B—Interactive Streaming and Limited Downloads

§385.10 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for interactive streams and limited downloads of musical works by subscription and nonsubscription digital music services in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes interactive streams or limited downloads of musical works through subscription or nonsubscription digital music services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a musical work copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

§385.11 Definitions.

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

Affiliate means an entity controlling, controlled by, or under common control with another entity, except that an affiliate of a record company shall not include a copyright owner of musical works to the extent it is engaging in business as to musical works.

Applicable consideration means anything of value given for the identified rights to undertake the licensed activity, including, without limitation, ownership equity, monetary advances, barter or any other monetary and/or nonmonetary consideration, whether such consideration is conveyed via a single agreement, multiple agreements and/or agreements that do not themselves authorize the licensed activity but nevertheless provide consideration for the identified rights to undertake the licensed activity, and including any such value given to an affiliate of a record company for such rights to undertake the licensed activity. For the avoidance of doubt, value given to a copyright owner of musical works that is controlling, controlled by, or

under common control with a record company for rights to undertake the licensed activity shall not be considered value given to the record company. Notwithstanding the foregoing, applicable consideration shall not include in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings embodying musical works or the paid use of music services through which sound recordings embodying musical works are available where such in-kind promotional consideration is given in connection with a use that qualifies for licensing under 17 U.S.C. 115.

Family plan means a single subscription account that authorizes access to a digital music service for up to six listener profiles for a single discounted fee payable via one form of payment.

Fraudulent stream means a stream that a Service has determined was either not directly initiated or requested by a human user of the service or otherwise initiated to artificially increase play count. Without limiting the foregoing, if a single end user plays the same track more than 50 straight times, all plays after play 50 shall be deemed fraudulent.

GAAP means U.S. Generally Accepted Accounting Principles, except that if the U.S. Securities and Exchange Commission permits or requires entities with securities that are publicly traded in the U.S. to employ International Financial Reporting Standards, as issued by the International Accounting Standards Board, or as accepted by the Securities and Exchange Commission if different from that issued by the International Accounting Standards Board, in lieu of Generally Accepted Accounting Principles, then an entity may employ International Financial Reporting Standards as "GAAP" for purposes of this subpart.

Interactive stream means a stream of a sound recording of a musical work, where the performance of the sound recording by means of the stream is not exempt under 17 U.S.C. 114(d)(1) and does not in itself or as a result of a program in which it is included qualify for statutory licensing under 17 U.S.C. 114(d)(2).

Licensee means a person that has obtained a compulsory license under 17 U.S.C. 115 and its implementing regulations.

Licensed activity means interactive streams or limited downloads of musical works, as applicable, licensed pursuant to this subpart B.

Limited download means a digital transmission of a sound recording of a musical work to an end user, other than a stream, that results in a specifically identifiable reproduction of that sound recording that is only accessible for listening for—

(1) An amount of time not to exceed 1 month from the time of the transmission (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use for another time period not to exceed 1 month), or in the case of a subscription transmission, a period of time following the end of the applicable subscription no longer than a subscription renewal period or 3 months, whichever is shorter; or

(2) A specified number of times not to exceed 12 (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use of another series of 12 or fewer plays), or in the case of a subscription transmission, 12 times after the end of the applicable subscription.

(3) A limited download is a general digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D).

Offering means a service provider's offering of licensed activity that is subject to a particular rate set forth in §385.13(a) (e.g., a particular subscription plan available through the service provider).

Play means an interactive stream or limited download play of 30 seconds or more, except a sound recording of a musical work that is, in its entirety, under 30 seconds shall constitute a "play" if it is streamed by the end user for the entire duration of such sound recording. A Fraudulent Streams does not constitute a Play.

Promotional royalty rate means the statutory royalty rate of zero in the case of certain promotional interactive streams and certain promotional limited downloads, as provided in §385.14.

Record company means a person or entity that

(1) Is a copyright owner of a sound recording of a musical work;

(2) In the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under the common law or statutes of any State, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under title 17, United States Code;

(3) Is an exclusive licensee of the rights to reproduce and distribute a sound recording of a musical work; or

(4) Performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the copyright owner of the sound recording.

Relevant page means a page (including a Web page, screen or display) from which licensed activity offered by a service provider is directly available to end users, but only where the offering of licensed activity and content that directly relates to the offering of licensed activity (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed activity is directly available to end users from a page if sound recordings of musical works can

be accessed by end users for licensed activity from such page (in most cases this will be the page where the limited download or interactive stream takes place).

Service provider means that entity (which may or may not be the licensee) that, with respect to the licensed activity,

(1) Contracts with or has a direct relationship with end users in a case where a contract or relationship exists, or otherwise controls the content made available to end users;

(2) Is able to report fully on service revenue from the provision of the licensed activity to the public, and to the extent applicable, verify service revenue through an audit; and

(3) Is able to report fully on usage of musical works by the service, or procure such reporting, and to the extent applicable, verify usage through an audit.

Service revenue. (1) Subject to paragraphs (2) through (5) of the definition of "Service revenue," and subject to GAAP, *service revenue* shall mean the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed activity;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed activity (*i.e.*, advertising placed immediately at the start, end or during the actual delivery, by way of interactive streaming or limited downloads, as applicable, of a musical work); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a relevant page of the service or on any page that directly follows such relevant page leading up to and including the limited download or interactive streaming, as applicable, of a musical work; provided that, in the case where more than one service is actually available to end users from a relevant page, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, include:

(i) ~~Include a~~Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) ~~Include t~~The value of any barter or other nonmonetary consideration; and

~~(iii) Not be reduced by credit card commissions or similar payment process charges; and~~

(~~iv~~iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed activity that they were unable to use due to technical faults in the licensed activity or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, exclude ~~revenue~~:

(i) Revenue derived ~~solely~~ in connection with services and activities other than licensed activity, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Service revenue." By way of example, and not limitation, the following kinds of revenue shall be excluded:

(~~i~~A) Revenue derived from predominantly non-music voice, content and text services such as, by way of example and not limitation, news, talk, sports, weather, traffic, and comedy programming, or podcasts of any of the foregoing;

(~~ii~~B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions); and

(~~iii~~C) Revenue derived from music or music-related products and services that are not or do not include licensed activity.

(4) For purposes of paragraph (1) of the definition of "Service revenue~~,~~" ~~advertising or sponsorship revenue shall be reduced by the actual cost of obtaining such revenue, not to exceed 15%.~~:

(i) Advertising, sponsorship, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) Where the licensed activity is provided to end users as part of the same transaction with one or more other products or services that are not a music service engaged in licensed activity, then the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Service revenue" shall be the revenue recognized from end users for the bundle less the standalone published price for end users for each of the other component(s) of the bundle; provided that, if there is no such standalone published price for a component of the bundle, then the average standalone published price for end users for the most closely comparable product or service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

Stream means the digital transmission of a sound recording of a musical work to an end user—

(1) To allow the end user to listen to the sound recording, while maintaining a live network connection to the transmitting service, substantially at the time of transmission, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction;

(2) Using technology that is designed such that the sound recording does not remain accessible for future listening, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction; and

(3) That is also subject to licensing as a public performance of the musical work.

Streaming cache reproduction means a reproduction of a sound recording of a musical work made on a computer or other receiving device by a service solely for the purpose of permitting an end user who has previously received a stream of such sound recording to play such sound recording again from local storage on such computer or other device rather than by means of a transmission; provided that the user is only able to do so while maintaining a live network connection to the service, and such reproduction is encrypted or otherwise protected consistent with prevailing industry standards to prevent it from being played in any other manner or on any device other than the computer or other device on which it was originally made.

Student plan means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college or university geographically located in the United States or in its possessions or territories.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.14(b).

§385.12 Calculation of royalty payments in general.

(a) *Applicable royalty*. Licensees that make or authorize licensed activity pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the minimum royalties and subscriber-based royalty floors for specific types of services provided in §385.13, except as provided under §385.10(d) and for certain promotional uses in §385.14.

(b) *Rate calculation methodology*. Royalty payments for licensed activity in subpart B shall be calculated as provided in paragraph (b) of this section. If a service includes different offerings, royalties must be separately calculated with respect to each such offering taking into consideration service revenue and expenses associated with such offering. Uses subject to the

promotional royalty rate shall be excluded from the calculation of royalties due, as further described in this section and the following §385.13.

(1) *Step 1:* Calculate the All-In Royalty for the Offering. For each accounting period, the all-in royalty for each offering of the service provider is the greater of

(i) The applicable percentage of service revenue associated with the relevant offering as set forth in paragraph (c) of this section (excluding any service revenue derived solely from licensed activity uses subject to the promotional royalty rate), and

(ii) The minimum specified in §385.13 of the offering involved.

(2) *Step 2:* Determine the Payable Royalty Pool by Subtracting Applicable Performance Royalties. From the amount determined in step 1 in paragraph (b)(1) of this section, for each offering of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such offering during the accounting period that constitute licensed activity (other than licensed activity subject to the promotional royalty rate). Although this amount may be the total of the service's payments for that offering for the accounting period~~.~~, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed activity. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed activity, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering~~, as determined~~. If the payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering are not readily distinguishable from payments for public performances not allocable to licensed activity uses, then the payments allocated to licensed activity uses (other than promotional royalty uses) for the accounting period shall be made on the basis of plays of musical works for licensed activity uses (other than promotional royalty uses) in relation to all uses of musical works for which the public performance payments are made ~~for the accounting period. Such allocation shall be made on the basis of plays of musical works~~ or, where per-play information is unavailable due to bona fide technical limitations as described in step 4~~3~~ in paragraph (b)(4~~3~~) of this section, using the same alternative methodology as provided in step 4~~3~~.

~~(3) *Step 3:* Determine the Payable Royalty Pool. The payable royalty pool is the amount payable for the reproduction and distribution of all musical works used by the service provider by virtue of its licensed activity for a particular offering during the accounting period. This amount is the greater of~~

~~(i) The result determined in step 2 in paragraph (b)(2) of this section, and~~

~~(ii) The subscriber based royalty floor resulting from the calculations described in §385.13.~~

(~~4~~3) *Step ~~4~~3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed activity through a particular offering during the accounting period. To determine this amount, the result determined in step ~~3~~2 in paragraph (b)(~~3~~2) of this section must be allocated to each musical work used through the offering. The allocation shall be accomplished by dividing the payable royalty pool determined in step ~~3~~2 for such offering by the total number of plays of all musical works through such offering during the accounting period (other than promotional royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than promotional royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step ~~4~~3 only (*i.e.*, after the payable royalty pool has been determined), for sound recordings of musical works with a playing time of over 5 minutes, each play shall be counted as provided in paragraph (d) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices useable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(c) *Percentage of service revenue.* The percentage of service revenue applicable under paragraph (b) of this section is 10.5%.

(d) *Overtime adjustment.* For purposes of the calculations in step ~~4~~3 in paragraph (b)(~~4~~3) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 for each additional minute or fraction thereof.

(e) *Accounting.* The calculations required by paragraph (b) of this section shall be made in good faith and on the basis of the best knowledge, information and belief of the licensee at the time payment is due, and subject to the additional accounting and certification requirements of 17 U.S.C. 115(c)(5) and §201.19 of this title. Without limitation, a licensee's statements of account shall set forth each step of its calculations with sufficient information to allow the copyright owner to assess the accuracy and manner in which the licensee determined the payable royalty pool and per-play allocations (including information sufficient to demonstrate whether

and how a minimum royalty ~~or subscriber based royalty floor~~ pursuant to §385.13 does or does not apply) and, for each offering reported, also indicate the type of licensed activity involved and the number of plays of each musical work (including an indication of any overtime adjustment applied) that is the basis of the per-work royalty allocation being paid.

§385.13 Minimum royalty rates ~~and subscriber based royalty floors~~ for specific types of services.

