Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress
Washington, D.C.

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

SPOTIFY'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

SPOTIFY USA INC.'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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EXECUTIVE SUMMARY

It is undisputed that interactive streaming, the latest in a long history of technological innovations that have transformed the music industry, has benefitted *all* parties in this proceeding—*including* the Copyright Owners, who have seen overall steady or increasing revenues over the past rate period. That the music publishing industry has managed to increase its bottom line in the past five years is all the more remarkable given a rapidly-shifting music industry landscape that had been ravaged by piracy, which, due to file-sharing technology, made music consumption boundless and free. Interactive streaming, led by Spotify, began the transformation from illegal downloading to legal music consumption.

The rise of online piracy, led by peer-to-peer file sharing service Napster in the late '90s, caused a tremendous shift in the market away from the sales of CDs, as well as a sharp decline in mechanical royalties. Indeed, as the Copyright Owners complained to the Board in the *Phonorecords I* proceeding, it was *piracy that had devastated* their industry, it was *piracy* that was responsible for the "for sale" signs appearing in Nashville windows, and it was *piracy* that drove songwriters out of the business in large droves. But history showed that combating piracy through enforcement would not turn the tide. A legal alternative had to justify its price by offering a product that was superior to piracy and an experience that piracy could not offer. When Apple launched iTunes in 2003 as a legal, paid alternative for digital downloads, it did not reverse the declines in mechanical royalties. If anything, it only led to the unbundling of albums, such that only a few "hits" from an album were ever downloaded. More importantly, consumers were moving away from an ownership model towards an access model, such that downloads became a less attractive means of consuming music. To address these issues, Spotify has invested tremendous creative and financial resources since its global launch in 2008, to develop

the platform, technology, and user-friendly interface to lure consumers who were used to getting their music for free into a "freemium" model of consumption. The "freemium" model is meant to—*and does*—introduce consumers to the benefits of streaming through its free-to-the-user, ad-supported tier, and then converts them to the paid tier. With this model, Spotify aims to get users listening to, and loving, music—while also fairly compensating rightsholders. Spotify has over 100 million monthly active users globally, with [redacted] users on its paid service.

Since its global launch in 2008 and its U.S. launch in 2011, Spotify has spent [redacted] globally investing in technology that allows consumers to engage with music to suit their every mood, to discover all the world's new music right at their fingertips, and to connect with creators (singers, songwriters, artists) and other like-minded fans. Indeed, Spotify's investments in tools and features not only connect users with one of the largest catalogs of music online in an intuitive, easy-to-use user interface, but also improve the fortunes of creators. This includes building new ways for creators to connect with their fans and opening new markets for artist exploitation, as well as developing best-in-class technology to enhance music discovery. Indeed, since the launch of just *one* of Spotify's discovery products, Spotify has introduced an artist to a fan for the first time approximately *3 billion times per month*. Even as new market entrants arrive in the interactive streaming space, Spotify continues to stay ahead of the pack in terms of innovation and listener engagement.

Despite Spotify's tremendous creation of value for consumers and for the Copyright Owners, it has never earned a profit for itself. Under the current mechanical rates, Spotify's combined royalty payments constitute over [redacted] of its revenue. At these current rates, the future of Spotify is uncertain. Indeed, many companies have already failed. To ensure [redacted]

business models, Spotify, as well as the other streaming services, will need rate *reductions*—not increases.

Yet the Copyright Owners' rate proposal would ensure that Spotify [redacted]. Under the Copyright Owners' rate proposal, Spotify's mechanical royalty rates would increase [redacted], with its ad-supported tier seeing an [redacted]. Quite simply, the Copyright Owners' rate proposal would all but *guarantee* that [redacted]. More critically, Spotify's ad-supported tier, which targets users who would have otherwise gravitated towards piracy or other forms of free music, [redacted]. This result cannot be squared with the policy objectives of this rate-setting proceeding under Section 801(b)(1).

Conversely, the policy objectives of Section 801(b)(1) would be effectuated by the adoption of Spotify's rate proposal. *First*, there can be no doubt that interactive streaming has maximized the sheer *number* of songs available to users (over 30 million tracks are presently available on Spotify's service). And through the use of promotional discovery tools such as Spotify's Discover Weekly, Fresh Finds, and other curated or algorithmic playlists, Spotify helps break out hundreds of new music creators every day, ensuring that more of these tracks are actually *listened to*. Thus, allowing Spotify to continue to grow its service and develop new tools for user engagement will provide more, and more meaningful, availability and access to music. In contrast, the Copyright Owners' rate proposal threatens to *reduce* the availability of works to the public by [redacted] and raising barriers to the continued investment in service enhancements and technological advancement. Moreover, Spotify's rate proposal seeks to rid the current rate structure of inefficiencies that prevent Spotify from making the most works available to the *greatest number of consumers* by, removing the

economic inefficiencies in the structure that disincentivize Spotify from pricing efficiently to capture consumers further down the demand curve (consumers with lower "willingness-to-pay").

Second, Spotify's rate proposal allows it to finally achieve a fair income, while ensuring the Copyright Owners a fair return on their investments. As previously noted, despite having invested [redacted] of dollars to build a revolutionary streaming platform, Spotify has yet to see a profit. Conversely, the Copyright Owners are seeing increased revenue and profits in the new digital age, a reversal of the decline previously wrought by piracy and other factors. Spotify's rate proposal would offer Spotify and the other services a chance to ultimately achieve profitability, while continuing to provide a fair return to the Copyright Owners.

Third, there is no question that Spotify has taken on greater risk and cost, made greater capital investment, and made greater technological and creative contributions, than the Copyright Owners in developing a unique streaming platform—a platform that has helped grow the pie and increase revenues for the Copyright Owners. Even a cursory review of the Spotify service exposes the user or casual visitor to a plethora of music discovery tools and features that connect the listener to music in ways never before imagined.

Finally, there is no question that the Copyright Owners' rate proposal is disruptive: it would [redacted], which is generating revenue for *all* the parties in this proceeding, and would force services to change their fundamental "all you can eat" business models to accommodate a flat, indiscriminate per-play rate. It also would necessarily hinder the development of product and service enhancements that engage users. Instead, Spotify requests mostly a continuation of the *status quo* with some inefficiencies removed, which will ensure that rightsholders continue to be compensated appropriately, while digital services have a chance of reaching their full potential.

Spotify's proposed rate level of approximately [redacted] as an imputed mechanical rate is also supported by the most relevant benchmarks, namely, agreements made between comparable parties, selling comparable rights, and made under comparable circumstances. The first benchmark, the Subpart A rates that the Copyright Owners agreed to in this very proceeding, involve the same owners, and the same rights (mechanicals). That the Subpart A settlement is an appropriate comparison is especially true given that the Copyright Owners have argued that interactive streaming is substitutive of CD/PDD sales.

The second benchmark, the currently-operative rates, was the product of a settlement between the very same constituencies—the Copyright Owners and streaming services—in 2012. The Copyright Owners cannot dispute the comparability of that agreement in terms of the buyers, the sellers, and the rights being sold, so the Copyright Owners' only avenue to challenge that settlement is to weave a narrative that streaming was in its mere infancy as recently as *2012*, and its effects could not have been predicted. That *post-hoc*, made-for-litigation story is simply not true, and several of the Copyright Owners' *own witnesses* have admitted as much, with Mr. Kokakis stating that interactive streaming has been occurring since *2000*, and that it was not until 2008 that the Copyright Owners were finally able to get "a rate set under the regs." 3/27/17 Tr. 3266:11-16 (Kokakis). Thus, by 2008—and certainly by 2012—the Copyright Owners had a very good idea of what the streaming market would look like, and negotiated settlements accordingly. And it was *these* negotiated rates, with different categories for varying types of services like bundles and ad-supported tiers, that have allowed the flexibility in pricing plans and the myriad types of music services we see today.

The Copyright Owners' attempts to justify their request for a substantial rate increase and a *complete overhaul of the current rate structure*, based on purported hardships that (1) are not

supported by the record, (2) to the extent they exist, are not new, and (3) are not caused by interactive streaming, are unavailing. The Copyright Owners seek a sea change to the existing rate structure they helped establish—twice—through prior agreement, despite the fact that the Board has established a preference for continuing currently-operative rate structures. In fact, not a single rate-setting has ever completely overhauled the rate structure governing that specific type of service (*i.e.*, per-play for Section 114 services, percentage of revenue for satellite services). Yet the Copyright Owners argue that this dramatic change is required because the very rate structure they agreed to twice before is supposedly unworkable, and has allegedly led to revenue manipulation, revenue deferment, and flat-out revenue hiding.

The Copyright Owners promised that they would introduce evidence of this alleged mischief into the record to justify this sea change. But almost 110 hearing hours and thousands of exhibits later, the Copyright Owners have not introduced *any* evidence showing revenue manipulation or deferment on the part of the Services. Nor have the Copyright Owners introduced any evidence showing why the negotiated backstops in the current rate structure—for example, the 80 cent per-subscriber fee or the 21% total content costs prong for portable subscriptions—are insufficient to protect against such alleged revenue manipulation. All they have done is point to conjecture and what-ifs, marching a parade of theoretical horribles before the Board that point to all sorts of *potential* for revenue deferment, manipulation, or fraudulent accounting under a percentage of revenue structure. One need look no further than the Copyright Owners' opening statement, wherein counsel promised this Board that this possibility of revenue manipulation is "not just theoretical," citing [redacted], before acknowledging, "Now, I don't know that any of

these bundles have actually happened." 3/8/17 Tr. 110:1-111:5 (Semel). The Copyright Owners' failure to present any actual evidence on this point is telling, as no such evidence exists.

Furthermore, the Copyright Owners' hypotheticals do not suggest any inherent problems with a percentage of revenue structure—which is commonly used in a variety of intellectual property transactions and has been used in numerous other rate-setting proceedings. If anything, these hypotheticals suggest that what the Copyright Owners really should be asking for is an *audit clause*, which is one of the very terms in Spotify's rate proposal. Indeed, record evidence in this proceeding shows [redacted].