(a) *In general.* The following minimum royalty rates ~~and subscriber based royalty floors~~ shall apply to the following types of licensed activity:

(1) *Standalone non-portable subscription—streaming only.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings only in the form of interactive streams and only from a non-portable device to which such streams are originally transmitted while the device has a live network connection, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum II as described in paragraph (c) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month. ~~The subscriber based royalty floor for use in step 3 of §385.12(b)(3)(ii) is the aggregate amount of 15 cents per subscriber per month.~~

(2) *Standalone non-portable subscription—mixed.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings either in the form of interactive streams or limited downloads but only from a non-portable device to which such streams or downloads are originally transmitted, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of the subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month. ~~The subscriber based royalty floor for use in step 3 of §385.12(b)(3)(ii) is the aggregate amount of 30 cents per subscriber per month.~~

(3) *Standalone portable subscription service.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings in the form of interactive streams or limited downloads from a portable device, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 80 cents per subscriber per month. ~~The subscriber based royalty floor for use in step 3 of §385.12(b)(3)(ii) is the aggregate amount of 50 cents per subscriber per month.~~

(4) *Bundled subscription services.* In the case of a subscription service providing licensed activity that is made available to end users with one or more other products or services (including products or services subject to other subparts) as part of a single transaction without pricing for the subscription service providing licensed activity separate from the product(s) or service(s) with which it is made available (e.g., a case in which a user can buy a portable device and one-year access to a subscription service providing licensed activity for a single price), the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum I as described in paragraph (b) of this section for the accounting period. ~~The subscriber based royalty floor for use in step 3 of §385.12(b)(3)(ii) is the aggregate amount of 25 cents per month for each end user who has made~~

~~at least one play of a licensed work during such month (each such end user to be considered an "active subscriber").~~

(5) *Free nonsubscription/ad-supported services.* In the case of a service offering licensed activity free of any charge to the end user, the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum II described in paragraph (c) of this section for the accounting period. ~~There is no subscriber-based royalty floor for use in step 3 of §385.12(b)(3)(ii).~~

(b) *Computation of subminimum I.* For purposes of paragraphs (a)(2), (3), and (4) of this section, subminimum I for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period~~—~~

~~(1) In cases in which the record company is the licensee under 17 U.S.C. 115 and the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service together with the right to reproduce and distribute the musical work embodied therein, 17.36% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

~~(2) In~~ : in cases in which ~~the record company is not the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, 21% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(c) *Computation of subminimum II.* For purposes of paragraphs (a)(1) and (5) of this section, subminimum II for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period~~—~~

~~(1) In cases in which the record company is the licensee under 17 U.S.C. 115 and the record company has granted the rights to make interactive streams and limited downloads of a sound recording through the third-party service together with the right to reproduce and distribute the musical work embodied therein, 18% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

~~(2) In~~ : in cases in which ~~the record company is not the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, 22% of the total amount expensed by the

service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(d) *Payments made by third parties.* If a record company providing sound recording rights to the service provider for a licensed activity—

(1) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed activity and its affiliates, and

(2) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(3) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraphs (b) ~~(1), (b)(2), (c)(1),~~ or (c~~)(2~~) of this section, as applicable, if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(e) *Computation of subscriber-based royalty rates.* For purposes of paragraph (a) of this section, to determine the minimum ~~or subscriber-based royalty floor, as~~ applicable to any particular offering, the total number of subscriber-months for the accounting period, shall be calculated taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the promotional royalty rate as described in §385.14(b)(2), except that in the case of a bundled subscription service, subscriber-months shall instead be determined with respect to active subscribers as defined in paragraph (a)(4) of this section. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber (or active subscriber, as the case may be) shall be used as the subscriber-based component of the minimum or subscriber-based royalty floor, as applicable, for the accounting period. A family plan shall be treated as 1.5 subscribers per month, prorated in the case of a family plan end user who subscribed for only part of a calendar month.

§385.14 Promotional royalty rate.

(a) *General provisions.* (1) This section establishes a royalty rate of zero in the case of certain promotional interactive streaming activities, and of certain promotional limited downloads offered in the context of a free trial period for a digital music subscription service under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the promotional royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission of interactive streams or limited downloads of a sound recording that embodies such musical work, only if—

(i) The primary purpose of the record company in making or authorizing the interactive streams or limited downloads is to promote the sale or other paid use of sound recordings by the relevant artists, including such sound recording, through established retail channels or the paid use of one or more established retail music services through which the sound recording is available, and not to promote any other good or service;

(ii) Either—

(A) The sound recording (or a different version of the sound recording embodying the same musical work) is being lawfully distributed and offered to consumers through the established retail channels or services described in paragraph (a)(1)(i) of this section; or

(B) In the case of a sound recording of a musical work being prepared for commercial release but not yet released, the record company has a good faith intention of lawfully distributing and offering to consumers the sound recording (or a different version of the sound recording embodying the same musical work) through the established retail channels or services described in paragraph (a)(1)(i) of this section within 90 days after the commencement of the first promotional use authorized under this section (and in fact does so, unless it can demonstrate that notwithstanding its bona fide intention, it unexpectedly did not meet the scheduled release date);

(iii) In connection with authorizing the promotional interactive streams or limited downloads, the record company has obtained from the service provider it authorizes a written representation that—

(A) In the case of a promotional use other than interactive streaming subject to paragraph (d) of this section, the service provider agrees to maintain for a period of no less than 5 years from the conclusion of the promotional activity complete and accurate records of the relevant authorization and dates on which the promotion was conducted, and identifying each sound recording of a musical work made available through the promotion, the licensed activity involved, and the number of plays of such recording;

(B) The service provider is in all material respects operating with appropriate license authority with respect to the musical works it is using for promotional and other purposes; and

(C) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(iv) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the promotional royalty rate by that service;

(v) The interactive streams or limited downloads are offered free of any charge to the end user and, except in the case of interactive streaming subject to paragraph (d) of this section in the case of a free trial period for a digital music subscription service, no more than 5 sound recordings at a time are streamed in response to any individual request of an end user;

(vi) The interactive streams and limited downloads are offered in a manner such that the user is at the same time (e.g., on the same Web page) presented with a purchase opportunity for the relevant sound recording or an opportunity to subscribe to a paid service offering the sound recording, or a link to such a purchase or subscription opportunity, except—

(A) In the case of interactive streaming of a sound recording being prepared for commercial release but not yet released, certain mobile applications or other circumstances in which the foregoing is impracticable in view of the current state of the relevant technology; and

(B) In the case of a free trial period for a digital music subscription service, if end users are periodically offered an opportunity to subscribe to the service during such free trial period; and

(vii) The interactive streams and limited downloads are not provided in a manner that is likely to cause mistake, to confuse or to deceive, reasonable end users as to the endorsement or association of the author of the musical work with any product, service or activity other than the sale or paid use of sound recordings or paid use of a music service through which sound recordings are available. Without limiting the foregoing, upon receipt of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular use of such work under this section violates the limitation set forth in this paragraph (a)(1)(vii), the record company shall promptly cease such use of that work, and within 5 business days withdraw by written notice its authorization of such use by all relevant third parties it has authorized under this section.

(2) To rely upon the promotional royalty rate, a record company making or authorizing interactive streams or limited downloads shall keep complete and accurate

contemporaneous written records of such uses, including the sound recordings and musical works involved, the artists, the release dates of the sound recordings, a brief statement of the promotional activities authorized, the identity of the service or services where each promotion is authorized (including the Internet address if applicable), the beginning and end date of each period of promotional activity authorized, and the representation required by paragraph (a)(1)(iii) of this section; provided that, in the case of trial subscription uses, such records shall instead consist of the contractual terms that bear upon promotional uses by the particular digital music subscription services it authorizes; and further provided that, if the record company itself is conducting the promotion, it shall also maintain any additional records described in paragraph (a)(1)(iii)(A) of this section. The records required by this paragraph (a)(2) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed activity in the ordinary course of business, but in no event for less than 5 years from the conclusion of the promotional activity to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (a)(2) with respect to a specific promotion or relating to a particular sound recording of a musical work, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(1)(iii)(A) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(3) If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(1)(iii)(A) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(4) The promotional royalty rate is exclusively for audio-only interactive streaming and limited downloads of musical works subject to licensing under 17 U.S.C. 115. The promotional royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C.

115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the promotional royalty rate (including without limitation interactive streaming or limited downloads of a musical work beyond the time limitations applicable to the promotional royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101 *et seq.*

(b) *Interactive streaming and limited downloads of full-length musical works through third-party services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (b) apply to interactive streaming, and limited downloads (in the context of a free trial period for a digital music subscription service), authorized by record companies under the promotional royalty rate through third-party services (including Web sites) that is not subject to paragraphs (c) or (d) of this section. Such interactive streams and limited downloads may be made or authorized by a record company under the promotional royalty rate only if—

(1) No applicable consideration for making or authorizing the relevant interactive streams or limited downloads is received by the record company, any of its affiliates, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings or the paid use of music services through which sound recordings are available;

(2) In the case of interactive streaming and limited downloads offered in the context of a free trial period for a digital music subscription service, the free trial period does not exceed 30 consecutive days per subscriber per two-year period; and

(3) In contexts other than a free trial period for a digital music subscription service, interactive streaming subject to paragraph (b) of this section of a particular sound recording is authorized by the record company on no more than 60 days total for all services (*i.e.*, interactive streaming under paragraph (b) of this section of a particular sound recording may be authorized on no more than a total of 60 days, which need not be consecutive, and on any one such day, interactive streams may be offered on one or more services); provided, however, that an additional 60 days shall be available each time the sound recording is re-released by the record company in a remastered form or as a part of a compilation with a different set of sound recordings than the original release or any prior compilation including such sound recording.

(4) In the event that a record company authorizes promotional uses in excess of the time limitations of paragraph (b) of this section, the record company, and not the third-party service it has authorized, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved. In the event that a third-party service exceeds the scope of any authorization by a record company, the service provider, and not the record company, shall be liable for any

payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Interactive streaming of full-length musical works through record company and artist services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (c) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate through a service (e.g., a Web site) directly owned or operated by the record company, or directly owned or operated by a recording artist under the authorization of the record company, and that is not subject to paragraph (d) of this section. For the avoidance of doubt and without limitation, an artist page or site on a third-party service (e.g., a social networking service) shall not be considered a service operated by the record company or artist. Such interactive streams may be made or authorized by a record company under the promotional royalty rate only if—

(1) The interactive streaming subject to this paragraph (c) of a particular sound recording is offered or authorized by the record company on no more than 90 days total for all services (*i.e.*, interactive streaming under this paragraph (c) of a particular sound recording may be authorized on no more than a total of 90 days, which need not be consecutive, and on any such day, interactive streams may be offered on one or more services operated by the record company or artist, subject to the provisions of paragraph (b)(2) of this section); provided, however, that an additional 90 days shall be available each time the sound recording is re-released by the record company in a remastered form or as part of a compilation with a different set of sound recordings than prior compilations that include that sound recording;

(2) In the case of interactive streaming through a service devoted to one featured artist, the interactive streams subject to this paragraph (c) of this section of a particular sound recording are made or authorized by the record company on no more than one official artist site per artist and are recordings of that artist; and

(3) In the case of interactive streaming through a service that is not limited to a single featured artist, all interactive streaming on such service (whether eligible for the promotional royalty rate or not) is limited to sound recordings of a single record company and its affiliates and the service would not reasonably be considered to be a meaningful substitute for a paid music service.

(d) *Interactive streaming of clips.* In addition to those in paragraph (a) of this section, the provisions of this paragraph (d) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate of segments of sound recordings of musical works with a playing time that does not exceed 90 seconds. Such interactive streams may be made or authorized by a record company under the promotional royalty rate without any of the temporal limitations set forth in paragraphs (b) and (c) of this section (but subject to the other conditions of paragraphs (b) and (c) of this section, as applicable). For clarity, this paragraph (d) is strictly limited to the uses described herein and shall not be construed as permitting the creation or use of an excerpt of a musical work in violation of 17 U.S.C. 106(2) or 115(a)(2) or any other right of a musical work owner.

§385.15 ~~[Reserved]~~Discounts for Student Plans

In calculating the royalty payments for licensed activity in §385.12, for each student plan, a service provider may discount the minimum royalty rate(s) as set forth in §385.13 commensurate with the discount off the retail price offered to student plan subscribers, not to exceed 50%.

§385.16 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed activity, solely for the purpose of providing such licensed activity (and no other purpose).

§385.17 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

Subpart C—Limited Offerings, Mixed Service Bundles, Music Bundles, Paid Locker Services and Purchased Content Locker Services

§385.20 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for certain reproductions or distributions of musical works through limited offerings, mixed service bundles, music bundles, paid locker services and purchased content locker services provided in accordance with the provisions of 17 U.S.C. 115. For the avoidance of doubt, to the extent that product configurations for which rates are specified in subpart A of this part are included within licensed subpart C activity, as defined in §385.21, the rates specified in subpart A of this part shall not apply, except that in the case of a music bundle the compulsory licensee may elect to pay royalties for the music bundle pursuant to subpart C of this part or for the components of the bundle pursuant to subpart A of this part.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes reproduction or distribution of musical works in limited offerings, mixed service bundles, music bundles, paid locker services or purchased content locker services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

§385.21 Definitions.

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

Affiliate shall have the meaning given in §385.11.

Applicable consideration shall have the meaning given in §385.11, except that for purposes of this subpart C, references in the definition of "Applicable consideration" in §385.11 to licensed activity shall mean licensed subpart C activity, as defined in this section.

Free trial royalty rate means the statutory royalty rate of zero in the case of certain free trial periods, as provided in §385.24.

Fraudulent stream shall have the meaning given in §385.11.

GAAP shall have the meaning given in §385.11.

Interactive stream shall have the meaning given in §385.11.

Licensee shall have the meaning given in §385.11.

Licensed subpart C activity means, referring to subpart C of this part—

(1) In the case of a limited offering, the applicable interactive streams or limited downloads;

(2) In the case of a locker service, the applicable interactive streams, permanent digital downloads, restricted downloads or ringtones;

(3) In the case of a music bundle, the applicable reproduction or distribution of a physical phonorecord, permanent digital download or ringtone; and

(4) In the case of a mixed service bundle, the applicable—

(i) Permanent digital downloads;

(ii) Ringtones;

(iii) To the extent a limited offering is included in a mixed service bundle, interactive streams or limited downloads; or

(iv) To the extent a locker service is included in a mixed service bundle, interactive streams, permanent digital downloads, restricted downloads or ringtones.