In sum, Spotify respectfully submits that the totality of the evidence, the requirements of Section 801(b)(1), the relevant and appropriate benchmarks, and governing case law, all favor adoption of Spotify's rates and terms in this proceeding.

SPOTIFY FINDINGS OF FACT

To avoid duplication on common issues and mindful of the volume of paper this Board will receive, Amazon Digital Music LLC ("Amazon"), Google, Inc. ("Google"), Pandora Media, Inc. ("Pandora"), and Spotify USA, Inc. ("Spotify") (collectively, the "Services") have submitted a Joint Proposed Findings of Fact ("JPFF" or "Joint Findings"). The following Spotify Proposed Findings of Fact ("SPFF" or "Spotify Proposed Findings") provide further detail and support as to why Spotify's specific rate proposal should be adopted in this proceeding.

I. THE SPOTIFY SERVICE

SPFF1. Spotify is an interactive music streaming service that offers two tiers of service to users: an ad-supported service that is free to users (the "ad-supported" service) and a paid subscription tier (the "paid" or "Premium" service). 3/20/17 Tr. 1834:11-14 (Marx); Trial Ex. 1060, McCarthy WDT ¶ 9; Trial Ex. 1062, Vogel WDT ¶ 5; Trial Ex. 1065, Marx WDT ¶ 48.

SPFF2. Spotify launched in Sweden in 2008, and went live in the United States in July 2011. 3/20/17 Tr. 1665:21-1665:24 (Page); *id.* at 1778:13-1778:14; Eisenach WDT ¶ 131. Spotify has become the world's largest interactive streaming service, with over 100 million monthly active users ("MAU") worldwide by the end of June 2016, and is the largest interactive streaming service in the United States. Trial Ex. 1060, McCarthy WDT ¶ 6; Trial Ex. 1064, Lucchese WDT ¶ 22; Trial Ex. 1063, Harteau WDT ¶ 7; Trial Ex. 1065, Marx WDT ¶ 48; Trial Ex. 1069, Marx WRT ¶ 48; Trial Ex. 3027, Eisenach WDT ¶ 131. At that time, about [redacted] MAU ([redacted]) were from the United States. Trial Ex. 1060, McCarthy WDT ¶ 6; Trial Ex. 1065, Marx WDT ¶ 49. As of the end of June 2016, there were [redacted] paid subscribers globally,

and [redacted] of those subscribers ([redacted]) were from the United States. Trial Ex. 1060, McCarthy WDT ¶ 6.

SPFF3. This growth has been fueled by Spotify's unparalleled status as an innovator in music delivery. As described more fully below, Spotify invested in a music streaming service that offers over 30 million music tracks to its users, each of which can be delivered instantaneously to a user at the touch of a button. Trial Ex. 1061, Page WDT ¶ 65. Spotify's service makes it much easier for artists and songwriters to find and reach an audience than traditional terrestrial radio, which has inherent biases that tend to favor hit music from limited genres and tend to leave less opportunity for songs outside those categories. Trial Ex. 1064, Lucchese WDT ¶¶ 17-21. To develop its innovative service, Spotify spent over [redacted] on technology infrastructure, and it continues to invest in the development and improvement of the service. Trial Ex. 1063, Harteau WDT ¶ 18. To personalize music recommendations for listeners and to help artists reach and maintain fans, Spotify developed an innovative platform to help musicians understand their fans, called Spotify Fan Insights, and groundbreaking technology for global music discovery and promotion, such as the popular weekly playlist Discover Weekly. Trial Ex. 1064, Lucchese WDT ¶ 35; *see also* 3/21/17 Tr. 2086:7-2087:18 (McCarthy) (stating that while Spotify's founders feel a moral obligation to investors, their objective is to build a business to afford more music creators the opportunity to make a living being creators, and that they have been oriented in terms of the long-term health and success of the business, rather than short-term tradeoffs in favor of investors). By investing in these features and creating a "freemium" model that brings users on a path to paid accounts, Spotify has been and is a leader in combating piracy and improving the overall health of the music ecosystem. Trial Ex. 1061, Page WDT ¶ 13.

A. Spotify's Freemium Funnel Was Created Specifically to Combat Piracy

1. *The Freemium "Path to Paid" Is Designed to Draw Listeners Away From Piracy Towards Monetized Services*

SPFF4. Spotify was founded specifically to compete with, and beat, piracy. Trial Ex. 1061, Page WDT ¶ 4. The problem in 2006, when Spotify was founded, was that technology had made it incredibly easy for anyone to download a song for free, and the consumption of online content through peer-to-peer music file sharing services like Napster, was going unmonetized, leading to a precipitous decline in the music industry. 3/20/17 Tr. 1769:4-8 (Page). To solve this problem, Spotify sought to "create the right product" as a superior legal alternative to piracy—one that gave consumers what they wanted, and more. 3/20/17 Tr. 1667:6-10 (Page) ("So the vision that Spotify had back in 2006…was if you can build a superior alternative to piracy, those consumers will come and we can get the industry onto a sustainable recovery."); Trial Ex. 1061, Page WDT ¶¶ 4, 6. The development of a legal alternative to piracy can be likened to offering consumers an incentive (carrots) rather than the blunt threat of lawsuits (sticks), a conversation that few were having back in 2006 when Spotify was founded. 3/20/17 Tr. 1666:18-24 (Page) ("[W]hat I saw was [that] the debate about piracy was 95 percent focused on sticks and 5 percent focused on carrots.").

SPFF5. Spotify's commercial strategy has been to make it frictionless to move someone from piracy to a legal music service—otherwise, users would not make the transition. Trial Ex. 1061, Page WDT ¶ 13. In particular, Spotify uses the "freemium" strategy to get users on a path to a paid account. 3/20/17 Tr. 1713:19-22 (Page); 3/20/17 Tr. 1738:4-7 (Page); Trial Ex. 1061, Page WDT ¶ 13. To create this frictionless experience, Spotify offers two services: a free-to-users ad-supported service and a paid subscription service that charged subscribers a

monthly subscription fee. 3/20/17 Tr. 1834:11-21 (Marx); Trial Ex. 1060, McCarthy WDT ¶ 9; Trial Ex. 1062, Vogel WDT ¶¶ 5, 29; Trial Ex. 1065, Marx WDT ¶ 48.

SPFF6. Often a Spotify user's journey begins in the ad-supported tier, which offers users a broad range of tracks. Trial Ex. 1061, Page WDT ¶ 13. The ad-supported tier has drawbacks as compared to the paid service, including no ability to listen offline, limited ability to skip, limited ability to listen on mobile devices, and lower quality audio than the paid service. Trial Ex. 1065, Marx WRT ¶ 246. Later, the user may upgrade to a paid subscription as he or she becomes more familiar with the enhanced paid-only features through trial promotions and/or marketing efforts. Trial Ex. 1061, Page WDT ¶ 13. The ad-supported service has proven to demonstrate strong promotional effects—about [redacted] of Spotify's paid U.S. subscribers were previously active on the ad-supported service. 3/21/17 Tr. 2114:1-10 (McCarthy); Trial Ex. 1066, McCarthy WRT ¶ 22.

SPFF7. This freemium model *works*, which is all the more remarkable given piracy's value proposition to consumers (get unlimited, untold amounts of music, *for free*). To evaluate the impact that interactive streaming has had on piracy, Spotify conducted a study on the company's effects in the Netherlands in 2012, when piracy was considered fair use in that country. 3/20/17 Tr. 1668:21-1669:23 (Page); Trial Ex. 1061, Page WDT ¶ 15. The Netherlands study demonstrated a decline in piracy where streaming was an available alternative. 3/20/17 Tr. 1670:2-5 (Page); *id.* at 1674:1-9 ("[A]rtists who engage with Spotify have success in our service and are able to reduce the level of piracy they were experiencing."). It also showed that streaming "grows the pie" by increasing revenues; this means that music consumption is not a zero-sum game between ownership and access. 3/20/17 Tr. 1670:12-1671:4 (Page); Trial Ex. 1061, Page WDT ¶ 19. When it comes to music consumption, "it's not just about sales and

streams; it's about sales, streams, and piracy." 3/20/17 Tr. 1674:4-5 (Page). Continuing to follow the state of the music industry in the Netherlands, Spotify found that streaming revenues were almost entirely responsible for the 23% growth of the Dutch music industry from 2015 to 2016; those streaming revenues were driven by Spotify, which held a vast majority of the Dutch market share at that time. Trial Ex. 1061, Page WDT ¶ 19.

SPFF8. Spotify also studied Canadian data to observe the effects of cannibalization, or the effects of streaming displacing digital album sales that would have occurred in the absence of the streaming alternative. 3/20/17 Tr. 1774:12-1775:24 (Page); Trial Ex. 1061, Page WDT ¶ 29. Spotify first compared digital album sales for a corresponding week across 2012 and 2013, when there were no large streaming services in Canada, such as Spotify, Pandora, or iTunes Radio; the study found a decrease in downloads from one year to the next, which was notable because the decline in downloads could not be attributed to streaming. 3/20/17 Tr. 1777:9-14, 1779:1-25 (Page); Trial Ex. 1061, Page WDT ¶ 30. Then, after launching in Canada in late 2014, Spotify compared digital album sales from 2014, before launch, against a corresponding week in 2015; in that case, digital album sales *increased*, which indicated that streaming "grows the pie" for the music industry, as opposed to cannibalizing music sales that would have occurred in the absence of streaming. Trial Ex. 1061, Page WDT ¶ 31.