Limited download shall have the meaning given in §385.11.

Limited offering means a subscription service providing interactive streams or limited downloads where—

(1) An end user is not provided the opportunity to listen initially to a particular sound recording chosen by the end user at a time chosen by the end user (i.e., the service does not provide interactive streams of individual recordings that are on-demand, and any limited downloads are rendered only as part of programs rather than as individual recordings that are on-demand); ~~or~~provided that the ability of an end user to replay a sound recording previously and recently provided to the end user on a noninteractive basis shall not be deemed for the purposes of this subparagraph (1) to be a sound recording chosen by the end user at a time chosen by the end user; or

(2) The particular sound recordings available to the end user over a period of time are substantially limited relative to services in the marketplace providing access to a comprehensive catalog of recordings (e.g., a service limited to a particular genre, or permitting interactive streaming only from a monthly playlist consisting of a limited set of recordings).

Locker service means a service providing access to sound recordings of musical works in the form of interactive streams, permanent digital downloads, restricted downloads or ringtones, where the service has reasonably determined that phonorecords of the applicable sound recordings have been purchased by the end user or are otherwise in the possession of the end user prior to the end user's first request to access such sound recordings by means of the service. The term locker service does not extend to any part of a service otherwise meeting this definition as to which a license is not obtained for the applicable reproductions and distributions of musical works.

Mixed service bundle means an offering of one or more of permanent digital downloads, ringtones, locker services or limited offerings, together with one or more of non-music services (e.g., Internet access service, mobile phone service) or non-music products (e.g., a device such as a phone) of more than token value, that is provided to users as part of one transaction without pricing for the music services or music products separate from the whole offering.

Music bundle means an offering of two or more of physical phonorecords, permanent digital downloads or ringtones provided to users as part of one transaction (e.g., download plus ringtone, CD plus downloads). A music bundle must contain at least two different product configurations and cannot be combined with any other offering containing licensed activity under subpart B of this part or subpart C of this part.

(1) In the case of music bundles containing one or more physical phonorecords, the physical phonorecord component of the music bundle must be sold under a single catalog number, and the musical works embodied in the digital phonorecord delivery configurations in the music bundle must be the same as, or a subset of, the musical works embodied in the physical phonorecords; provided that when the music bundle contains a set of digital phonorecord deliveries sold by the same record company under substantially the same title as the physical phonorecord (e.g., a corresponding digital album), up to 5 sound recordings of musical works that are included in the stand-alone version of such set of digital phonorecord deliveries but are not included on the physical phonorecord may be included among the digital phonorecord deliveries in the music bundle. In addition, the seller must permanently part with possession of the physical phonorecord or phonorecords sold as part of the music bundle.

(2) In the case of music bundles composed solely of digital phonorecord deliveries, the number of digital phonorecord deliveries in either configuration cannot exceed 20, and the musical works embodied in each configuration in the music bundle must be the same as, or a subset of, the musical works embodied in the configuration containing the most musical works.

Paid locker service means a locker service that is a subscription service.

Permanent digital download shall have the meaning given in §385.2.

Play shall have the meaning given in §385.11.

Purchased content locker service means a locker service made available to end-user purchasers of permanent digital downloads, ringtones or physical phonorecords at no incremental charge above the otherwise applicable purchase price of the permanent digital downloads, ringtones or physical phonorecords, with respect to the sound recordings embodied in permanent digital downloads or ringtones or physical phonorecords purchased from a qualifying seller as described in paragraph (1) of this definition of "Purchased content locker service," whereby the locker service enables the purchaser to engage in one or both of the qualifying activities i~~n~~dentified in paragraph (2) of this definition of "Purchased content locker service." In addition, in the case of a locker service made available to end-user purchasers of physical phonorecords, the seller must permanently part with possession of the physical phonorecords.

(1) A qualifying seller for purposes of this definition of "purchased content locker service" is the same entity operating such locker service, one of its affiliates or predecessors, or—

(i) In the case of permanent digital downloads or ringtones, a seller having another legitimate connection to the locker service provider set forth in one or more written agreements (including that the locker service and permanent digital downloads or ringtones are offered through the same third party); or

(ii) In the case of physical phonorecords, a seller having an agreement with—

(A) The locker service provider whereby such parties establish an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service; or

(B) A service provider that also has an agreement with the entity offering the locker service, where pursuant to those agreements the service provider has established an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service.

(2) Qualifying activity for purposes of this definition of "purchased content locker service" is enabling the purchaser to—

(i) Receive one or more additional phonorecords of such purchased sound recordings of musical works in the form of permanent digital downloads or ringtones at the time of purchase, or

(ii) Subsequently access such purchased sound recordings of musical works in the form of interactive streams, additional permanent digital downloads, restricted downloads or ringtones.

Record company shall have the meaning given in §385.11.

Restricted download means a digital phonorecord delivery distributed in the form of a download that may not be retained and played on a permanent basis. The term restricted download includes a limited download.

Ringtone shall have the meaning given in §385.2.

Service provider shall have the meaning given in §385.11, except that for purposes of this subpart references in the definition of "Service provider" in §385.11 to licensed activity and service revenue shall mean licensed subpart C activity, as defined in this section, and subpart C service revenue, as defined in this section, respectively.

Subpart C offering means, referring to subpart C of this part, a service provider's offering of licensed subpart C activity, as defined in this section, that is subject to a particular rate set forth in §385.23(a) (e.g., a particular subscription plan available through the service provider).

Subpart C relevant page means, referring to subpart C of this part, a page (including a Web page, screen or display) from which licensed subpart C activity, as defined in this section, offered by a service provider is directly available to end users, but only where the offering of licensed subpart C activity, as defined in this section, and content that directly relates to the offering of licensed subpart C activity, as defined in this section, (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed subpart C activity, as defined in this section, is directly available to end users from a page if sound recordings of musical works can be accessed by end users for licensed subpart C activity, as defined in this section, from such page (in most cases this will be the page where the transmission takes place).

Subpart C service revenue. (1) Subject to paragraphs (2) through (6) of the definition of "Subpart C service revenue," as defined in this section, and subject to GAAP, subpart C service revenue shall mean, referring to subpart C of this part, the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed subpart C activity, as defined in this section;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed subpart C activity, as defined in this section, (i.e., advertising placed immediately at the start, end or during the actual delivery, by way of transmissions of a musical work that constitute licensed subpart C activity, as defined in this section); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a subpart C relevant page, as defined in this section, of the service or on any page that directly follows such subpart C relevant page, as defined in this section, leading up to and including the

transmission of a musical work that constitutes licensed subpart C activity, as defined in this section; provided that, in the case where more than one service is actually available to end users from a subpart C relevant page, as defined in this section, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue," of this section such revenue shall, for the avoidance of doubt, include:

(i) ~~Include a~~Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) ~~Include t~~The value of any barter or other nonmonetary consideration; and

~~(iii) Not be reduced by credit card commissions or similar payment process charges; and~~

(~~iv~~iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed subpart C activity, as defined in this section, that they were unable to use due to technical faults in the licensed subpart C activity, as defined in this section, or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue" of this section, such revenue shall, for the avoidance of doubt, exclude ~~revenue~~:

(i) Revenue derived ~~solely~~ in connection with services and activities other than licensed subpart C activity, as defined in this section, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Subpart C service revenue" of this section. By way of example, and not limitation, the following kinds of revenue shall be excluded:

(~~i~~A) Revenue derived from predominantly non-music voice, content and text services, such as, by way of example and not limitation, news, talk, sports, weather, traffic and comedy programming, or podcasts of any of the foregoing;

(~~ii~~B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions);

(~~iii~~C) Revenue generated from the sale of actual locker service storage space to the extent that such storage space is sold at a separate retail price;

(~~iv~~D) In the case of a locker service, revenue derived from the sale of permanent digital downloads or ringtones; and

(~~v~~ii) Revenue derived from other music or music-related products and services that are not or do not include licensed subpart C activity, as defined in this section.

(4) For purposes of paragraph (1) of the definition of "Subpart C service revenue" of this section ~~advertising or~~:

(i) Advertising, sponsorship~~-~~, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) In the case of a mixed service bundle, the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Subpart C service revenue" of this section shall be the greater of—

(i) The revenue recognized from end users for the mixed service bundle less the standalone published price for end users for each of the non-music product or non-music service components of the bundle; provided that, if there is no such standalone published price for a non-music component of the bundle, then the average standalone published price for end users for the most closely comparable non-music product or non-music service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(ii) Either—

(A) In the case of a mixed service bundle that either has 750,000 subscribers or other registered users, or is reasonably expected to have 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle, 40% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and further provided that in any case in which royalties were paid based on this paragraph due to a reasonable expectation of reaching 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle and that does not actually happen, applicable payments shall, in the accounting period next following the end of such 1-year period, retroactively be adjusted as if paragraph (5)(ii)(B) of the definition of "Subpart C service revenue" of this section applied; or

(B) Otherwise, 50% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if

more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

(6) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee—

(i) Service revenue shall be 150% of the record company's wholesale revenue from the music bundle; and

(ii) The times at which distribution and revenue recognition are deemed to occur shall be in accordance with §201.19 of this title.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.24.

§385.22 Calculation of royalty payments in general.

(a) *Applicable royalty.* Licensees that make or authorize licensed subpart C activity, as defined in §385.21, pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the royalty rates and subscriber-based royalty floors for specific types of services provided in §385.23, except as provided for certain free trial periods in §385.24.

(b) *Rate calculation methodology.* Royalty payments for licensed subpart C activity, as defined in §385.21, shall be calculated as provided in this paragraph (b). If a service provides different subpart C offerings, as defined in §385.21, royalties must be separately calculated with respect to each such subpart C offering, as defined in §385.21, taking into consideration service revenue and expenses associated with such offering. Uses subject to the free trial royalty rate shall be excluded from the calculation of royalties due, as further described in this section and §385.23.

(1) *Step 1:* Calculate the All-In Royalty for the Subpart C Offering, as Defined in §385.21. For each accounting period, the all-in royalty for each subpart C offering, as defined in §385.21, of the service provider is the greater of:

(i) The applicable percentage of subpart C service revenue, as defined in §385.21, associated with the relevant offering as set forth in §385.23(a) (excluding any subpart C service revenue, as defined in §385.21, derived solely from licensed subpart C activity, as defined in §385.21, uses subject to the free trial royalty rate); and

(ii) The minimum specified in §385.23(a) for the subpart C offering, as defined in §385.21, involved.

(2) *Step 2:* Subtract applicable performance royalties to determine the payable royalty pool, which is the amount payable for the reproduction and distribution of all musical works used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, for a particular subpart C offering, as defined in §385.21, during the accounting period. From the amount determined in step 1 in paragraph (b)(1) of this section, for each subpart C offering, as defined in §385.21, of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such subpart C offering, as defined in §385.21, during the accounting period that constitute licensed subpart C activity, as defined in §385.21, (other than licensed subpart C activity, as defined in §385.21, subject to the free trial royalty rate), or in connection with previewing of such subpart C offering, as defined in §385.21, during the accounting period. Although this amount may be the total of the payments with respect to the service for that subpart C offering, as defined in §385.21, for the accounting period, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, or previewing of such licensed subpart C activity, as defined in §385.21. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed subpart C activity, as defined in §385.21, uses (other than free trial royalty rate uses), and previewing of such uses, in connection with the relevant subpart C offering, as defined in §385.21, as determined in relation to all uses of musical works for which the public performance payments are made for the accounting period. Such allocation shall be made on the basis of plays of musical works or, where per-play information is unavailable due to bona fide technical limitations as described in step 3 in paragraph (b)(3) of this section, using the same alternative methodology as provided in step 3 in paragraph (b)(3) of this section.

(3) *Step 3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, through a particular subpart C offering, as defined in §385.21, during the accounting period. To determine this amount, the result determined in step 2 in paragraph (b)(2) of this section must be allocated to each musical work used through the subpart C offering, as defined in §385.21. The allocation shall be accomplished as follows:

(i) In the case of limited offerings (but not limited offerings that are part of mixed service bundles), by dividing the payable royalty pool determined in step 2 in paragraph (b)(2) of this section for such offering by the total number of plays of all musical works through such offering during the accounting period (other than free trial royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than free trial royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step 3 only (i.e., after the payable royalty pool has been determined), for sound recordings of musical works with a

playing time of over 5 minutes, each play shall be counted as provided in paragraph (c) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices usable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(ii) In the case of mixed service bundles and locker services, by—

(A) Determining a constructive number of plays of all licensed musical works that is the sum of the total number of interactive streams of all licensed musical works made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads);

(B) Determining a constructive per-play allocation that is the payable royalty pool determined in step 2 of paragraph (b)(2) of this section for such offering divided by the constructive number of plays of all licensed musical works determined in paragraph (b)(3)(ii)(A) of this section;

(C) For each licensed musical work, determining a constructive number of plays of that musical work that is the sum of the total number of interactive streams of such licensed musical work made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of such licensed musical work made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of such licensed musical work made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads); and

(D) For each licensed musical work, determining the per-work royalty allocation by multiplying the constructive per-play allocation determined in paragraph (b)(3)(ii)(B) of this section by the constructive number of plays of that musical work determined in paragraph (b)(3)(ii)(C) of this section.

(E) Notwithstanding the foregoing, if a service provider offers both a paid locker service and a purchased content locker service, and with respect to the purchased content locker service there is no subpart C service revenue, as defined in §385.21, and the applicable subminimum is zero dollars, then the service provider shall be permitted to include within the calculation of constructive plays under paragraphs (b)(3)(ii)(A) and (C) of this section for the paid locker service, the licensed subpart C activity, as defined in §385.21, made through the purchased content locker service (i.e., the total number of interactive streams of all licensed

musical works made through the purchased content locker service during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through the purchased content locker service during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through the purchased content locker service during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads)); provided that the relevant licensed subpart C activity, as defined in §385.21, made through the purchased content locker service is similarly included within the play calculation for the paid locker service for the corresponding sound recording rights.

(iii) In the case of music bundles, by—

(A) Allocating the payable royalty pool determined in step 2 of paragraph (b)(2) of this section to separate pools for each type of product configuration included in the music bundle (e.g., CD, permanent digital download, ringtone) in accordance with the ratios that the standalone published prices of the products that are included in the music bundle bear to each other; provided that, if there is no such standalone published price for such a product, then the average standalone published price for end users for the most closely comparable product in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(B) Allocating the product configuration pools determined in paragraph (b)(3)(iii)(A) of this section to individual musical works by dividing each such pool by the total number of sound recordings of musical works included in products of that configuration in the music bundle.

(c) *Overtime adjustment.* For purposes of the calculations in step 3 of paragraph (b)(3)(i) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 plays for each additional minute or fraction thereof.

§385.23 Royalty rates and subscriber-based royalty floors for specific types of services.

(a) *In general.* The following royalty rates and subscriber-based royalty floors shall apply to the following types of licensed subpart C activity, as defined in §385.21:

(1) *Mixed service bundle.* In the case of a mixed service bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the ~~appropriate~~ subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b) ~~(1) is 17.36%, and the sound recording-only percentage applicable to §385.23(b)(2)~~ is 21%.

(2) *Music bundle.* In the case of a music bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) ~~and (3) is 17.36%, and the sound recording-only percentage applicable to §385.23(b)(2)~~ is 21%.

(3) *Limited offering.* In the case of a limited offering, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 10.5%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~17.36%, and the sound recording-only percentage applicable to §385.23(b)(2) is~~ 21%; and

(ii) The aggregate amount of 18 cents per subscriber per month.

(4) *Paid locker service.* In the case of a paid locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~17.11%, and the sound recording-only percentage applicable to §385.23(b)(2) is~~ 20.65%; and

(ii) The aggregate amount of 17 cents per subscriber per month.

(5) *Purchased content locker service.* In the case of a purchased content locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. For the avoidance of doubt, paragraph (1)(i) of the definition of "Subpart C service revenue," as defined in §385.21, shall not apply. The minimum for use in step 1 in §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~18%, and the sound recording-only percentage applicable to §385.23(b)(2) is~~ 22%, except that for

purposes of paragraph (b) of this section the applicable consideration expensed by the service for the relevant rights shall consist only of applicable consideration expensed by the service, if any, that is incremental to the applicable consideration expensed for the rights to make the relevant permanent digital downloads and ringtones.

(b) *Computation of subminima.* For purposes of paragraph (a) of this section, the subminimum for an accounting period is the aggregate of the following with respect to all sound recordings of musical works used in the relevant subpart C offering, as defined in §385.21, of the service provider during the accounting period—:

~~(1) Except as provided in paragraph (b)(3) of this section, in cases in which the record company is the licensee under 17 U.S.C. 115 and the record company has granted the rights to engage in licensed subpart C activity, as defined in §385.21, with respect to a sound recording through the third-party service together with the right to reproduce and distribute the musical work embodied therein, the appropriate all-in percentage from paragraph (a) of this section of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

(~~2~~1) In cases in which ~~the record company is not the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to engage in licensed subpart C activity, as defined in §385.21, with respect to a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, the appropriate sound recording-only percentage from paragraph (a) of this section of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(~~3~~2) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee, the appropriate all-in percentage from paragraph (a) of this section of the record company's total wholesale revenue from the music bundle in accordance with GAAP for the accounting period, which amount shall equal the applicable consideration for such music bundle at the time such applicable consideration is properly recognized as revenue under GAAP, subject to the provisions of §201.19 of this title concerning the times at which distribution and revenue recognition are deemed to occur.

(~~4~~3) If a record company providing sound recording rights to the service provider for a licensed subpart C activity, as defined in §385.21—

(i) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed subpart C activity, as defined in §385.21, and its affiliates, and

(ii) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(iii) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraph (b)(1) ~~or (2)~~ of this section ~~, as applicable,~~ if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(c) *Computation of subscriber-based royalty rates.* For purposes of paragraphs (a)(3) and (4) of this section, to determine the subscriber-based minimum applicable to any particular subpart C offering, as defined in §385.21, the total number of subscriber-months for the accounting period shall be calculated, taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the free trial royalty rate as described in §385.24. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber shall be used as the subscriber-based component of the minimum for the accounting period.

§385.24 Free trial periods.

(a) *General provisions.* This section establishes a royalty rate of zero in the case of certain free trial periods for mixed service bundles, paid locker services and limited offerings under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the free trial royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission, as part of a mixed service bundle, paid locker service or limited offering, of a sound recording that embodies such musical work, only if—

(1) The primary purpose of the record company in providing or authorizing the free trial period is to promote the applicable subpart C offering, as defined in §385.21;

(2) No applicable consideration for making or authorizing the transmissions is received by the record company, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration used to promote the sale or paid use of sound recordings or audiovisual works embodying musical works or the paid use of music services through which sound recordings or audiovisual works embodying musical works are available;

(3) The free trial period does not exceed 30 consecutive days per subscriber per two-year period;

(4) In connection with authorizing the transmissions, the record company has obtained from the service provider it authorizes a written representation that—

(i) The service provider agrees to maintain for a period of no less than 5 years from the end of each relevant accounting period complete and accurate records of the relevant authorization, and identifying each sound recording of a musical work made available through the free trial period, the licensed subpart C activity, as defined in §385.21, involved, and the number of plays or downloads, as applicable, of such recording;

(ii) The service is in all material respects operating with appropriate license authority with respect to the musical works it is using; and

(iii) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(5) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the free trial royalty rate by that service;

(6) The free trial period is offered free of any charge to the end user; and

(7) End users are periodically offered an opportunity to subscribe to the service during such free trial period.

(b) *Recordkeeping by record companies.* To rely upon the free trial royalty rate for a free trial period, a record company making or authorizing the free trial period shall keep complete and accurate contemporaneous written records of the contractual terms that bear upon the free trial period; and further provided that, if the record company itself is conducting the free trial period, it shall also maintain any additional records described in paragraph (a)(4)(i) of this section. The records required by this paragraph (b) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed subpart C activity, as defined in §385.21, in the ordinary course of business, but in no event for less than 5 years from the conclusion of the licensed subpart C activity, as defined in §385.21, to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (b) with respect to a specific free trial period, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(4)(i) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the record company shall have a reasonable time, in view of the amount of information

requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Recordkeeping by services.* If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(4)(i) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(d) *Interpretation.* The free trial royalty rate is exclusively for audio-only licensed subpart C activity, as defined in §385.21, involving musical works subject to licensing under 17 U.S.C. 115. The free trial royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the free trial royalty rate (including without limitation licensed subpart C activity, as defined in §385.21, beyond the time limitations applicable to the free trial royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101, *et seq.*

§385.25 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed subpart C activity, as defined in §385.21, solely for the purpose of providing such licensed subpart C activity, as defined in §385.21 (and no other purpose).

§385.26 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

APPENDIX C

Subpart B—Interactive Streaming and Limited Downloads

§385.10 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for interactive streams and limited downloads of musical works by subscription and nonsubscription digital music services in accordance with the provisions of 17 U.S.C. 115.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes interactive streams or limited downloads of musical works through subscription or nonsubscription digital music services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a musical work copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

~~[74 FR 4529, Jan. 26, 2009, as amended at 78 FR 67942, Nov. 13, 2013]~~

§385.11 Definitions.

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

Affiliate means an entity controlling, controlled by, or under common control with another entity, except that an affiliate of a record company shall not include a copyright owner of musical works to the extent it is engaging in business as to musical works.

Applicable consideration means anything of value given for the identified rights to undertake the licensed activity, including, without limitation, ownership equity, monetary advances, barter or any other monetary and/or nonmonetary consideration, whether such consideration is conveyed via a single agreement, multiple agreements and/or agreements that do not themselves authorize the licensed activity but nevertheless provide consideration for the identified rights to undertake the licensed activity, and including any such value given to an

affiliate of a record company for such rights to undertake the licensed activity. For the avoidance of doubt, value given to a copyright owner of musical works that is controlling, controlled by, or under common control with a record company for rights to undertake the licensed activity shall not be considered value given to the record company. Notwithstanding the foregoing, applicable consideration shall not include in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings embodying musical works or the paid use of music services through which sound recordings embodying musical works are available where such in-kind promotional consideration is given in connection with a use that qualifies for licensing under 17 U.S.C. 115.

Family plan means a single subscription account that authorizes access to a digital music service for up to six listener profiles for a single discounted fee payable via one form of payment.

Fraudulent stream means a stream that a Service has determined was either not directly initiated or requested by a human user of the service or otherwise initiated to artificially increase play count. Without limiting the foregoing, if a single end user plays the same track more than 50 straight times, all plays after play 50 shall be deemed fraudulent.

GAAP means U.S. Generally Accepted Accounting Principles, except that if the U.S. Securities and Exchange Commission permits or requires entities with securities that are publicly traded in the U.S. to employ International Financial Reporting Standards, as issued by the International Accounting Standards Board, or as accepted by the Securities and Exchange Commission if different from that issued by the International Accounting Standards Board, in lieu of Generally Accepted Accounting Principles, then an entity may employ International Financial Reporting Standards as "GAAP" for purposes of this subpart.

Interactive stream means a stream of a sound recording of a musical work, where the performance of the sound recording by means of the stream is not exempt under 17 U.S.C. 114(d)(1) and does not in itself or as a result of a program in which it is included qualify for statutory licensing under 17 U.S.C. 114(d)(2).

Licensee means a person that has obtained a compulsory license under 17 U.S.C. 115 and its implementing regulations.

Licensed activity means interactive streams or limited downloads of musical works, as applicable, licensed pursuant to this subpart B.

Limited download means a digital transmission of a sound recording of a musical work to an end user, other than a stream, that results in a specifically identifiable reproduction of that sound recording that is only accessible for listening for—

(1) An amount of time not to exceed 1 month from the time of the transmission (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use for another time period not to exceed 1 month), or in the case of a

subscription transmission, a period of time following the end of the applicable subscription no longer than a subscription renewal period or 3 months, whichever is shorter; or

(2) A specified number of times not to exceed 12 (unless the service provider, in lieu of retransmitting the same sound recording as another limited download, separately and upon specific request of the end user made through a live network connection, reauthorizes use of another series of 12 or fewer plays), or in the case of a subscription transmission, 12 times after the end of the applicable subscription.

(3) A limited download is a general digital phonorecord delivery under 17 U.S.C. 115(c)(3)(C) and (D).

Offering means a service provider's offering of licensed activity that is subject to a particular rate set forth in §385.13(a) (e.g., a particular subscription plan available through the service provider).

Play means an interactive stream or limited download play of 30 seconds or more, except a sound recording of a musical work that is, in its entirety, under 30 seconds shall constitute a "play" if it is streamed by the end user for the entire duration of such sound recording. A Fraudulent Streams does not constitute a Play.

Promotional royalty rate means the statutory royalty rate of zero in the case of certain promotional interactive streams and certain promotional limited downloads, as provided in §385.14.

Record company means a person or entity that

(1) Is a copyright owner of a sound recording of a musical work;

(2) In the case of a sound recording of a musical work fixed before February 15, 1972, has rights to the sound recording, under the common law or statutes of any State, that are equivalent to the rights of a copyright owner of a sound recording of a musical work under title 17, United States Code;

(3) Is an exclusive licensee of the rights to reproduce and distribute a sound recording of a musical work; or

(4) Performs the functions of marketing and authorizing the distribution of a sound recording of a musical work under its own label, under the authority of the copyright owner of the sound recording.

Relevant page means a page (including a Web page, screen or display) from which licensed activity offered by a service provider is directly available to end users, but only where the offering of licensed activity and content that directly relates to the offering of licensed activity (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75%

or more of the space on that page, excluding any space occupied by advertising. A licensed activity is directly available to end users from a page if sound recordings of musical works can be accessed by end users for licensed activity from such page (in most cases this will be the page where the limited download or interactive stream takes place).