2. *The Freemium Model Greatly Benefits Rightsholders*

SPFF9. Interactive streaming generates more royalties for rightsholders than do other distribution channels. Trial Ex. 1061, Page WDT ¶ 26; Trial Ex. 1069, Marx WRT ¶¶ 176, 179-180; *see also* Trial Ex. 1065, Marx WDT ¶ 42 ("Moving listening from terrestrial radio to interactive streaming, for instance, will generally increase copyright holder revenue. Displacing piracy will unambiguously increase revenue."). The people who listen to terrestrial radio, pirated

music, or no music pay zero for those services. Trial Ex. 1061, Page WDT ¶ 26. Conversely, Spotify's paid service brings in about [redacted] the amount per user that a buyer spends on CD/PDD purchases: in 2015, the average buyer spent only [redacted] for CD/PDD purchases. Trial Ex. 1061, Page WDT ¶ 28. The same year, by comparison, Spotify's average revenue per user ("ARPU") was about [redacted] per paid member. Trial Ex. 1061, Page WDT ¶ 27. This larger revenue base likewise yields greater royalties for rightsholders, as Spotify pays more royalties as a percent of revenue than radio or CD/PDD sales do. Trial Ex. 1065, Marx WDT ¶¶ 71, 113 (comparing Spotify's [redacted]% of revenue royalty rate against a conservative estimate of [redacted]% of revenue for CD sales and [redacted]% of revenue for PDDs; about [redacted]% of terrestrial radio revenues are paid as royalties, none of which are paid as mechanical); Trial Ex. 1069, Marx WRT ¶ 177-79 (same); Trial Ex. 1067, Page WRT ¶ 28 (comparing Spotify's annual payments to publishers and songwriters: [redacted] per paid member or about [redacted] per average user, against the average [redacted] per buyer of CD/PDDs).

SPFF10. Spotify's core commercial proposition has been to grow the business by growing the ARPU across all music listeners, not by targeting the shrinking minority of people buying CDs or PDDs. Trial Ex. 1061, Page WDT ¶ 24. For rightsholders, Spotify offers a licensing proposition that takes users from free options that pay little to no royalties—such as piracy, or even AM/FM radio—to an ad-supported service that generates higher royalties, and then takes these users further to a paid service that generates even higher royalties. Trial Ex. 1061, Page WDT ¶ 14; Trial Ex. 1065, Marx WDT ¶ 42; Trial Ex. 1069, Marx WRT ¶¶ 177, 179-180.

SPFF11. In sum, through its freemium model, Spotify has reduced piracy, which means it has reduced the unlicensed exploitation of songwriters' works, and has grown the

average revenue per user, reaching out to the minority who buy music and monetizing the lost majority who previously did not. Trial Ex. 1061, Page WDT ¶ 42. As a result, the U.S. music industry is now growing. *See* JPFF Section III.A.

B. Spotify Has Spent in Excess of [redacted] on Its Service

SPFF12. Spotify made significant investments, over [redacted], into developing the technology infrastructure of its interactive streaming service. Trial Ex. 1063, Harteau WDT ¶ 18; *see also* Trial Ex. 1060, McCarthy WDT ¶ 61 ("From January 2010 through August 2016, Spotify has invested approximately [redacted] in R&D…."). This includes spending on the "frontend" that a user can see, such as discovery features, and "backend" costs that are behind the scenes, including sophisticated data storage and processing for delivering a song instantaneously to a user—which requires delivering megabytes of information on networks that may have varying degrees of strength and speeds. Trial Ex. 1063, Harteau WDT ¶¶ 5-6; *see id.* at ¶¶ 11-12.

SPFF13. Spotify's "backend" technological platform includes the research and development ("R&D") costs, operating costs, and capital expenditures associated with developing and maintaining the streaming platform. Trial Ex. 1063, Harteau WDT ¶ 5. R&D spending includes the costs to research and develop infrastructure, and incorporates personnel expenses. Trial Ex. 1063, Harteau WDT ¶ 6. From [redacted], Spotify spent [redacted] on infrastructure R&D alone. Trial Ex. 1063, Harteau WDT ¶ 8. In [redacted], R&D comprised about [redacted] of Spotify's global revenue, which Spotify considers [redacted] for a tech company to remain competitive. Trial Ex. 1060, McCarthy WDT ¶ 39. These investments were necessary to scale the platform to match the needs of a growing number of users. Trial Ex. 1063, Harteau WDT ¶ 10. To maintain high quality service for millions of users,

Spotify is in the process of a complex migration [redacted] to the cloud, which is being conducted without impact to the users' service. Trial Ex. 1063, Harteau WDT ¶¶ 11-13; *see also* Trial Ex. 1060, McCarthy WDT ¶ 41. Spotify's infrastructure R&D costs are expected to grow [redacted]. Trial Ex. 1063, Harteau WDT ¶ 9.

SPFF14. Operating costs are recurring non-personnel costs to run Spotify's infrastructure, from electricity for powering computer equipment to payments to service providers. Trial Ex. 1063, Harteau WDT ¶ 6. It is very resource-intensive to collect and analyze the data that allows Spotify to make personalized, context-dependent suggestions to each user in real time. Trial Ex. 1063, Harteau WDT ¶¶ 15-16. From [redacted], infrastructure operating costs [redacted]. Trial Ex. 1063, Harteau WDT ¶ 14. For [redacted], infrastructure operating costs are expected to [redacted], respectively. Trial Ex. 1063, Harteau WDT ¶ 15.

SPFF15. Capital expenditures are one-time costs, such as purchasing a server. Trial Ex. 1063, Harteau WDT ¶ 6. From [redacted], capital expenditures totaled [redacted]. Trial Ex. 1063, Harteau WDT ¶ 14.

SPFF16. In sum, Spotify invested [redacted] to create and support its streaming service's technology infrastructure (including R&D, capital and operating expenditures), and Spotify [redacted] during the 2018-2022 rate period. Trial Ex. 1063, Harteau WDT ¶ 18.

SPFF17. Spotify also has "frontend" costs that are associated with the customer-facing Spotify product, including the time and resources invested in features of the service. Trial Ex. 1063, Harteau WDT ¶ 5. For example, Spotify employs [redacted] people to work

on the technology suite for music discovery. 3/21/17 Tr. 2265:14-17 (Lucchese). The company also has sales and marketing costs, including the cost of the salespeople who generate ad sales revenue and marketing expenses associated with growing both the ad sales business and the paid subscription business. 3/21/17 Tr. 2044:14-24 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶¶ 26, 35-38.

SPFF18. Thus, far from being a set of "dumb pipes," Spotify's innovative service was built at great cost over many years to enable an entirely new form of music distribution. *See* 3/29/17 Tr. 3768:21-3769:18 (Israelite) (recognizing the Services as "important partners" that "played a positive role" in stemming the flow of piracy, and stating that the Services "have increased the availability of works [which are now] certainly more accessible than if you were to try to find a physical version of those 40 million songs, no question.").

C. Spotify Offers Unique Discovery Tools and Data Insights For Artists and Songwriters To Connect with Listeners and Generate Revenue

1. *Spotify's Online Streaming Service Innovates Above and Beyond Traditional Radio's Spectrum Scarcity*

SPFF19. Terrestrial radio stations are limited by spectrum scarcity, and further constrained with genre limitations, with only a few hundred songs in rotation at any given time. 3/21/17 Tr. 2260:9-10 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶¶ 19, 24. As a result, a songwriter or artist would need to appeal to intermediary gatekeepers before his or her song is played on the radio. 3/21/17 Tr. 2260:14-2260:16 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶¶ 19-20.

SPFF20. On the other hand, by personalizing a radio station for each listener, Spotify represents a vast improvement over terrestrial radio due to its "essentially… limitless number of slots" for songs, thus "open[ing] up…opportunities for a much wider range of

artists…globally." 3/21/17 Tr. 2260:16-23 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 21. Spotify's advantages over radio are two fold: one, in the sheer number of available songs (over 30 million tracks) and two, in its recommendation engines, which customize playlists for *each individual user*, without artificial genre limitations. 3/20/17 Tr. 1731:3-4 (Page); Trial Ex. 1064, Lucchese WDT ¶¶ 21, 27; 1063, Harteau WDT ¶ 7.

2. *Spotify Fan Insights Helps Artists and Songwriters Connect with Their Fans*

SPFF21. Spotify also helps artists and singer-songwriters by enabling an in-depth fan analytics tool called Spotify Fan Insights to help artists (including singer-songwriters) understand their fans. 3/21/17 Tr. 2252:8-13 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 8. Fan Insights provides information on [redacted]. 3/21/17 Tr. 2252:14-2554:21 (Lucchese); *id.* at 2257:10-2258:21; Trial Ex. 1064, Lucchese WDT ¶¶ 8, 10, 11. Spotify provides this service at no charge. 3/21/17 Tr. 2257:1-3 (Lucchese). The Fan Insights tool is used by over [redacted] musicians. *Id*. at 2257:8-9; Trial Ex. 1064, Lucchese WDT ¶ 9.

SPFF22. Unlike the limited, static information accessible from CD sales, PDD sales, or terrestrial broadcast, artists and singer-songwriters can use data from Spotify Fan Insights to route tours, pick their next single, connect with other music creators for music collaborations, find opening acts, and serve as the blueprint for global promotional campaigns. 3/21/17 Tr. 2557:13-2258:2 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶¶ 8, 10, 12, 13. Artists

and singer-songwriters also use Spotify data to run "SuperFan" campaigns to grow, engage, and monetize their fan base [redacted]. 3/21/17 Tr. 2558:3-22 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶¶ 14-16. These are all contributions Spotify makes to the music industry that are independent of the contribution of its royalty contributions to songwriters.

3. *Spotify's Discovery Tools have Promotional Benefits for Music Creators*

SPFF23. Spotify drives music discovery by curating music with the use of algorithms, human editors, and combinations of the two. 3/21/17 Tr. 2263:3-9 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 23. The tailored editorial playlists are developed for specific listening situations, such as for a genre, activity, or mood. Trial Ex. 1064, Lucchese WDT ¶ 24. Among the numerous custom Spotify products that promote music discovery are features such as Discover Weekly, Fresh Finds, Release Radar, and Daily Mix. 3/21/17 Tr. 2261:1-2263:2 (Lucchese); *e.g.* Trial Ex. 1064, Lucchese WDT ¶ 38. Spotify's curated streaming accounts for nearly [redacted] of all streams, which makes the discovery tools a significant avenue of promotion. Trial Ex. 1061, Page WDT ¶ 75.