Service provider means that entity (which may or may not be the licensee) that, with respect to the licensed activity,

(1) Contracts with or has a direct relationship with end users in a case where a contract or relationship exists, or otherwise controls the content made available to end users;

(2) Is able to report fully on service revenue from the provision of the licensed activity to the public, and to the extent applicable, verify service revenue through an audit; and

(3) Is able to report fully on usage of musical works by the service, or procure such reporting, and to the extent applicable, verify usage through an audit.

Service revenue. (1) Subject to paragraphs (2) through (5) of the definition of "Service revenue," and subject to GAAP, *service revenue* shall mean the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed activity;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download" advertising as part of licensed activity (*i.e.*, advertising placed immediately at the start, end or during the actual delivery, by way of interactive streaming or limited downloads, as applicable, of a musical work); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a relevant page of the service or on any page that directly follows such relevant page leading up to and including the limited download or interactive streaming, as applicable, of a musical work; provided that, in the case where more than one service is actually available to end users from a relevant page, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, include:

(i) Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) The value of any barter or other nonmonetary consideration; and

(iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed activity that they were unable to use due to technical faults in the licensed activity or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Service revenue," such revenue shall, for the avoidance of doubt, exclude:

(i) Revenue derived ~~solely~~ in connection with services and activities other than licensed activity, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Service revenue." By way of example, and not limitation, the following kinds of revenue shall be excluded:

(A) Revenue derived from predominantly non-music voice, content and text services such as, by way of example and not limitation, news, talk, sports, weather, traffic, and comedy programming, or podcasts of any of the foregoing;

(B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions); and

(C) Revenue derived from music or music-related products and services that are not or do not include licensed activity.

(4) For purposes of paragraph (1) of the definition of "Service revenue":

(i) Advertising, sponsorship, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) Where the licensed activity is provided to end users as part of the same transaction with one or more other products or services that are not a music service engaged in licensed activity, then the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Service revenue" shall be the revenue recognized from end users for the bundle less the standalone published price for end users for each of the other component(s) of the bundle; provided that, if there is no such standalone published price for a component of the bundle, then the average standalone published price for end users for the most closely comparable product or service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

Stream means the digital transmission of a sound recording of a musical work to an end user—

(1) To allow the end user to listen to the sound recording, while maintaining a live network connection to the transmitting service, substantially at the time of transmission, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction;

(2) Using technology that is designed such that the sound recording does not remain accessible for future listening, except to the extent that the sound recording remains accessible for future listening from a streaming cache reproduction; and

(3) That is also subject to licensing as a public performance of the musical work.

Streaming cache reproduction means a reproduction of a sound recording of a musical work made on a computer or other receiving device by a service solely for the purpose of permitting an end user who has previously received a stream of such sound recording to play such sound recording again from local storage on such computer or other device rather than by means of a transmission; provided that the user is only able to do so while maintaining a live network connection to the service, and such reproduction is encrypted or otherwise protected consistent with prevailing industry standards to prevent it from being played in any other manner or on any device other than the computer or other device on which it was originally made.

Student plan means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college or university geographically located in the United States or in its possessions or territories.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.14(b).

~~[74 FR 4529, Jan. 26, 2009, as amended at 74 FR 6834, Feb. 11, 2009; 78 FR 67942, Nov. 13, 2013]~~

§385.12 Calculation of royalty payments in general.

(a) *Applicable royalty*. Licensees that make or authorize licensed activity pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the minimum royalties and subscriber-based royalty floors for specific types of services provided in §385.13, except as provided under §385.10(d) and for certain promotional uses in §385.14.

(b) *Rate calculation methodology*. Royalty payments for licensed activity in subpart B shall be calculated as provided in paragraph (b) of this section. If a service includes different offerings, royalties must be separately calculated with respect to each such offering taking into consideration service revenue and expenses associated with such offering. Uses subject to the

promotional royalty rate shall be excluded from the calculation of royalties due, as further described in this section and the following §385.13.

(1) *Step 1:* Calculate the All-In Royalty for the Offering. For each accounting period, the all-in royalty for each offering of the service provider is the greater of

(i) The applicable percentage of service revenue associated with the relevant offering as set forth in paragraph (c) of this section (excluding any service revenue derived solely from licensed activity uses subject to the promotional royalty rate), and

(ii) The minimum specified in §385.13 of the offering involved.

(2) *Step 2:* Determine the Payable Royalty Pool by Subtracting Applicable Performance Royalties. From the amount determined in step 1 in paragraph (b)(1) of this section, for each offering of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such offering during the accounting period that constitute licensed activity (other than licensed activity subject to the promotional royalty rate). Although this amount may be the total of the service's payments for that offering for the accounting period, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed activity. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed activity, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering. If the payments allocable to licensed activity uses (other than promotional royalty rate uses) through the relevant offering are not readily distinguishable from payments for public performances not allocable to licensed activity uses, then the payments allocated to licensed activity uses (other than promotional royalty uses) for the accounting period shall be made on the basis of plays of musical works for licensed activity uses (other than promotional royalty uses) in relation to all uses of musical works for which the public performance payments are made or, where per-play information is unavailable due to bona fide technical limitations as described in step 3 in paragraph (b)(3) of this section, using the same alternative methodology as provided in step 3.

(3) *Step 3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed activity through a particular offering during the accounting period. To determine this amount, the result determined in step 2 in paragraph (b)(2) of this section must be allocated to each musical work used through the offering. The allocation shall be accomplished by dividing the payable royalty pool determined in step 2 for such offering by the total number of plays of all musical works through such offering during the accounting period (other than promotional royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than promotional royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step 3 only (*i.e.*, after the payable royalty pool has been determined), for sound recordings of musical works with a

playing time of over 5 minutes, each play shall be counted as provided in paragraph (d) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices useable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(c) *Percentage of service revenue.* The percentage of service revenue applicable under paragraph (b) of this section is 10.5%.

(d) *Overtime adjustment.* For purposes of the calculations in step 3 in paragraph (b)(3) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 for each additional minute or fraction thereof.

(e) *Accounting.* The calculations required by paragraph (b) of this section shall be made in good faith and on the basis of the best knowledge, information and belief of the licensee at the time payment is due, and subject to the additional accounting and certification requirements of 17 U.S.C. 115(c)(5) and §201.19 of this title. Without limitation, a licensee's statements of account shall set forth each step of its calculations with sufficient information to allow the copyright owner to assess the accuracy and manner in which the licensee determined the payable royalty pool and per-play allocations (including information sufficient to demonstrate whether and how a minimum royalty pursuant to §385.13 does or does not apply) and, for each offering reported, also indicate the type of licensed activity involved and the number of plays of each musical work (including an indication of any overtime adjustment applied) that is the basis of the per-work royalty allocation being paid.

~~[74 FR 4529, Jan. 26, 2009, as amended at 78 FR 67943, Nov. 13, 2013]~~

§385.13 Minimum royalty rates for specific types of services.

(a) *In general.* The following minimum royalty rates shall apply to the following types of licensed activity:

(1) *Standalone non-portable subscription—streaming only.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings only in the form of interactive streams and only from a non-portable device to which such streams are originally transmitted while the device has a live network connection, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum II as described in paragraph (c) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month.

(2) *Standalone non-portable subscription—mixed.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings either in the form of interactive streams or limited downloads but only from a non-portable device to which such streams or downloads are originally transmitted, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of the subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 50 cents per subscriber per month.

(3) *Standalone portable subscription service.* Except as provided in paragraph (a)(4) of this section, in the case of a subscription service through which an end user can listen to sound recordings in the form of interactive streams or limited downloads from a portable device, the minimum for use in step 1 of §385.12(b)(1)(ii) is the lesser of subminimum I as described in paragraph (b) of this section for the accounting period and the aggregate amount of 80 cents per subscriber per month.

(4) *Bundled subscription services.* In the case of a subscription service providing licensed activity that is made available to end users with one or more other products or services (including products or services subject to other subparts) as part of a single transaction without pricing for the subscription service providing licensed activity separate from the product(s) or service(s) with which it is made available (e.g., a case in which a user can buy a portable device and one-year access to a subscription service providing licensed activity for a single price), the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum I as described in paragraph (b) of this section for the accounting period.

(5) *Free nonsubscription/ad-supported services.* In the case of a service offering licensed activity free of any charge to the end user, the minimum for use in step 1 of §385.12(b)(1)(ii) is subminimum II described in paragraph (c) of this section for the accounting period.

(b) *Computation of subminimum I.* For purposes of paragraphs (a)(2), (3), and (4) of this section, subminimum I for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period~~—~~

: in ~~(1) In~~ cases in which ~~the record company is the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service ~~together~~ without the right to reproduce and distribute the musical work embodied therein, ~~17.36~~21% of the total amount expensed by the

service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

~~(2) In cases in which the record company is not the licensee under 17 U.S.C. 115 and the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, 21% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

(c) *Computation of subminimum II.* For purposes of paragraphs (a)(1) and (5) of this section, subminimum II for an accounting period means the aggregate of the following with respect to all sound recordings of musical works used in the relevant offering of the service provider during the accounting period~~—~~

: in ~~(1) In cases in which the record company is the licensee under 17 U.S.C. 115 and the record company has granted the rights to make interactive streams and limited downloads of a sound recording through the third-party service together with the right to reproduce and distribute the musical work embodied therein, 18% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

~~(2) In~~ cases in which ~~the record company is not the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to make interactive streams or limited downloads of a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, 22% of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(d) *Payments made by third parties.* If a record company providing sound recording rights to the service provider for a licensed activity—

(1) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed activity and its affiliates, and

(2) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(3) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraphs (b) ~~(1), (b)(2), (c)(1),~~ or (c~~)(2~~) of this section, as

applicable, if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(e) *Computation of subscriber-based royalty rates.* For purposes of paragraph (a) of this section, to determine the minimum applicable to any particular offering, the total number of subscriber-months for the accounting period, shall be calculated taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the promotional royalty rate as described in §385.14(b)(2), except that in the case of a bundled subscription service, subscriber-months shall instead be determined with respect to active subscribers as defined in paragraph (a)(4) of this section. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber (or active subscriber, as the case may be) shall be used as the subscriber-based component of the minimum or subscriber-based royalty floor, as applicable, for the accounting period. A family plan shall be treated as 1.5 subscribers per month, prorated in the case of a family plan end user who subscribed for only part of a calendar month.

~~[74 FR 4529, Jan. 26, 2009, as amended at 78 FR 67943, Nov. 13, 2013]~~

§385.14 Promotional royalty rate.

(a) *General provisions.* (1) This section establishes a royalty rate of zero in the case of certain promotional interactive streaming activities, and of certain promotional limited downloads offered in the context of a free trial period for a digital music subscription service under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the promotional royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission of interactive streams or limited downloads of a sound recording that embodies such musical work, only if—

(i) The primary purpose of the record company in making or authorizing the interactive streams or limited downloads is to promote the sale or other paid use of sound recordings by the relevant artists, including such sound recording, through established retail channels or the paid use of one or more established retail music services through which the sound recording is available, and not to promote any other good or service;

(ii) Either—

(A) The sound recording (or a different version of the sound recording embodying the same musical work) is being lawfully distributed and offered to consumers through the established retail channels or services described in paragraph (a)(1)(i) of this section; or

(B) In the case of a sound recording of a musical work being prepared for commercial release but not yet released, the record company has a good faith intention of lawfully distributing and offering to consumers the sound recording (or a different version of the sound recording embodying the same musical work) through the established retail channels or services described in paragraph (a)(1)(i) of this section within 90 days after the commencement of the first promotional use authorized under this section (and in fact does so, unless it can demonstrate that notwithstanding its bona fide intention, it unexpectedly did not meet the scheduled release date);

(iii) In connection with authorizing the promotional interactive streams or limited downloads, the record company has obtained from the service provider it authorizes a written representation that—

(A) In the case of a promotional use other than interactive streaming subject to paragraph (d) of this section, the service provider agrees to maintain for a period of no less than 5 years from the conclusion of the promotional activity complete and accurate records of the relevant authorization and dates on which the promotion was conducted, and identifying each sound recording of a musical work made available through the promotion, the licensed activity involved, and the number of plays of such recording;

(B) The service provider is in all material respects operating with appropriate license authority with respect to the musical works it is using for promotional and other purposes; and

(C) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(iv) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the promotional royalty rate by that service;

(v) The interactive streams or limited downloads are offered free of any charge to the end user and, except in the case of interactive streaming subject to paragraph (d) of this section in the case of a free trial period for a digital music subscription service, no more than 5 sound recordings at a time are streamed in response to any individual request of an end user;

(vi) The interactive streams and limited downloads are offered in a manner such that the user is at the same time (e.g., on the same Web page) presented with a purchase opportunity for the relevant sound recording or an opportunity to subscribe to a paid service offering the sound recording, or a link to such a purchase or subscription opportunity, except—

(A) In the case of interactive streaming of a sound recording being prepared for commercial release but not yet released, certain mobile applications or other circumstances in which the foregoing is impracticable in view of the current state of the relevant technology; and

(B) In the case of a free trial period for a digital music subscription service, if end users are periodically offered an opportunity to subscribe to the service during such free trial period; and

(vii) The interactive streams and limited downloads are not provided in a manner that is likely to cause mistake, to confuse or to deceive, reasonable end users as to the endorsement or association of the author of the musical work with any product, service or activity other than the sale or paid use of sound recordings or paid use of a music service through which sound recordings are available. Without limiting the foregoing, upon receipt of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular use of such work under this section violates the limitation set forth in this paragraph (a)(1)(vii), the record company shall promptly cease such use of that work, and within 5 business days withdraw by written notice its authorization of such use by all relevant third parties it has authorized under this section.