SPFF24. Discover Weekly is one example of Spotify's innovative music discovery products. The Discover Weekly tool uses machine learning techniques to build evolving, anonymized "taste profiles" for each Spotify user, identify lower-familiarity artists that match a user's taste, and bring each user two hours of custom music recommendations at the beginning of each week. 3/21/17 Tr. 2263:14-2264:2 (Lucchese); 3/21/17 Tr. 2259:14-15 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 26. Because the results are individual to each user, Spotify introduces an artist to a new fan about [redacted] times every month. 3/21/17 Tr. 2266:3-7

(Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 27. After being featured on Discover Weekly, music creators see significant growth of repeat listeners. Trial Ex. 1064, Lucchese WDT ¶¶ 29-30; Trial Ex. 1061, Page WDT ¶ 76 [redacted]. Some "get publishing deals, record deals, are able to go on tour" after gaining listeners from Discover Weekly. 3/21/17 Tr. 2267:1-6 (Lucchese).

SPFF25. Fresh Finds is another Spotify discovery tool, which focuses on introducing lesser-known, "long-tail" songs to listeners. Trial Ex. 1064, Lucchese WDT ¶ 31. Spotify algorithms identify "tastemakers" among Spotify users by [redacted], identify other songs these tastemakers are listening to, identify the songs that are generating the most buzz among these tastemakers, and produce results to Spotify curators, who organize the songs into six Fresh Finds playlists—each week, there is one flagship playlist and five genre-based playlists. 3/21/17 Tr. 2268:7-24 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 33. After a Fresh Finds debut, artists gain about [redacted] more listeners. *Id.* at ¶ 36.

SPFF26. Taken together, Spotify's music discovery products identify relatively unknown artists who are resonating with a small fan base, recommend these songs to relevant audiences through discovery playlists such as Fresh Finds, amplify the songs' promotional effect through playlists like Discover Weekly, in order to reach an even larger audience. Trial Ex. 1064, Lucchese WDT ¶ 35; 3/21/17 Tr. 2253:10-2254:22 (Lucchese, discussing the contextual understanding of fan activity).

SPFF27. After listeners discover new music through these playlists, they can share music and playlists with their friends using Spotify's social features, exposing artists to more potential fans. 3/21/17 Tr. 2254:16-21 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶¶ 13, 26.

Spotify's music discovery products and social features result in promotion for many artists and songwriters who otherwise may not receive any exposure at all. Trial Ex. 1066, McCarthy WRT ¶ 60; *see also* Trial Ex. 1065, Marx WDT ¶ 46.

SPFF28. And, because Spotify's online platform is independent of geography and intermediaries, many more creators break out on Spotify, resulting in more listening and ultimately, increased revenue for the songwriters behind the music. 3/21/17 Tr. 2247:9-15 (Lucchese); Trial Ex. 1064, Lucchese WDT ¶ 39-40; *see also* Trial Ex. 1061, Page WDT ¶¶ 75-79 (discussing singer-songwriter promotion on an international level). *See generally* 3/14/17 Tr. 869:6-18 (Herring) (discussing how songwriters benefit from increased exposure from the Services).

II. SPOTIFY'S RATE PROPOSAL

SPFF29. Spotify proposes a continuation of the same rates and structure that are currently in place, with a few modest, surgical changes designed to further align the current rates and terms with the Section 801(b) factors.

SPFF30. The percentage of revenue rate structure for interactive streaming services has been instrumental in reinvigorating the music industry after the blight of piracy and the shock of unbundling the album. *See* JPFF Sections I, III. The proven success of the current percentage of revenue structure is confirmed by its economic justifications, including its promotion of the overall health of the music ecosystem, its flexibility to allow different product offerings, and its economic efficiency. *See* Section III, *infra*. Spotify's proposed changes described below are geared towards improving the formula on which the industry has built a working model, while avoiding disruption to the industry and its prevailing practices.

SPFF31. First, Spotify proposes to eliminate the subscriber-based mechanical-only royalty floor applicable to its paid tier (as currently set forth in step 3 of 37 C.F.R. § 385.12(b)(3)(ii) and 37 C.F.R. § 385.13(a)(1) & (3) (for standalone non-portable subscription—streaming only service and standalone portable subscription service, respectively)) in order to create a more economically efficient rate structure. *See* Section V.C, *infra*. The mechanical-only floor, [redacted], makes it harder for Spotify to engage in revenue-enhancing price discrimination, or, offering different access plans at different price points to consumers with differing willingness-to-pay. *See* Trial Ex. 1062, Vogel WDT ¶¶ 28-29, 31; Trial Ex. 1060, McCarthy WDT ¶ 69; 3/9/17 Tr. 1125:6-10 (Parness); 3/15/17 Tr. 1224:7-1225:2 (Leonard).

SPFF32. Second, Spotify proposes certain discounts for family and student plans, namely that a family plan be considered 1.5 subscribers and a student plan be considered 0.5 subscribers in the computation of the subscriber-based royalty rate. Doing so will remove obstacles services face in developing innovative pricing schemes to monetize low willingness-to-pay consumers, such as students and additional family members. *See* Section VI.C, *infra.*

SPFF33. Third, Spotify proposes additions to the current terms, including provisions for reductions for app store, carrier billing, and credit card transaction fees, as well as an audit right for publishers *and* a revised definition of service revenue. *See* Section VI, *infra*.

SPFF34. Spotify puts forth a revised definition of "Service Revenue" to address any perceived concerns about third-party bundling (bundles between a music service and an unaffiliated company). *See* Section VI.A, *infra*. Spotify proposes to define such bundles as those "[w]here 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, where at least one of the products or services are offered by a party *unaffiliated* with the party offering

the music service engaged in licensed activity." *See* Second Amended Proposed Rates and Terms of Spotify USA Inc. (emphasis added). Spotify proposes that in such cases, "Service revenue" be defined as "the *net revenue realized* by the party offering the music service." *Id*. (emphasis added). Spotify's proposal ensures that the royalty base is the money received from the bundle without any deduction for the stand-alone price of the third-party services that form part of that bundle. *See* Section VI.A, *infra*.

SPFF35. Next, the proposed reductions in the calculation of "service revenue" for app store, carrier billing, and credit card transaction (and similar) fees—are proposed with the idea that Services and Copyright Owners should share the burden of accessing new distribution channels that benefit everyone in the value chain, not to mention increasing the availability of creative works. *See* Section VI.D, *infra*.

SPFF36. Spotify also proposes instituting an audit right that provides the Copyright Owners with additional comfort in knowing that they can monitor the royalty calculations first-hand. *See* Section VI.B, *infra*. These proposals help the Services and the Copyright Owners while fulfilling the policy objectives of the Section 801(b) factors.

SPFF37. Finally, Spotify's proposal also sets forth specific definitions for "Play," "Fraudulent Stream," and "Service Revenue" (as it relates to third-party bundling). *See* Section VI.A, E, *infra*. For the definition of "Play"—which currently is not explicitly defined—Spotify proposes "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 and played to its full duration." The definition of "Play" also excludes any "Fraudulent Streams," which are defined as streams "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." These two

definitions are proposed to bring the regulations in line with industry standards, as illustrated by benchmark agreements in the music industry, and are based on notions of fairness as emphasized in the second and third Section 801(b) factors.

III. THE ECONOMIC ADVANTAGES OF PRESERVING A PERCENTAGE OF REVENUE RATE STRUCTURE

SPFF38. Since the settlement nearly a decade ago between the Copyright Owners and services in *Phonorecords I* setting a multi-tiered percentage of revenue rate structure, the interactive streaming industry has paid mechanical royalties on a percentage of revenue basis. JPFF Section V. The conditions in the market were essentially the same when Copyright Owners settled *Phonorecords II* in 2012 by rolling over the percentage of revenue structure and the corresponding rates set in *Phonorecords I.*

SPFF39. Since the *Phonorecords II* settlement, the music industry has started to turn the tide. No longer seeing massive declines in revenue, the industry is now experiencing growth for the first time in years and music publishers are thriving. JPFF Section III.A. This growth has been driven in large part by the growth and popularity of interactive streaming services. Trial Ex. 1065, Marx WDT ¶¶ 33-35; *see also* JPFF Section I.C. Although "listeners will always have the ability to get their music for free," Spotify and other services offer consumers a compelling value proposition—a free service that's better than piracy and a premium service that charges a flat price for tens of millions of music tracks and unlimited music consumption—which has drawn consumers away from pirating music and into paying for music. Trial Ex. 1061, Page WDT ¶ 63; Trial Ex. 1066, McCarthy WRT ¶¶ 40, 58.

SPFF40. The growth of Spotify, and interactive streaming generally, was made possible by the percentage of revenue structure first put in place in *Phonorecords I* and affirmed in *Phonorecords II*. Operating on revenue-based royalty structures has allowed Spotify (and

other services) to "maximize value for the entire ecosystem—including not only publishers and Services but also songwriters, artists, and listeners." Trial Ex. 1066, McCarthy WRT ¶ 2. [redacted] And for good reason: this percentage of revenue structure matches royalty costs with the different demands of the market, aligns the incentives of all parties, and promotes the continuation of the business model all of the Services have adopted—which has resonated with consumers. In light of the success of this model, Spotify has proposed a rate structure that preserves the ad-supported and subscription service tiers and their percentage of revenue headline rates, while eliminating certain inefficiencies.

A. Percentage of Revenue Rate Structure Best Promotes the Overall Growth and Health of the Music Ecosystem

1. *Percentage of Revenue Structure is More Economically Efficient and Allows Services to Foster Engagement and Draw Users*

SPFF41. Interactive streaming's core value proposition to consumers is the all-you-can-eat business model: pay a monthly subscription price (or listen to ads) for unlimited access. This model has resonated with consumers and proven an effective antidote to piracy, which itself radically altered the way consumers could access music. Central to the services' value proposition is engagement—the more a consumer listens to music on a service, the greater value she derives from it and the less likely she is to cancel. 3/22/17 Tr. 2471:4-13 (Dorn); Trial Ex. 1066, McCarthy WRT ¶¶ 58-59.

SPFF42. This common sense business logic encapsulates a central tenet of economics. As Dr. Leslie Marx testified, "economics teaches that total surplus, [and] overall economic efficiency is maximized when the price [of a good or service] is set equal to marginal cost [to produce that good or service]." 3/20/17 Tr. 1891:13-20 (Marx). "Marginal cost" is "the

increase in total cost resulting from an additional unit of output." Trial Ex. 1065, Marx WDT ¶¶38, n.39. As she explains:

> When a producer prices a product above its marginal cost, consumers who value the product more than its cost to produce but less than the price will not purchase it. Thus, some value-enhancing transactions do not take place. This creates a deadweight loss for society and reduces total surplus. This deadweight loss is sometimes labeled economic inefficiency. It reduces the total value available to be divided among producers and consumers. The economically efficient outcome, in contrast, maximizes total surplus.

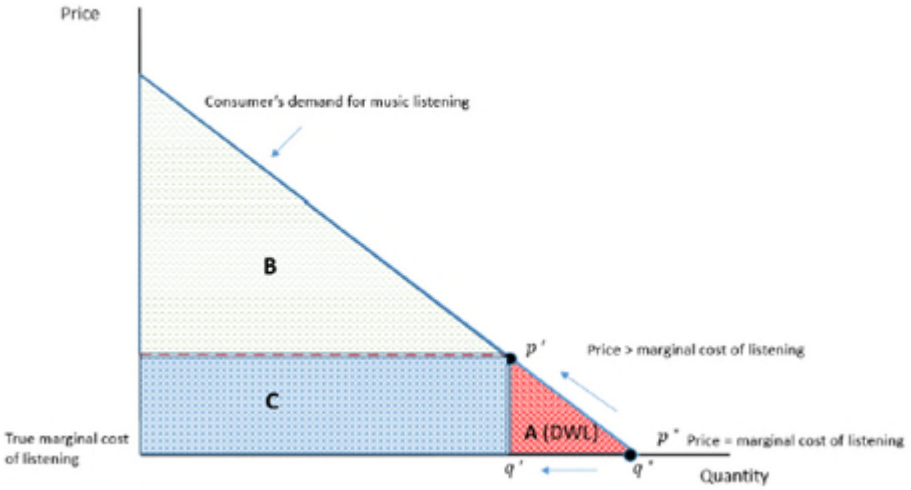
Trial Ex. 1065, Marx WDT ¶ 120.

SPFF43. As current streaming subscription prices do not increase with the amount of music consumed, consumers face a zero marginal cost of listening to additional music. Likewise, the marginal cost to the Services of digitally delivering a stream is zero. 3/20/17 Tr. 1891:21-23 (Marx); 3/27/17 Tr. 3167:12-16 (Watt) (stating that the marginal cost of an additional stream is "very small"); 3/30/17 Tr. 4086:6-10 (Gans) (agreeing that the marginal physical cost of a stream equals zero); 4/3/17 Tr. 4318:8-22 (Rysman) (stating that "copyrighted work and most digital work has zero [marginal] production cost").

SPFF44. Applying the economic logic here, by setting a marginal stream's royalty equal to its marginal cost to the service, a percentage of revenue structure maximizes economic efficiency. This concept is illustrated in Figure 25 of Dr. Marx's Written Direct Testimony (Trial Ex. 1065, Marx WDT ¶¶ 124-125): When subscribers/listeners are charged zero for each incremental stream, they will choose the economically efficient level of streaming (*i.e.*, as much streaming as they desire to consume, thus maximizing consumer surplus), and the total available surplus (*i.e.*, the entire area under the demand curve, areas A, B and C in Figure 25 of Dr. Marx's WDT) is captured. 3/20/17 Tr. 1893:10-15 (Marx); Trial Ex. 1065, Marx WDT ¶¶ 125-126. And

when a consumer can achieve her economically efficient level of streaming, she is streaming as much as she wants and enjoys.

Figure 25: Efficiency of pricing marginal consumption at zero



SPFF45. If, however, services are charged a positive price per stream and they pass this cost on to consumers, consumers will reduce the number of streams that they choose to play and will be "less willing to stream songs that have a low or uncertain value to them." 3/20/17 Tr. 1893:16-21 (Marx). This creates what is known in economics as an economic inefficiency or "deadweight loss," which is surplus that is not captured, but could have been if the good or service was priced consistently with the marginal cost to produce. 3/20/17 Tr. 1893:22-24 (Marx). This concept is illustrated graphically in Figure 25 of Dr. Marx's WDT as the red triangle under the demand curve marked as "A." (Trial Ex. 1065, Marx WDT ¶ 125).

SPFF46. A percent of revenue structure sets the marginal costs of a stream to zero and removes any obstacles to the Services' successful all-you-can-eat pricing model. 3/20/17 Tr. 1895:19-23 (Marx). This permits Spotify and services like it to focus on user engagement (such as by developing Spotify's innovative discovery tools), which has allowed these services to

attract, retain and monetize customers by maximizing the value those customers perceive. Trial Ex. 1066, McCarthy WRT ¶¶ 58-59; 3/16/17 Tr. 1625:11-23 (Mirchandani) ("[T]he way we maximize value is to retain the customer. We do that by trying to drive engagement. We do that by driving features to get them to use the service more."); 3/22/17 Tr. 2471:4-13 (Dorn) (noting that fostering engagement adds "value to the service"). All told, a zero marginal cost structure has allowed Spotify, in an environment where consumers can choose to pay zero for music, to build a product that has attracted over [redacted] subscribers in the United States. Trial Ex. 1060, McCarthy WDT ¶ 6.

SPFF47. It is the percent of revenue structure for mechanicals on the ad-supported tier that has made it possible for Spotify to offer that service, and use it as a stepping stone to get users to try streaming and love it, and convert them to paid subscribers. 3/21/17 Tr. 2058:13-2059:14 (McCarthy). On the other hand, a royalty structure that increases the marginal cost of an incremental stream above zero radically changes the current cost structure of the services, making delivering music to consumers a variable cost (a cost that varies with the amount of music consumed), thereby requiring the Services to *introduce* scarcity in order to achieve profitability. Creating these cost-control incentives cuts against the Services' revenue-enhancing incentives to promote streaming and user engagement. *See, e.g.*, 3/14/17 Tr. 895:2-896:13 (Herring) ("[I]f we're paying on a per-play basis, we have an incentive to reduce listening as much as possible in order to be profitable. By reducing engagement, we increase the propensity to churn or likelihood to cancel."); 3/20/17 Tr. 1896:4-21 (Marx).

SPFF48. If Services are faced with royalty structures that set incentives against user engagement, their proven value proposition to consumers will be irreparably harmed. Trial Ex. 1063, Harteau WDT ¶ 23 ("[W]e tout our innovations—our product features, platform scope, and

predictive capabilities—as value propositions to encourage more users than ever to listen to more music, and greater variety of music."). Services could be forced to charge per play, cap usage, or use other ways to keep streams, and hence costs, down. 4/6/17 Tr. 5222:12-5223:16 (Leonard) (stating that per-play rate results in incentives to charge per-play or limit usage); 3/21/17 Tr. 2021:20-21 (Marx) (stating that per-play fee provides bad incentives including encouraging the Services to charge per play and cap usage, which create deadweight loss, as well as streaming longer songs, inserting delays between songs, and reducing investment in cueing up songs efficiently); 4/7/17 Tr. 5632:12-5633:1 (Marx) (same); 3/16/17 Tr. 1625:11-1626:7 (Mirchandani) (stating that a per-play rate is "fundamentally inconsisten[t]" with driving engagement); Trial Ex. 1066, McCarthy WRT ¶ 59 ("[A] per-stream rate, which incentivizes services to decrease engagement, effectively incentivizes them to increase churn, and as such misaligns incentives."); 3/8/17 Tr. 174:16-175:20 (Levine) ("[I]f we had an incentive to decrease [engagement], I think we would see fewer dollars coming in."); 4/6/17 Tr. 5240:21-5241:4 (Leonard) (per-play rate could lead to a reduction ultimately in revenue); 3/8/17 Tr. 83:23-84:5 (Zakarin) (Copyright Owners conceding that one pricing alternative their proposal may require is an access price plus a per stream price). In short, any royalty structure that sets a positive marginal cost for a stream incentivizes music services to restrict the consumer experience and limit engagement. If consumers are not engaged they will turn to other sources for music—such as YouTube, terrestrial radio and piracy—that pay lower or zero royalties. Trial Ex. 1065, Marx WDT ¶ 127; Trial Ex. 249, Klein WRT ¶¶ 67-68; Trial Ex. 1025.

2. *Percentage of Revenue Rate Structure Aligns Incentives Between the Copyright Owners and Services*

SPFF49. A percentage of revenue structure uniquely aligns incentives of the Services and the Copyright Owners. Such alignment fosters each of the Section 801(b) goals,

including the first and second factors, namely: maximizing the availability of creative works to the public and affording the copyright owner and user fair income and returns. When these incentives are aligned, the Services' efforts to raise their returns translates directly into income for the Copyright Owners, allowing both to invest in the creation and dissemination of musical works. This is precisely why the industry uses such percentage of revenue rate structures: because all parties have determined that it works, and it does so to the benefit of *all* parties, including rightsholders. 3/13/17 Tr. 588:15-24 (Katz) ("Well, I mean, the -- the biggest thing, I guess, would be -- I would say, that the parties have seemed to determine that, in fact, that it works for them and that it's something they've come to in their agreement. And that we also see that in other agreements, for example, between the Services and record companies. And so it's a structure that people in the industry have decided works. I would say that's the Number 1 reason."); *id*. at 619:5-13 ("[S]o the publishers are profitable, certainly the leading ones are because you can see that in their public financial statements. So it's not confidential. As we've said, music revenues have stabilized. And the Services are unprofitable. Now, you know, as -- I take from that that, again, the Services are unprofitable, but they're still continuing to invest."); *id*. at 739:17-22 ("[W]hat I have concluded is that looking at how the industry has performed under the 2012 settlement, that within the bounds of the ability to judge these things, that the industry is performing satisfactory under it and it is meeting the statutory objectives."); 3/15/17 Tr. 1120:4-8 (Leonard) ("There is really no evidence that, for instance, you know, songwriters are -- under the existing situation, you know, are being harmed. Certainly, the publishers aren't being harmed. They appear to be profitable."); *id*. at 1121:11-23 ("So I think the -- the structure, to the extent that, again, it has led to something like the all-you-can-eat plan, which is very attractive, which then gets people away from piracy, which gets people willing to listen to music

more and pay that money, you know, are people who, again, weren't, you know, willing to pay that money but they are willing to endure some ads. Okay. So the ads generate money on those people. That, to the extent that the existing structure is part of what enabled that, and I think it is, then that's something that has benefitted musical work Copyright Owners."); 3/15/17 Tr. 1335:14-1336:3 (Mirchandani) ([redacted]); 4/3/17 Tr. 4418:13-17 (Rysman) (agreeing that "[u]nder Spotify's percentage of revenue rate proposal, increased advertising revenue for Spotify for these targeted ads would mean increased royalties for rightsholders").