(2) To rely upon the promotional royalty rate, a record company making or authorizing interactive streams or limited downloads shall keep complete and accurate contemporaneous written records of such uses, including the sound recordings and musical works involved, the artists, the release dates of the sound recordings, a brief statement of the promotional activities authorized, the identity of the service or services where each promotion is authorized (including the Internet address if applicable), the beginning and end date of each period of promotional activity authorized, and the representation required by paragraph (a)(1)(iii) of this section; provided that, in the case of trial subscription uses, such records shall instead consist of the contractual terms that bear upon promotional uses by the particular digital music subscription services it authorizes; and further provided that, if the record company itself is conducting the promotion, it shall also maintain any additional records described in paragraph (a)(1)(iii)(A) of this section. The records required by this paragraph (a)(2) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed activity in the ordinary course of business, but in no event for less than 5 years from the conclusion of the promotional activity to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (a)(2) with respect to a specific promotion or relating to a particular sound recording of a musical work, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(1)(iii)(A) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of

promotions or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(3) If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(1)(iii)(A) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of promotions or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the promotional royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(4) The promotional royalty rate is exclusively for audio-only interactive streaming and limited downloads of musical works subject to licensing under 17 U.S.C. 115. The promotional royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the promotional royalty rate (including without limitation interactive streaming or limited downloads of a musical work beyond the time limitations applicable to the promotional royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101 *et seq.*

(b) *Interactive streaming and limited downloads of full-length musical works through third-party services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (b) apply to interactive streaming, and limited downloads (in the context of a free trial period for a digital music subscription service), authorized by record companies under the promotional royalty rate through third-party services (including Web sites) that is not subject to paragraphs (c) or (d) of this section. Such interactive streams and limited downloads may be made or authorized by a record company under the promotional royalty rate only if—

(1) No applicable consideration for making or authorizing the relevant interactive streams or limited downloads is received by the record company, any of its affiliates, or any other person or entity acting on behalf of or in lieu of the record company, except for in-kind promotional consideration given to a record company (or affiliate thereof) that is used to promote the sale or paid use of sound recordings or the paid use of music services through which sound recordings are available;

(2) In the case of interactive streaming and limited downloads offered in the context of a free trial period for a digital music subscription service, the free trial period does not exceed 30 consecutive days per subscriber per two-year period; and

(3) In contexts other than a free trial period for a digital music subscription service, interactive streaming subject to paragraph (b) of this section of a particular sound recording is authorized by the record company on no more than 60 days total for all services (*i.e.*, interactive streaming under paragraph (b) of this section of a particular sound recording may be authorized on no more than a total of 60 days, which need not be consecutive, and on any one such day, interactive streams may be offered on one or more services); provided, however, that an additional 60 days shall be available each time the sound recording is re-released by the record company in a remastered form or as a part of a compilation with a different set of sound recordings than the original release or any prior compilation including such sound recording.

(4) In the event that a record company authorizes promotional uses in excess of the time limitations of paragraph (b) of this section, the record company, and not the third-party service it has authorized, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved. In the event that a third-party service exceeds the scope of any authorization by a record company, the service provider, and not the record company, shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Interactive streaming of full-length musical works through record company and artist services.* In addition to those of paragraph (a) of this section, the provisions of this paragraph (c) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate through a service (e.g., a Web site) directly owned or operated by the record company, or directly owned or operated by a recording artist under the authorization of the record company, and that is not subject to paragraph (d) of this section. For the avoidance of doubt and without limitation, an artist page or site on a third-party service (e.g., a social networking service) shall not be considered a service operated by the record company or artist. Such interactive streams may be made or authorized by a record company under the promotional royalty rate only if—

(1) The interactive streaming subject to this paragraph (c) of a particular sound recording is offered or authorized by the record company on no more than 90 days total for all services (*i.e.*, interactive streaming under this paragraph (c) of a particular sound recording may be authorized on no more than a total of 90 days, which need not be consecutive, and on any such day, interactive streams may be offered on one or more services operated by the record

company or artist, subject to the provisions of paragraph (b)(2) of this section); provided, however, that an additional 90 days shall be available each time the sound recording is re-released by the record company in a remastered form or as part of a compilation with a different set of sound recordings than prior compilations that include that sound recording;

(2) In the case of interactive streaming through a service devoted to one featured artist, the interactive streams subject to this paragraph (c) of this section of a particular sound recording are made or authorized by the record company on no more than one official artist site per artist and are recordings of that artist; and

(3) In the case of interactive streaming through a service that is not limited to a single featured artist, all interactive streaming on such service (whether eligible for the promotional royalty rate or not) is limited to sound recordings of a single record company and its affiliates and the service would not reasonably be considered to be a meaningful substitute for a paid music service.

(d) *Interactive streaming of clips.* In addition to those in paragraph (a) of this section, the provisions of this paragraph (d) apply to interactive streaming conducted or authorized by record companies under the promotional royalty rate of segments of sound recordings of musical works with a playing time that does not exceed 90 seconds. Such interactive streams may be made or authorized by a record company under the promotional royalty rate without any of the temporal limitations set forth in paragraphs (b) and (c) of this section (but subject to the other conditions of paragraphs (b) and (c) of this section, as applicable). For clarity, this paragraph (d) is strictly limited to the uses described herein and shall not be construed as permitting the creation or use of an excerpt of a musical work in violation of 17 U.S.C. 106(2) or 115(a)(2) or any other right of a musical work owner.

~~[74 FR 4529, Jan. 26, 2009, as amended at 74 FR 6834, Feb. 11, 2009; 78 FR 67944, Nov. 13, 2013]~~

§385.15 Discounts for Student Plans

In calculating the royalty payments for licensed activity in §385.12, for each student plan, a service provider may discount the minimum royalty rate(s) as set forth in §385.13 commensurate with the discount off the retail price offered to student plan subscribers, not to exceed 50%.

§385.16 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed activity, solely for the purpose of providing such licensed activity (and no other purpose).

§385.17 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.

Subpart C—Limited Offerings, Mixed Service Bundles, Music Bundles, Paid Locker Services and Purchased Content Locker Services

~~Source: 78 FR 67944, Nov. 13, 2013, unless otherwise noted.~~

§385.20 General.

(a) *Scope.* This subpart establishes rates and terms of royalty payments for certain reproductions or distributions of musical works through limited offerings, mixed service bundles, music bundles, paid locker services and purchased content locker services provided in accordance with the provisions of 17 U.S.C. 115. For the avoidance of doubt, to the extent that product configurations for which rates are specified in subpart A of this part are included within licensed subpart C activity, as defined in §385.21, the rates specified in subpart A of this part shall not apply, except that in the case of a music bundle the compulsory licensee may elect to pay royalties for the music bundle pursuant to subpart C of this part or for the components of the bundle pursuant to subpart A of this part.

(b) *Legal compliance.* A licensee that, pursuant to 17 U.S.C. 115, makes or authorizes reproduction or distribution of musical works in limited offerings, mixed service bundles, music bundles, paid locker services or purchased content locker services shall comply with the requirements of that section, the rates and terms of this subpart, and any other applicable regulations, with respect to such musical works and uses licensed pursuant to 17 U.S.C. 115.

(c) *Interpretation.* This subpart is intended only to set rates and terms for situations in which the exclusive rights of a copyright owner are implicated and a compulsory license pursuant to 17 U.S.C. 115 is obtained. Neither this subpart nor the act of obtaining a license under 17 U.S.C. 115 is intended to express or imply any conclusion as to the circumstances in which any of the exclusive rights of a copyright owner are implicated or a license, including a compulsory license pursuant to 17 U.S.C. 115, must be obtained.

(d) *Relationship to voluntary agreements.* Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by copyright owners and Licensees (as defined below) concerning rights within the scope of 17 U.S.C. 115, shall apply in lieu of the rates and terms of this subpart to the use of musical works within the scope of such agreements.

§385.21 Definitions.

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

Affiliate shall have the meaning given in §385.11.

Applicable consideration shall have the meaning given in §385.11, except that for purposes of this subpart C, references in the definition of "Applicable consideration" in §385.11 to licensed activity shall mean licensed subpart C activity, as defined in this section.

Free trial royalty rate means the statutory royalty rate of zero in the case of certain free trial periods, as provided in §385.24.

Fraudulent stream shall have the meaning given in §385.11.

GAAP shall have the meaning given in §385.11.

Interactive stream shall have the meaning given in §385.11.

Licensee shall have the meaning given in §385.11.

Licensed subpart C activity means, referring to subpart C of this part—

(1) In the case of a limited offering, the applicable interactive streams or limited downloads;

(2) In the case of a locker service, the applicable interactive streams, permanent digital downloads, restricted downloads or ringtones;

(3) In the case of a music bundle, the applicable reproduction or distribution of a physical phonorecord, permanent digital download or ringtone; and

(4) In the case of a mixed service bundle, the applicable—

(i) Permanent digital downloads;

(ii) Ringtones;

(iii) To the extent a limited offering is included in a mixed service bundle, interactive streams or limited downloads; or

(iv) To the extent a locker service is included in a mixed service bundle, interactive streams, permanent digital downloads, restricted downloads or ringtones.

Limited download shall have the meaning given in §385.11.

Limited offering means a subscription service providing interactive streams or limited downloads where—

(1) An end user is not provided the opportunity to listen initially to a particular sound recording chosen by the end user at a time chosen by the end user (i.e., the service does not provide interactive streams of individual recordings that are on-demand, and any limited

downloads are rendered only as part of programs rather than as individual recordings that are on-demand); provided that the ability of an end user to replay a sound recording previously and recently provided to the end user on a noninteractive basis shall not be deemed for the purposes of this subparagraph (1) to be a sound recording chosen by the end user at a time chosen by the end user; or

(2) The particular sound recordings available to the end user over a period of time are substantially limited relative to services in the marketplace providing access to a comprehensive catalog of recordings (e.g., a service limited to a particular genre, or permitting interactive streaming only from a monthly playlist consisting of a limited set of recordings).

Locker service means a service providing access to sound recordings of musical works in the form of interactive streams, permanent digital downloads, restricted downloads or ringtones, where the service has reasonably determined that phonorecords of the applicable sound recordings have been purchased by the end user or are otherwise in the possession of the end user prior to the end user's first request to access such sound recordings by means of the service. The term locker service does not extend to any part of a service otherwise meeting this definition as to which a license is not obtained for the applicable reproductions and distributions of musical works.

Mixed service bundle means an offering of one or more of permanent digital downloads, ringtones, locker services or limited offerings, together with one or more of non-music services (e.g., Internet access service, mobile phone service) or non-music products (e.g., a device such as a phone) of more than token value, that is provided to users as part of one transaction without pricing for the music services or music products separate from the whole offering.

Music bundle means an offering of two or more of physical phonorecords, permanent digital downloads or ringtones provided to users as part of one transaction (e.g., download plus ringtone, CD plus downloads). A music bundle must contain at least two different product configurations and cannot be combined with any other offering containing licensed activity under subpart B of this part or subpart C of this part.

(1) In the case of music bundles containing one or more physical phonorecords, the physical phonorecord component of the music bundle must be sold under a single catalog number, and the musical works embodied in the digital phonorecord delivery configurations in the music bundle must be the same as, or a subset of, the musical works embodied in the physical phonorecords; provided that when the music bundle contains a set of digital phonorecord deliveries sold by the same record company under substantially the same title as the physical phonorecord (e.g., a corresponding digital album), up to 5 sound recordings of musical works that are included in the stand-alone version of such set of digital phonorecord deliveries but are not included on the physical phonorecord may be included among the digital phonorecord deliveries in the music bundle. In addition, the seller must permanently part with possession of the physical phonorecord or phonorecords sold as part of the music bundle.

(2) In the case of music bundles composed solely of digital phonorecord deliveries, the number of digital phonorecord deliveries in either configuration cannot exceed 20,

and the musical works embodied in each configuration in the music bundle must be the same as, or a subset of, the musical works embodied in the configuration containing the most musical works.

Paid locker service means a locker service that is a subscription service.

Permanent digital download shall have the meaning given in §385.2.

Play shall have the meaning given in §385.11.

Purchased content locker service means a locker service made available to end-user purchasers of permanent digital downloads, ringtones or physical phonorecords at no incremental charge above the otherwise applicable purchase price of the permanent digital downloads, ringtones or physical phonorecords, with respect to the sound recordings embodied in permanent digital downloads or ringtones or physical phonorecords purchased from a qualifying seller as described in paragraph (1) of this definition of "Purchased content locker service," whereby the locker service enables the purchaser to engage in one or both of the qualifying activities identified in paragraph (2) of this definition of "Purchased content locker service." In addition, in the case of a locker service made available to end-user purchasers of physical phonorecords, the seller must permanently part with possession of the physical phonorecords.

(1) A qualifying seller for purposes of this definition of "purchased content locker service" is the same entity operating such locker service, one of its affiliates or predecessors, or—

(i) In the case of permanent digital downloads or ringtones, a seller having another legitimate connection to the locker service provider set forth in one or more written agreements (including that the locker service and permanent digital downloads or ringtones are offered through the same third party); or

(ii) In the case of physical phonorecords, a seller having an agreement with—

(A) The locker service provider whereby such parties establish an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service; or

(B) A service provider that also has an agreement with the entity offering the locker service, where pursuant to those agreements the service provider has established an integrated offer that creates a consumer experience commensurate with having the same service both sell the physical phonorecord and offer the locker service.

(2) Qualifying activity for purposes of this definition of "purchased content locker service" is enabling the purchaser to—

(i) Receive one or more additional phonorecords of such purchased sound recordings of musical works in the form of permanent digital downloads or ringtones at the time of purchase, or

(ii) Subsequently access such purchased sound recordings of musical works in the form of interactive streams, additional permanent digital downloads, restricted downloads or ringtones.

Record company shall have the meaning given in §385.11.

Restricted download means a digital phonorecord delivery distributed in the form of a download that may not be retained and played on a permanent basis. The term restricted download includes a limited download.

Ringtone shall have the meaning given in §385.2.

Service provider shall have the meaning given in §385.11, except that for purposes of this subpart references in the definition of "Service provider" in §385.11 to licensed activity and service revenue shall mean licensed subpart C activity, as defined in this section, and subpart C service revenue, as defined in this section, respectively.

Subpart C offering means, referring to subpart C of this part, a service provider's offering of licensed subpart C activity, as defined in this section, that is subject to a particular rate set forth in §385.23(a) (e.g., a particular subscription plan available through the service provider).

Subpart C relevant page means, referring to subpart C of this part, a page (including a Web page, screen or display) from which licensed subpart C activity, as defined in this section, offered by a service provider is directly available to end users, but only where the offering of licensed subpart C activity, as defined in this section, and content that directly relates to the offering of licensed subpart C activity, as defined in this section, (e.g., an image of the artist or artwork closely associated with such offering, artist or album information, reviews of such offering, credits and music player controls) comprises 75% or more of the space on that page, excluding any space occupied by advertising. A licensed subpart C activity, as defined in this section, is directly available to end users from a page if sound recordings of musical works can be accessed by end users for licensed subpart C activity, as defined in this section, from such page (in most cases this will be the page where the transmission takes place).

Subpart C service revenue. (1) Subject to paragraphs (2) through (6) of the definition of "Subpart C service revenue," as defined in this section, and subject to GAAP, subpart C service revenue shall mean, referring to subpart C of this part, the following:

(i) All revenue recognized by the service provider from end users from the provision of licensed subpart C activity, as defined in this section;

(ii) All revenue recognized by the service provider by way of sponsorship and commissions as a result of the inclusion of third-party "in-stream" or "in-download"

advertising as part of licensed subpart C activity, as defined in this section, (i.e., advertising placed immediately at the start, end or during the actual delivery, by way of transmissions of a musical work that constitute licensed subpart C activity, as defined in this section); and

(iii) All revenue recognized by the service provider, including by way of sponsorship and commissions, as a result of the placement of third-party advertising on a subpart C relevant page, as defined in this section, of the service or on any page that directly follows such subpart C relevant page, as defined in this section, leading up to and including the transmission of a musical work that constitutes licensed subpart C activity, as defined in this section; provided that, in the case where more than one service is actually available to end users from a subpart C relevant page, as defined in this section, any advertising revenue shall be allocated between such services on the basis of the relative amounts of the page they occupy.

(2) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue," of this section such revenue shall, for the avoidance of doubt, include:

(i) Any such revenue recognized by the service provider, or if not recognized by the service provider, by any associate, affiliate, agent or representative of such service provider in lieu of its being recognized by the service provider;

(ii) The value of any barter or other nonmonetary consideration; and

(iii) Except as expressly set forth in this subpart, not be subject to any other deduction or set-off other than refunds to end users for licensed subpart C activity, as defined in this section, that they were unable to use due to technical faults in the licensed subpart C activity, as defined in this section, or other bona fide refunds or credits issued to end users in the ordinary course of business.

(3) In each of the cases identified in paragraph (1) of the definition of "Subpart C service revenue" of this section, such revenue shall, for the avoidance of doubt, exclude:

(i) Revenue derived ~~solely~~ in connection with services and activities other than licensed subpart C activity, as defined in this section, provided that advertising or sponsorship revenue shall be treated as provided in paragraphs (2) and (4) of the definition of "Subpart C service revenue" of this section. By way of example, and not limitation, the following kinds of revenue shall be excluded:

(A) Revenue derived from predominantly non-music voice, content and text services, such as, by way of example and not limitation, news, talk, sports, weather, traffic and comedy programming, or podcasts of any of the foregoing;

(B) Revenue derived from other non-music products and services (including ticketing for live events or concerts, search services, sponsored searches and click-through commissions);

(C) Revenue generated from the sale of actual locker service storage space to the extent that such storage space is sold at a separate retail price;

(D) In the case of a locker service, revenue derived from the sale of permanent digital downloads or ringtones; and

(ii) Revenue derived from other music or music-related products and services that are not or do not include licensed subpart C activity, as defined in this section.

(4) For purposes of paragraph (1) of the definition of "Subpart C service revenue" of this section:

(i) Advertising, sponsorship, and subscription revenue shall be reduced by the actual cost (whether internal or paid to a third party) of obtaining such revenue (including credit card commissions, app store commissions, and similar payment process charges), not to exceed 15%.

(5) In the case of a mixed service bundle, the revenue deemed to be recognized from end users for the service for the purpose of the definition in paragraph (1) of the definition of "Subpart C service revenue" of this section shall be the greater of—

(i) The revenue recognized from end users for the mixed service bundle less the standalone published price for end users for each of the non-music product or non-music service components of the bundle; provided that, if there is no such standalone published price for a non-music component of the bundle, then the average standalone published price for end users for the most closely comparable non-music product or non-music service in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(ii) Either—

(A) In the case of a mixed service bundle that either has 750,000 subscribers or other registered users, or is reasonably expected to have 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle, 40% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and further provided that in any case in which royalties were paid based on this paragraph due to a reasonable expectation of reaching 750,000 subscribers or other registered users within 1 year after commencement of the mixed service bundle and that does not actually happen, applicable payments shall, in the accounting period next following the end of such 1-year period, retroactively be adjusted as if paragraph (5)(ii)(B) of the definition of "Subpart C service revenue" of this section applied; or

(B) Otherwise, 50% of the standalone published price of the licensed music component of the bundle (i.e., the permanent digital downloads, ringtones, locker service or limited offering); provided that, if there is no such standalone published price for the licensed music component of the bundle, then the average standalone published price for end users for the most closely comparable licensed music component in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used.

(6) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee—

(i) Service revenue shall be 150% of the record company's wholesale revenue from the music bundle; and

(ii) The times at which distribution and revenue recognition are deemed to occur shall be in accordance with §201.19 of this title.

Subscription service means a digital music service for which end users are required to pay a fee to access the service for defined subscription periods of 3 years or less (in contrast to, for example, a service where the basic charge to users is a payment per download or per play), whether such payment is made for access to the service on a standalone basis or as part of a bundle with one or more other products or services, and including any use of such a service on a trial basis without charge as described in §385.24.

§385.22 Calculation of royalty payments in general.

(a) *Applicable royalty.* Licensees that make or authorize licensed subpart C activity, as defined in §385.21, pursuant to 17 U.S.C. 115 shall pay royalties therefor that are calculated as provided in this section, subject to the royalty rates and subscriber-based royalty floors for specific types of services provided in §385.23, except as provided for certain free trial periods in §385.24.

(b) *Rate calculation methodology.* Royalty payments for licensed subpart C activity, as defined in §385.21, shall be calculated as provided in this paragraph (b). If a service provides different subpart C offerings, as defined in §385.21, royalties must be separately calculated with respect to each such subpart C offering, as defined in §385.21, taking into consideration service revenue and expenses associated with such offering. Uses subject to the free trial royalty rate shall be excluded from the calculation of royalties due, as further described in this section and §385.23.

(1) *Step 1:* Calculate the All-In Royalty for the Subpart C Offering, as Defined in §385.21. For each accounting period, the all-in royalty for each subpart C offering, as defined in §385.21, of the service provider is the greater of:

(i) The applicable percentage of subpart C service revenue, as defined in §385.21, associated with the relevant offering as set forth in §385.23(a) (excluding any subpart C service revenue, as defined in §385.21, derived solely from licensed subpart C activity, as defined in §385.21, uses subject to the free trial royalty rate); and

(ii) The minimum specified in §385.23(a) for the subpart C offering, as defined in §385.21, involved.

(2) *Step 2:* Subtract applicable performance royalties to determine the payable royalty pool, which is the amount payable for the reproduction and distribution of all musical works used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, for a particular subpart C offering, as defined in §385.21, during the accounting period. From the amount determined in step 1 in paragraph (b)(1) of this section, for each subpart C offering, as defined in §385.21, of the service provider, subtract the total amount of royalties for public performance of musical works that has been or will be expensed pursuant to public performance licenses in connection with uses of musical works through such subpart C offering, as defined in §385.21, during the accounting period that constitute licensed subpart C activity, as defined in §385.21, (other than licensed subpart C activity, as defined in §385.21, subject to the free trial royalty rate), or in connection with previewing of such subpart C offering, as defined in §385.21, during the accounting period. Although this amount may be the total of the payments with respect to the service for that subpart C offering, as defined in §385.21, for the accounting period, it will be less than the total of such public performance payments if the service is also engaging in public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, or previewing of such licensed subpart C activity, as defined in §385.21. In the case where the service is also engaging in the public performance of musical works that does not constitute licensed subpart C activity, as defined in §385.21, the amount to be subtracted for public performance payments shall be the amount of such payments allocable to licensed subpart C activity, as defined in §385.21, uses (other than free trial royalty rate uses), and previewing of such uses, in connection with the relevant subpart C offering, as defined in §385.21, as determined in relation to all uses of musical works for which the public performance payments are made for the accounting period. Such allocation shall be made on the basis of plays of musical works or, where per-play information is unavailable due to bona fide technical limitations as described in step 3 in paragraph (b)(3) of this section, using the same alternative methodology as provided in step 3 in paragraph (b)(3) of this section.

(3) *Step 3:* Calculate the Per-Work Royalty Allocation for Each Relevant Work. This is the amount payable for the reproduction and distribution of each musical work used by the service provider by virtue of its licensed subpart C activity, as defined in §385.21, through a particular subpart C offering, as defined in §385.21, during the accounting period. To determine this amount, the result determined in step 2 in paragraph (b)(2) of this section must be allocated to each musical work used through the subpart C offering, as defined in §385.21. The allocation shall be accomplished as follows:

(i) In the case of limited offerings (but not limited offerings that are part of mixed service bundles), by dividing the payable royalty pool determined in step 2 in paragraph (b)(2) of this section for such offering by the total number of plays of all musical works through

such offering during the accounting period (other than free trial royalty rate plays) to yield a per-play allocation, and multiplying that result by the number of plays of each musical work (other than free trial royalty rate plays) through the offering during the accounting period. For purposes of determining the per-work royalty allocation in all calculations under this step 3 only (i.e., after the payable royalty pool has been determined), for sound recordings of musical works with a playing time of over 5 minutes, each play shall be counted as provided in paragraph (c) of this section. Notwithstanding the foregoing, if the service provider is not capable of tracking play information due to bona fide limitations of the available technology for services of that nature or of devices usable with the service, the per-work royalty allocation may instead be accomplished in a manner consistent with the methodology used by the service provider for making royalty payment allocations for the use of individual sound recordings.

(ii) In the case of mixed service bundles and locker services, by—

(A) Determining a constructive number of plays of all licensed musical works that is the sum of the total number of interactive streams of all licensed musical works made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads);

(B) Determining a constructive per-play allocation that is the payable royalty pool determined in step 2 of paragraph (b)(2) of this section for such offering divided by the constructive number of plays of all licensed musical works determined in paragraph (b)(3)(ii)(A) of this section;

(C) For each licensed musical work, determining a constructive number of plays of that musical work that is the sum of the total number of interactive streams of such licensed musical work made through such offering during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of such licensed musical work made through such offering during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of such licensed musical work made through such offering during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads); and

(D) For each licensed musical work, determining the per-work royalty allocation by multiplying the constructive per-play allocation determined in paragraph (b)(3)(ii)(B) of this section by the constructive number of plays of that musical work determined in paragraph (b)(3)(ii)(C) of this section.