SPFF50. As with any business, the Services have an incentive to grow revenue. *See, e.g.*, 4/6/17 Tr. 5299:10-13 (Vogel) ("[A]s any business, our incentive is to grow revenue for business because that's what healthy for shareholders."); 4/6/17 Tr. 5238:23-5239:4 (Leonard) ("[L]ook, the service wants to make a lot of revenue. That's, of course in a percentage of revenue setup going to lead to more royalties as well. So there's -- a good aligning of incentives."). The Copyright Owners likewise want to grow their revenue. *See, e.g.*, Trial Ex. 3014, Israelite WDT ¶ 66 ("Publishers and songwriters invest the time and money needed to create these songs because they expect that they will be able to receive at least a fair return for their efforts.").

SPFF51. Under a percentage of revenue royalty structure, revenue growth for the Services results in concomitant royalty growth for the Copyright Owners. *See, e.g.*, 3/21/17 Tr. 2065:21-2066:1 (McCarthy) ("[Spotify's] proposal is as we grow, so grows our license fee payments to…Copyright Owners on a percentage basis."); 4/6/17 Tr. 5296:20-5297:1 (Vogel) (stating that Spotify "ha[s] incentives to grow. And as we grow, they'll just grow right along with us."); *id.* at 5302:10-13 ("[W]e believe that as we continue to grow our revenue, which we

have every intention to do, the publishers will benefit as our revenue grows."); *see also* 4/6/17 Tr. 5240:17-20 (Leonard) ("[T]he Copyright Owners would like the Services to make the subscriber base as big as possible, which, you know, is more or less going to be the same as any revenues go up too."); 4/7/17 Tr. 5601:15-23 (Marx) ("[I]n the Shapley value setting, if revenues increased, it would require that…royalty payments, the dollar amounts paid upstream, would also increase. And so a percentage of revenue rate structure is consistent with the Shapley value view of fairness."). However, under a per-play or per-user rate, the Services would have the incentive to maximize their revenues (and profits) without regard to the Copyright Owners. Consequently, the Services may make business decisions that are good for the Services but bad for the Copyright Owners. On the other hand, under Spotify's proposal, the Copyright Owners get to share in the upside—an argument that other rightsholders have previously ***advocated*** for in rate-setting proceedings. *See, e.g.*, *Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings*, 81 Fed. Reg. 26,316, 26,326 (May 2, 2016) ("Web IV") (SoundExchange advocating for a percentage of revenue rate structure because it allows rightsholders to share in the upside). Thus, if publishers and songwriters want to earn a fair return, a percentage of revenue royalty structure will align their incentives with those of the Services, as revenue maximization is the priority for both parties.

SPFF52. The Services are willing to share revenues because they need content suppliers to have a healthy ecosystem (*i.e.*, rightsholders need a fair return to continue to create and Services need a fair income to stay in business). *See, e.g.*, 4/6/17 Tr. 5298:6-18 (Vogel):

> JUDGE STRICKLER: Why would you want to share profits with somebody else?
>
> THE WITNESS [Paul Vogel]: Look, I think in any business, you'd love to take more than less. I think the proposal we put up here was fair based on what had existed in the past and based on what we

> think would allow everyone to keep a healthy ecosystem. So for us to have a healthy ecosystem, the suppliers…of content to our product need to have a healthy ecosystem as well. So we're not looking to eliminate anyone's growth or anyone's profitability. We just need to do it in a way that allows us to grow profitably as well.

Accord, Trial Ex. 1060, McCarthy WDT ¶ 27; *see also* 3/21/17 Tr. 2086:7-2087:18 (McCarthy) (stating that while Spotify's founders feel a moral obligation to investors, their objective is to build a business to afford more music creators the opportunity to make a living being creators, and that they have been oriented in terms of the long-term health and success of the business, rather than short-term tradeoffs in favor of investors).

SPFF53. The Copyright Owners acknowledge, as they must, that they benefit from increased revenue under a percentage of revenue structure. But they allege that Spotify is not trying to maximize revenue, and is instead prioritizing growth, purportedly to obtain a higher price in a sale or IPO. *See, e.g.*, Trial Ex. 3016, Brodsky WDT ¶ 66; Trial Ex. 3018, Kokakis WDT ¶ 61. In the Copyright Owners' opening statement, they promised that the Board "will see an enormous amount of evidence at trial concerning revenue deferment, which is what we talk about when you are not even trying to make revenues now; you are trying to get user growth and market share, and so you are pushing your revenues off." 3/8/17 Tr. 105:18-106:2 (Semel). However, the Copyright Owners failed to deliver on this promise.

SPFF54. The Copyright Owners did not introduce any evidence that Spotify (or any other Service) is in fact prioritizing user growth at the expense of revenue. To the contrary, the Copyright Owners' allegations are belied by the evidence. *See, e.g.*, 4/7/17 Tr. 5550:24-5551:6 (Marx) ([redacted]

[redacted]); Trial Ex. 1066, McCarthy WRT ¶ 37 ("[W]hile it is true that user numbers might positively impact a company's IPO valuation, revenue and profit margins are, by far, the more important determinants of enterprise value in both the late-stage private and public markets."); 4/5/17 Tr. 5046:17-5047:7 (Katz) (pointing out that the interests of the Copyright Owners are aligned with Spotify whether or not there is an IPO or a sale, because "the way you maximize the value of the IPO is to maximize the net present value of your profits"); *id.* at 5050:6-17 ("[Y]ou typically are going to raise the net present value of costs and, therefore, those strategies will be profitable only if they raise the net present value of revenues, in which case…it is going to be raising then the net present value of royalty payments. So the same thing that you do, maximizing net present value of profits in order to boost the IPO value also are strategies that raise the net present value of revenues…."); 4/7/17 Tr. 5519:23-5521:12 (Marx) (same); *see also* 4/13/17 Tr. 5901:5-7 (Hubbard) ("[The] service providers would charge higher fees if they thought they would increase revenues.").

SPFF55. That is, Spotify and the other Services have shown that the industry's use of lower price points is not to prioritize user growth at the expense of revenue, but rather to prioritize total revenue growth *through* user growth. *See, e.g.*, Trial Ex. 1060, McCarthy WDT ¶ 53 ("While lower prices may result in less revenue per user, it often brings in more than enough users to make up the difference."); McCarthy WDT ¶¶ 67-68 ([redacted]); 3/21/17 Tr. 2052:23-2053:16 (McCarthy) (same); 3/22/17 Tr. 2457:8-2458:22 (Dorn) (family discount plans and student discount plans exist to target those with a lower willingness-to-pay); 3/15/17 Tr. 1322:17-21 (Mirchandani) (family plans increase revenue compared to individual plans); *id.* at 1322:22-1323:12 (discussing student plans); *see*

also 3/30/17 Tr. 4087:12-25 (Gans) (if the Services were able to practice perfect price discrimination, it would be in the interest of all parties who provide music to listeners—*i.e.*, services, labels and publishers alike—to do so because it would increase the amount of surplus to all of them).

SPFF56. Conversely, and critically, [redacted]. 4/13/17 Tr. 5903:15-5904:18 (Hubbard) ([redacted]). Mr. Klein's survey results are instructive. [redacted]. *See id.* at 5906:20-5907:15 (Hubbard).

SPFF57. The percentage of revenue royalty structure removes obstacles to using this type of price discrimination to grow revenue. 3/20/17 Tr. 1967:12-19 (Marx) (agreeing that the rate structure upstream should be derived from the need to exploit the willingness-to-pay of various user downstream, and that percentage of revenue works because the downstream variances in willingness-to-pay should be exploited to the mutual benefit of both licensees *and* licensors); 3/21/17 Tr. 1998:5-9 (Marx) ("[A] percentage of-revenue royalty is most beneficial as far as promoting economic efficiency, in particular the incentives for Services to serve low- and no-willingness-to-pay consumers."); 4/13/17 Tr. 5897:22-25 (Hubbard) ("[T]he flexible structure that presently exists is what facilitates diverse services that really get at differences in tastes, preferences, and willingness-to-pay."); *id.* at 5944:14-23 ("The market as I see it on the demand

side has this heterogeneity in tastes and willingness-to-pay. The flexible royalty structure is what allows you to deal with that effective downstream price discrimination.").

SPFF58. This price discrimination has benefited the Copyright Owners, which only further illustrates that a percentage of revenue royalty structure properly aligns incentives by permitting such price discrimination. *See, e.g.*, 3/21/17 Tr. 2189:10-14 (Hubbard) ("To the extent that you expand the customer base drawing people in from the margins, you actually increase the total revenue pool and, hence, the pool on which royalties are paid."); 4/7/17 Tr. 5568:3-23 (Marx) (the current rate structure allows for differentiated products serving different customer segments with a variety of preferences and a variety of willingness-to-pay for streaming services, and noting that "the publishers' and labels' royalty revenues have increased as interactive streaming has grown."); 3/15/17 Tr. 1224:14-1225:2 (Leonard) (from the point of view of the Copyright Owners, trying to get as many people in the door, perhaps at different price points and generating a lot of revenue is a good thing); 3/8/17 Tr. 237:19-23 (Levine) (align interests under a percentage of revenue structure to get the optimal price and the most amount of revenue that the market can reasonably bear); Trial Ex. 1065, Marx WDT ¶ 133 ("In contrast to per-play or per-subscriber fees, a royalty based on a percentage of revenue aligns the incentives of the interactive streaming service with surplus maximization.").

3. *There is No Evidence Of Misaligned Incentives Under a Percentage of Revenue Structure*

SPFF59. The Copyright Owners allege that a percentage of revenue royalty structure misaligns incentives because the Services are incentivized to engage in so-called "revenue displacement" or "revenue gaming" (in which "you don't really try to book the revenue in the category that you are paying your royalties on," *e.g.*, by bundling). 3/8/17 Tr. 106:2-9, 108:1-2 (Semel) (Copyright Owners' opening statement). However, there is no evidence in the

record that Spotify (or any other "pure-play" Service) currently engages in—or ever engaged in—such tactics. *See, e.g.*, 3/28/17 Tr. 3419:6-13, 3420:7-12 (Timmins) (admitting that as a pure play business, Spotify does not offer hardware or other services and thus does not—and cannot—use music to help drive sales of hardware and other services); *see also* 3/21/17 Tr. 2039:12-18 (McCarthy) (Spotify has no material sources of revenue besides streaming music).

SPFF60. That is, the Copyright Owners have presented no "*market evidence*" showing any *actual* revenue displacement, either by "pure play" services, like Pandora or Spotify, or even by other, more integrated streaming services. 4/3/17 Tr. 4254:23-4255:7 (Rysman). As this Board has correctly pointed out, the Copyright Owners' expert, Dr. Rysman, who opines on the so-called "loss leading" strategies of the Services, can do nothing more than speculate on the business strategies of the Services, without pointing to actual evidence that such revenue deferment or displacement is actually occurring. *Id.*

SPFF61. For example, Dr. Rysman points to a certain New York Times and Spotify bundle, stating that "it appears that this would generate no revenue into the royalty base because [of] the way the regulations are currently written." *Id.* at 4256:8-10 (Rysman). That the Copyright Owners have no actual *evidence* that Spotify is in *fact* allocating zero revenues to the bundle is highlighted by Dr. Rysman's use of the word "appears," and Dr. Rysman confirmed that he (a) does not even know *which* entity—whether it is even Spotify, or the New York Times—is collecting revenue from Spotify's bundle with the New York Times and (b) has seen no actual evidence of how Spotify is allocating revenue from the Times bundle. *Id.* at 4423:5-4424:23 (Rysman). Indeed, Dr. Rysman misses the point that the New York Times deal bundles a Spotify product with a *third-party* product, and as such the parties would need to figure out how to share the bundled payment from the consumer—*i.e.* how to allocate the revenue between

them and recognize the revenue for each company's finances. *Id.* at 4423:16-20. And indeed, Spotify's revised rate proposal, as discussed in Section VI.A, ensures that any revenue earned by Spotify as a result of this bundle would have to be reported by Spotify and would form part of the relevant royalty base.

SPFF62. Several of the Copyright Owners' other experts likewise admitted that they do not have *any* evidence suggesting that Spotify is actually using its streaming service to cross-sell other products or services, be they hardware or otherwise. 3/28/17 Tr. 3468:15-22 (Barry) ("Q: Have you seen any evidence that Spotify is using its interactive streaming services to cross-sell other services that are unrelated to interactive streaming? A: Not yet, correct. I should be more precise. I haven't seen *any ev*idence that they are doing that to date." (emphasis added)); *id.* at 3468:23-3469:3 ("Q: And you have not seen any documents or anything suggesting that it is probable that Spotify will enter into additional business lines unrelated to interactive streaming, correct? A: I don't have anything that concrete about Spotify's plans."); 3/28/17 Tr. 3419:6-13 (Timmins) ("Q: Spotify does not use music to help drive sales of hardware and other services; is that correct? A: That's my understanding. Q: And this is because Spotify does not currently offer hardware or other services; is that correct? A: Again, that's my understanding."); *id.* at 3420:2-12 (agreeing that Spotify is not a large diversified company and that he would categorize it as a pure play streaming service).

SPFF63. At best, the Copyright Owners have pointed to [redacted]"—ideas that Spotify's own CFO, Mr. McCarthy, [redacted] 3/21/17 Tr.

2098:1-2099:12 (citing Trial Ex. 2719). That these are just [redacted] *Id.* at 2099:13-16 (McCarthy).

SPFF64. Not only is the Copyright Owners' complaint based solely on conjecture, but it can be easily addressed with a tweak to the existing definition of "service revenue." It certainly does *not* require a complete overhaul of the current rate structure and the ensuing disruption to the industry—and to Spotify, the largest interactive streaming service—that would result. *See, e.g.*, 4/3/17 Tr. 4256:7-10 (Rysman) ("[I]t appears this would generate no revenue into the royalty base because [of] the way the regulations are currently written."); 3/20/17 Tr. 1890:6-13 (Marx) (staying relatively close to the current rate structure would be less disruptive). A reasonable rate structure cannot be set based on hypothetical "what ifs" and speculation. *See* 3/8/17 Tr. 15:11-13 (Chief Judge Barnett stating that "[t]he judges cannot determine rates or terms without an evidentiary record").

4. *Nor Have Copyright Owners Shown That Spotify Is Using Its Ad-Supported Service To Defer Revenues*

SPFF65. Spotify is committed to fully monetizing its ad-supported service. For example, Spotify has already increased its overall revenue and ad revenue yield from its ad-supported tier. Comparing the first half of 2016 with the first half of 2015, Spotify's ad-supported RPM, or revenue per thousand music listening hours, increased [redacted] Trial Ex. 1068, Vogel WRT ¶ 24. That is, Spotify's advertising RPM was [redacted] in the first six months of 2015, and it grew to [redacted] in the first six months of 2016. *Id.* at ¶ 24 n.15. And of course, better monetization of advertisements under a percentage of revenue rate structure means greater, better returns to Copyright Owners. *Cf.* 4/3/17 Tr. 4418:13-17 (Rysman) (agreeing that

under Spotify's percentage of revenue rate proposal, increased advertising revenue for Spotify translates to increased royalties for rightsholders).

SPFF66. And as Mr. McCarthy explained, Spotify is constantly seeking to improve revenue on its ad-supported service through better ad monetization. *See* Trial Ex. 1066, McCarthy WRT ¶ 37 fn. 16 ("Spotify constantly works to improve its advertising services and revenue on the ad-supported service. Spotify makes considerable investments in our advertising sales, operations, marketing, and engineering workforce, and it continues to grow.").

B. Different Rate Structures for Different Service Categories Allows Services to Promote Music and Interactive Streaming By Targeting Consumers With Differing Willingness-to-Pay

SPFF67. A flat, indiscriminate per-play or per-user rate prevents the flourishing of a variety of service types, such as bundles, ad-supported, and paid subscription services. The music market consists of many different consumer groups, each group with different price sensitivities and willingness-to-pay. Trial Ex. 1061, Page WRT ¶ 50; Trial Ex. 1025; *see also* 3/20/17 Tr. 1894:19-1895:2 (Marx). Price sensitivity and willingness-to-pay in economics is best illustrated by a demand curve that embodies the marginal willingness-to-pay of consumers, such as the demand curve set forth in Figure 25 of Dr. Marx's WDT and reproduced in Section III.A, *supra*. This illustrative demand curve reflects that some consumers are willing to pay a high amount for accessing music while others are willing to pay a low amount or no amount at all. 3/20/17 Tr. 1891:15-17 (Marx).

1. *Consumer Willingness-to-Pay Varies Widely and Spotify Monetizes these Groups*

SPFF68. [redacted]

[redacted] *See* 4/6/2016 Tr. 5396:10-5397:10 (Klein); Trial Ex. 249, Klein WRT ¶¶ 67-68, 70. [redacted] Trial Ex. 249, Klein WRT ¶ 68; 4/6/17 Tr. 5457:7-5459:6 (Klein). [redacted] 4/6/2016 Tr. 5400:11-25 (Klein); Trial Ex. 249, Klein WRT ¶ 70. [redacted] 4/6/2016 Tr. 5401:6-13 (Klein); Trial Ex. 249, Klein WRT ¶¶ 67-68. [redacted] 4/6/2016 Tr. 5399:22-5400:3 (Klein); Trial Ex. 249, Klein WRT ¶ 64. These survey results are indicative of just how price sensitive consumers of music are, particularly in a market environment where there are a number of free alternatives. Similarly, Spotify's internal study on price elasticity found that [redacted] Trial Ex. 1067, Page WRT ¶ 50.

SPFF69. To monetize these different groups of consumers, Spotify's rate proposal continues the use of different rate structures for ad-supported and paid services. Different rate

structures for these two services are necessary to allow ad-supported services to target zero or low willingness-to-pay consumers—a necessity with rampant piracy. 4/6/17 Tr. 5236:4-5237:4 (Leonard). In particular, different rate structures for ad-supported and paid are necessary to account for the differences in the revenues and value generated from each service tier, all of which provide benefits to consumers *and* the Copyright Owners. *Id.* at 4/6/17 Tr. 5236:4-5237:4 (Leonard).

SPFF70. Ad-supported offerings allow Services to offer access to consumers with a willingness-to-pay lower than the price of a paid subscription, including consumers that are not willing to pay anything, while still monetizing those consumers through advertisements. 3/20/17 Tr. 1894:7-14; 1894:19-1895:2 (Marx). Paid services, on the other hand, monetize users at a higher ARPU [average revenue per user], thereby generating more revenue for the Services and royalties for the Copyright Owners. From an economic perspective, it is reasonable and in the interest of both the Services and Copyright Owners to have different rates for different product categories, because "there can be differences both in consumer demand or willingness-to-pay for different products, and also there can be different costs, including opportunity cost, for the different products…that reflect those differences and vary across products." 3/13/17 Tr. 550:22-551:19, 586:21-587:7 (Katz); 3/14/17 Tr. 884:21-885:16 (Herring). A rate structure that accounts for both service tiers allows the services to move "down the demand curve" to monetize customers who have a lower or no willingness-to-pay and grows the pie for all parties. 3/14/17 Tr. 884:21-885:16 (Herring) (stating that "having multiple [rate] tiers allows for innovation. It allows for diversity from a product perspective. And it grows the overall pie, both from a revenue perspective [for the Services]…as well as royalties to the copyright holders").