(E) Notwithstanding the foregoing, if a service provider offers both a paid locker service and a purchased content locker service, and with respect to the purchased

content locker service there is no subpart C service revenue, as defined in §385.21, and the applicable subminimum is zero dollars, then the service provider shall be permitted to include within the calculation of constructive plays under paragraphs (b)(3)(ii)(A) and (C) of this section for the paid locker service, the licensed subpart C activity, as defined in §385.21, made through the purchased content locker service (i.e., the total number of interactive streams of all licensed musical works made through the purchased content locker service during the accounting period (other than free trial royalty rate interactive streams), plus the total number of plays of restricted downloads of all licensed musical works made through the purchased content locker service during the accounting period as to which the service provider tracks plays (other than free trial royalty rate restricted downloads), plus 5 times the total number of downloads of all licensed musical works made through the purchased content locker service during the accounting period as to which the service provider does not track plays (other than free trial royalty rate downloads)); provided that the relevant licensed subpart C activity, as defined in §385.21, made through the purchased content locker service is similarly included within the play calculation for the paid locker service for the corresponding sound recording rights.

(iii) In the case of music bundles, by—

(A) Allocating the payable royalty pool determined in step 2 of paragraph (b)(2) of this section to separate pools for each type of product configuration included in the music bundle (e.g., CD, permanent digital download, ringtone) in accordance with the ratios that the standalone published prices of the products that are included in the music bundle bear to each other; provided that, if there is no such standalone published price for such a product, then the average standalone published price for end users for the most closely comparable product in the U.S. shall be used or, if more than one such comparable exists, the average of such standalone prices for such comparables shall be used; and

(B) Allocating the product configuration pools determined in paragraph (b)(3)(iii)(A) of this section to individual musical works by dividing each such pool by the total number of sound recordings of musical works included in products of that configuration in the music bundle.

(c) *Overtime adjustment.* For purposes of the calculations in step 3 of paragraph (b)(3)(i) of this section only, for sound recordings of musical works with a playing time of over 5 minutes, adjust the number of plays as follows:

(1) 5:01 to 6:00 minutes—Each play = 1.2 plays

(2) 6:01 to 7:00 minutes—Each play = 1.4 plays

(3) 7:01 to 8:00 minutes—Each play = 1.6 plays

(4) 8:01 to 9:00 minutes—Each play = 1.8 plays

(5) 9:01 to 10:00 minutes—Each play = 2.0 plays

(6) For playing times of greater than 10 minutes, continue to add .2 plays for each additional minute or fraction thereof.

§385.23 Royalty rates and subscriber-based royalty floors for specific types of services.

(a) *In general.* The following royalty rates and subscriber-based royalty floors shall apply to the following types of licensed subpart C activity, as defined in §385.21:

(1) *Mixed service bundle.* In the case of a mixed service bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the ~~appropriate~~ subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b) ~~(1) is 17.36%, and the sound recording only percentage applicable to §385.23(b)(2)~~ is 21%.

(2) *Music bundle.* In the case of a music bundle, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 11.35%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) ~~and (3) is 17.36%, and the sound recording only percentage applicable to §385.23(b)(2)~~ is 21%.

(3) *Limited offering.* In the case of a limited offering, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 10.5%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~17.36%, and the sound recording only percentage applicable to §385.23(b)(2) is~~ 21%; and

(ii) The aggregate amount of 18 cents per subscriber per month.

(4) *Paid locker service.* In the case of a paid locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. The minimum for use in step 1 of §385.22(b)(1)(ii) is the greater of—

(i) The appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~17.11%, and the sound recording only percentage applicable to §385.23(b)(2) is~~ 20.65%; and

(ii) The aggregate amount of 17 cents per subscriber per month.

(5) *Purchased content locker service.* In the case of a purchased content locker service, the percentage of subpart C service revenue, as defined in §385.21, applicable in step 1 of §385.22(b)(1)(i) is 12%. For the avoidance of doubt, paragraph (1)(i) of the definition of "Subpart C service revenue," as defined in §385.21, shall not apply. The minimum for use in step

1 in §385.22(b)(1)(ii) is the appropriate subminimum as described in paragraph (b) of this section for the accounting period, where the all-in percentage applicable to §385.23(b)(1) is ~~18%, and the sound recording-only percentage applicable to §385.23(b)(2) is~~ 22%, except that for purposes of paragraph (b) of this section the applicable consideration expensed by the service for the relevant rights shall consist only of applicable consideration expensed by the service, if any, that is incremental to the applicable consideration expensed for the rights to make the relevant permanent digital downloads and ringtones.

(b) *Computation of subminima.* For purposes of paragraph (a) of this section, the subminimum for an accounting period is the aggregate of the following with respect to all sound recordings of musical works used in the relevant subpart C offering, as defined in §385.21, of the service provider during the accounting period~~—~~:

~~(1) Except as provided in paragraph (b)(3) of this section, in cases in which the record company is the licensee under 17 U.S.C. 115 and the record company has granted the rights to engage in licensed subpart C activity, as defined in §385.21, with respect to a sound recording through the third-party service together with the right to reproduce and distribute the musical work embodied therein, the appropriate all-in percentage from paragraph (a) of this section of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.~~

(~~2~~1) In cases in which ~~the record company is not the licensee under 17 U.S.C. 115 and~~ the record company has granted the rights to engage in licensed subpart C activity, as defined in §385.21, with respect to a sound recording through the third-party service without the right to reproduce and distribute the musical work embodied therein, the appropriate sound recording-only percentage from paragraph (a) of this section of the total amount expensed by the service provider or any of its affiliates in accordance with GAAP for such rights for the accounting period, which amount shall equal the applicable consideration for such rights at the time such applicable consideration is properly recognized as an expense under GAAP.

(~~3~~2) In the case of a music bundle containing a physical phonorecord, where the music bundle is distributed by a record company for resale and the record company is the compulsory licensee, the appropriate all-in percentage from paragraph (a) of this section of the record company's total wholesale revenue from the music bundle in accordance with GAAP for the accounting period, which amount shall equal the applicable consideration for such music bundle at the time such applicable consideration is properly recognized as revenue under GAAP, subject to the provisions of §201.19 of this title concerning the times at which distribution and revenue recognition are deemed to occur.

(~~4~~3) If a record company providing sound recording rights to the service provider for a licensed subpart C activity, as defined in §385.21—

(i) Recognizes revenue (in accordance with GAAP, and including for the avoidance of doubt all applicable consideration with respect to such rights for the accounting

period, regardless of the form or timing of payment) from a person or entity other than the service provider providing the licensed subpart C activity, as defined in §385.21, and its affiliates, and

(ii) Such revenue is received, in the context of the transactions involved, as applicable consideration for such rights,

(iii) Then such revenue shall be added to the amounts expensed by the service provider solely for purposes of paragraph (b)(1) ~~or (2)~~ of this section ~~, as applicable,~~ if not already included in such expensed amounts. Where the service provider is the licensee, if the service provider provides the record company all information necessary for the record company to determine whether additional royalties are payable by the service provider hereunder as a result of revenue recognized from a person or entity other than the service provider as described in the immediately preceding sentence, then the record company shall provide such further information as necessary for the service provider to calculate the additional royalties and indemnify the service provider for such additional royalties. The sole obligation of the record company shall be to pay the licensee such additional royalties if actually payable as royalties hereunder; provided, however, that this shall not affect any otherwise existing right or remedy of the copyright owner nor diminish the licensee's obligations to the copyright owner.

(c) *Computation of subscriber-based royalty rates.* For purposes of paragraphs (a)(3) and (4) of this section, to determine the subscriber-based minimum applicable to any particular subpart C offering, as defined in §385.21, the total number of subscriber-months for the accounting period shall be calculated, taking into account all end users who were subscribers for complete calendar months, prorating in the case of end users who were subscribers for only part of a calendar month, and deducting on a prorated basis for end users covered by a free trial period subject to the free trial royalty rate as described in §385.24. The product of the total number of subscriber-months for the accounting period and the specified number of cents per subscriber shall be used as the subscriber-based component of the minimum for the accounting period.

§385.24 Free trial periods.

(a) *General provisions.* This section establishes a royalty rate of zero in the case of certain free trial periods for mixed service bundles, paid locker services and limited offerings under a license pursuant to 17 U.S.C. 115. Subject to the requirements of 17 U.S.C. 115 and the additional provisions of paragraphs (b) through (e) of this section, the free trial royalty rate shall apply to a musical work when a record company transmits or authorizes the transmission, as part of a mixed service bundle, paid locker service or limited offering, of a sound recording that embodies such musical work, only if—

(1) The primary purpose of the record company in providing or authorizing the free trial period is to promote the applicable subpart C offering, as defined in §385.21;

(2) No applicable consideration for making or authorizing the transmissions is received by the record company, or any other person or entity acting on behalf of or in lieu of the

record company, except for in-kind promotional consideration used to promote the sale or paid use of sound recordings or audiovisual works embodying musical works or the paid use of music services through which sound recordings or audiovisual works embodying musical works are available;

(3) The free trial period does not exceed 30 consecutive days per subscriber per two-year period;

(4) In connection with authorizing the transmissions, the record company has obtained from the service provider it authorizes a written representation that—

(i) The service provider agrees to maintain for a period of no less than 5 years from the end of each relevant accounting period complete and accurate records of the relevant authorization, and identifying each sound recording of a musical work made available through the free trial period, the licensed subpart C activity, as defined in §385.21, involved, and the number of plays or downloads, as applicable, of such recording;

(ii) The service is in all material respects operating with appropriate license authority with respect to the musical works it is using; and

(iii) The representation is signed by a person authorized to make the representation on behalf of the service provider;

(5) Upon receipt by the record company of written notice from the copyright owner of a musical work or agent of the copyright owner stating in good faith that a particular service is in a material manner operating without appropriate license authority from such copyright owner, the record company shall within 5 business days withdraw by written notice its authorization of such uses of such copyright owner's musical works under the free trial royalty rate by that service;

(6) The free trial period is offered free of any charge to the end user; and

(7) End users are periodically offered an opportunity to subscribe to the service during such free trial period.

(b) *Recordkeeping by record companies.* To rely upon the free trial royalty rate for a free trial period, a record company making or authorizing the free trial period shall keep complete and accurate contemporaneous written records of the contractual terms that bear upon the free trial period; and further provided that, if the record company itself is conducting the free trial period, it shall also maintain any additional records described in paragraph (a)(4)(i) of this section. The records required by this paragraph (b) shall be maintained for no less time than the record company maintains records of usage of royalty-bearing uses involving the same type of licensed subpart C activity, as defined in §385.21, in the ordinary course of business, but in no event for less than 5 years from the conclusion of the licensed subpart C activity, as defined in §385.21, to which they pertain. If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under this paragraph (b) with respect to a specific free

trial period, the record company shall provide complete and accurate documentation within 10 business days, except for any information required under paragraph (a)(4)(i) of this section, which shall be provided within 20 business days, and provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the record company shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the record company does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the record company (but not any third-party service it has authorized) shall be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(c) *Recordkeeping by services.* If the copyright owner of a musical work or its agent requests a copy of the information to be maintained under paragraph (a)(4)(i) of this section by a service authorized by a record company with respect to a specific promotion, the service provider shall provide complete and accurate documentation within 20 business days, provided that if the copyright owner or agent requests information concerning a large volume of free trial periods or sound recordings, the service provider shall have a reasonable time, in view of the amount of information requested, to respond to any request of such copyright owner or agent. If the service provider does not provide required information within the required time, and upon receipt of written notice citing such failure does not provide such information within a further 10 business days, the uses will be considered not to be subject to the free trial royalty rate and the service provider (but not the record company) will be liable for any payment due for such uses; provided, however, that all rights and remedies of the copyright owner with respect to unauthorized uses shall be preserved.

(d) *Interpretation.* The free trial royalty rate is exclusively for audio-only licensed subpart C activity, as defined in §385.21, involving musical works subject to licensing under 17 U.S.C. 115. The free trial royalty rate does not apply to any other use under 17 U.S.C. 115; nor does it apply to public performances, audiovisual works, lyrics or other uses outside the scope of 17 U.S.C. 115. Without limitation, uses subject to licensing under 17 U.S.C. 115 that do not qualify for the free trial royalty rate (including without limitation licensed subpart C activity, as defined in §385.21, beyond the time limitations applicable to the free trial royalty rate) require payment of applicable royalties. This section is based on an understanding of industry practices and market conditions at the time of its development, among other things. The terms of this section shall be subject to de novo review and consideration (or elimination altogether) in future proceedings before the Copyright Royalty Judges. Nothing in this section shall be interpreted or construed in such a manner as to nullify or diminish any limitation, requirement or obligation of 17 U.S.C. 115 or other protection for musical works afforded by the Copyright Act, 17 U.S.C. 101, *et seq.*

§385.25 Reproduction and distribution rights covered.

A compulsory license under 17 U.S.C. 115 extends to all reproduction and distribution rights that may be necessary for the provision of the licensed subpart C activity, as defined in

§385.21, solely for the purpose of providing such licensed subpart C activity, as defined in §385.21 (and no other purpose).

§385.26 Effect of rates.

In any future proceedings under 17 U.S.C. 115(c)(3)(C) and (D), the royalty rates payable for a compulsory license shall be established de novo.