SPFF71. Spotify's ad-supported service monetizes users with low willingness-to-pay *better* than other options available on the market, such as [redacted], terrestrial radio, and, of course, piracy, thus providing even greater *returns* to the Copyright Owners. *See* 4/7/17 Tr. 5503:15-19 (Marx). Further, not only do ad-supported services *target* and *monetize* those low willingness-to-pay consumers (resulting in greater gains for the public and Copyright Owners alike), but ad-supported services also serve as conversion tools. *See* Trial Ex. 1068, Vogel WRT ¶ 35; *see also id.* at ¶ 36 ("Spotify's free-to-user ad-supported product targets such casual and infrequent listeners, and is designed to get them to listen to more music, love using the service, and convert to Premium users that pay $9.99 a month."); Trial Ex. 1061, Page WDT ¶¶ 27-28. Indeed, the fact that Spotify uses its service as a conversion tool is a fact acknowledged by Copyright Owners' own experts. *See* 4/3/17 Tr. 4428:1-5 (Rysman).

SPFF72. And Spotify's freemium funnel *works.* As Mr. McCarthy testified, over time [redacted] of Spotify's ad-supported users who remain engaged convert to the paid service. 3/21/17 Tr. 2058:21-25 (McCarthy) ("So what was uniquely different about Spotify's approach to the business is they offered this ad-supported service for free, you try it, about [redacted] users who remain engaged with the free service become paying subscribers."); *id.* at 2059:5-9. The ad-supported tier is *so critical* to Spotify's business model, in fact, that approximately [redacted] of Spotify's paid subscribers in the United States were previously active on the ad-supported service. *See* McCarthy WRT ¶ 22; *see also* 3/21/17 Tr. 2059:2-4 (McCarthy). An ad-supported tier is critical, in fact, for pure-play services like Spotify that do *not* sell hardware or other goods. *See* 3/21/17 Tr. 2059:9-14 (McCarthy) ("And that's the power of the free model,

and that's the reason that we've been able to compete so successfully against Apple and others in the space.").

SPFF73. Therefore, the [redacted] of ad-supported services (as will be discussed immediately below) would not *just* result in the loss of valuable revenue to the Copyright Owners flowing from ad-supported—it would also result in the loss of users who may have otherwise converted to paid accounts (had they been given the opportunity to first experiment with an on-demand streaming service), thereby resulting in even less revenue for the Copyright Owners. *See* 4/7/17 Tr. 5498:9-23 (Marx); *see also* Trial Ex. 3026, Rysman WDT ¶ 97 ("A shift in the distribution of Spotify's users to Spotify's subscription platform from its ad-supported platforms would generate more revenue, because the subscription service generates higher per-user revenue margins"); 3/21/17 Tr. 2059:9-14 (McCarthy) (describing the "power of the free model" and how it has grown "the overall category, and now we see growth in music revenues for the industry as a consequence of the growth in the streaming").

2. *Ad-Supported Services* [redacted] *Under a Flat, Inflexible Per-User or Per-Play Rate*

SPFF74. Different mechanical rate structures for different service tiers have facilitated Spotify's ability to offer its ad-supported, free-to-the user service in conjunction with its paid service, as upstream pricing (*i.e.*, royalties) has a direct bearing on the downstream pricing Spotify is able to offer consumers. *See* Trial Ex. 1068, Vogel WRT ¶ 25 ([redacted]).

SPFF75. There is no question that the Copyright Owners' and Apple's rate proposals, which include either a flat per-stream or a greater of per-user/per-stream fee, would severely impede the targeting and capturing of these low willingness-to-pay consumers. 4/7/17 Tr. 5481:18-22 (Marx). Even Apple's own expert admits that relying on positive pricing that

would capture only those willing to pay the positive price in the marketplace results in deadweight loss for those who are excluded from the market. 3/23/17 Tr. 2886:1-6 (Ghose). And as discussed in more detail in Section VIII.D of the Joint Findings, application of the Copyright Owners' rate proposal—which consists of an inflexible, "greater of" "per-user" or "per-play" fee—to Spotify's ad-supported tier would [redacted].

IV. RELEVANT BENCHMARKS AND SHAPLEY VALUE DICTATE PRESERVING EXISTING RATES OR DECREASING RATES

A. Dr. Marx's Two Benchmarks Provide Support for Preserving the Existing Rates

SPFF76. Benchmarking has been recognized in past CRB proceedings as informative of reasonable royalties, and as one part of her economic analysis, Dr. Marx used a benchmarking approach to draw conclusions about the reasonableness of Spotify's rate proposal. Trial Ex. 1065, Marx WDT ¶ 92. Her analysis involved identifying relevant benchmarks, looking at what those benchmarks suggest for royalties, and comparing them to current royalty rate levels. 3/20/17 Tr. 1842:9-20 (Marx). Dr. Marx chose benchmarks that were set under the shadow of Section 801(b) and that are therefore likely to embody those factors. *Id.* at 1826:14-21; 1833:5-7 (Marx).

1. *Dr. Marx's Benchmarks*

SPFF77. Dr. Marx identified two benchmarks as particularly appropriate: (1) the recently-settled Subpart A CD/PDD mechanical royalty rates and (2) the current Subpart B mechanical royalty rates in place for interactive streaming. *Id.* at 3/20/17 Tr. 1826:14-21; 1842:23-1843:5 (Marx). Dr. Marx's analysis of both benchmarks suggested that a *decrease* in the current effective mechanical Subpart B rate levels would be appropriate.

a. *PDD/CD Per-Song Fee Equivalent Benchmark*

SPFF78. To make a comparison to current interactive streaming rates using the CD/PDD benchmark, Dr. Marx compared the penny rate applicable to CDs and PDDs to a percentage of revenue. Dr. Marx used two alternative measures of equivalence to ultimately arrive at a percentage of revenue mechanical royalty rate for interactive streaming. (3/20/17 Tr. 1847:11-19 (Marx); Trial Ex. 1065, Marx WDT ¶¶ 105, 111. First, Dr. Marx took the per-song royalty of CDs/PDDs and performed a calculation to derive a per-stream equivalent rate (solely for purposes of making the comparison, as she views per-stream rates as completely inappropriate here). Trial Ex. 1065, Marx WDT ¶ 105. For the second measure of equivalence, she calculated the rate as a percentage of per-song revenue from CD/PDD sales and performed a calculation to equate it to a percentage of revenue for interactive streaming. Trial Ex. 1065, Marx WDT ¶ 105.

SPFF79. For the first measure of equivalence (the per-song fee measure), Dr. Marx used a conversion ratio of PDDs to streams of 150:1. 3/20/17 Tr. 1848:22-1849:10 (Marx); Trial Ex. 1065, Marx WDT ¶ 108. This is a reasonable conversion ratio to use, as it is an industry standard used by the RIAA, by Billboard and by [redacted] 3/20/17 Tr. 1849:11-18, 1932:24-1933:10 (Marx); 3/29/17 Tr. 3869:5-3870:3 (Israelite) (admitting that the NMPA certifies songwriters for awards based on RIAA metrics, that the RIAA uses a 150-to-1 ratio for streams to downloads, and that the NMPA's participation in the RIAA's certification program is voluntary). [redacted]

[redacted][1] Trial Ex. 1095. This conversion ratio is likewise consistent with the results of a study done by an academic known for his careful research who was in fact disclosed *by the Copyright Owners* as an expert. 3/20/17 Tr. 1933:7-10 (Marx); 3/30/17 Tr. 4172:22-4173:15 (Gans); 3/22/17 Tr. 2636:6-10 (Ramaprasad).

SPFF80. Using the ratio of 150:1, Dr. Marx converted the CD/PDD mechanical license fee of [redacted] (the penny rate adjusted by average song length) to a per-play total streaming royalty of [redacted] 3/20/17 Tr. 1848:4-1849:7 (Marx); Trial Ex. 1065, Marx WDT ¶¶ 107-109. From this, Dr. Marx was able to calculate the percentage of Spotify revenue that the per-play total streaming royalty represents. Trial Ex. 1065, Marx WDT ¶ 111. She did this by multiplying [redacted] by the number of streams played during a period (calculated using Spotify data) and dividing the results by Spotify's total revenue during the same period. 3/20/17 Tr. 1852:1-7 (Marx); Trial Ex. 1065, Marx WDT ¶¶ 110-111. Subtracting her estimate of Spotify's existing interactive streaming performance rate, [redacted] from the total rate of [redacted][2], she obtained an estimate of [redacted] for the interactive streaming mechanical royalty. 3/20/17 Tr. 1852:8-1853:8 (Marx); Trial Ex. 1065, Marx WDT ¶ 112. This supports Dr. Marx's overall conclusion that mechanical royalty rates, and musical works rates, should decrease from current rates. Trial Ex. 1065, Marx WDT ¶ 165.

SPFF81. Dr. Marx explored the sensitivity of her calculations to an alternative conversion rate of 1:137 derived in the recent academic paper by Professors Aguiar and Waldfogel noted above. 3/20/17 Tr. 1849:19-24 (Marx); Trial Ex. 1065, Marx WDT ¶ 108. Using this alternative conversion ratio "you still get royalty rates that are below current levels.

[1] This document is the subject of a pending motion for admission by the Services that is to be decided by the Board.

[2] This rate was derived from the [redacted] per-stream rate.

So using that different conversion ratio wouldn't change [the] conclusions[,] based on these benchmarks[,] that reasonable royalty rates are likely lower than current levels." 3/20/17 Tr. 1851:8-25 (Marx).

b. *CD/PDD Percentage of Revenue Benchmark*

SPFF82. Dr. Marx also analyzed the CD/PDD benchmark by calculating the percentage of CD/PDD revenue that current per-song royalty rates imply, and then applying that percentage of revenue to interactive streaming. Trial Ex. 1065, Marx WDT ¶ 113. According to RIAA data from 2015, CD sales have a per-song revenue of $1.24, and PDD sales have a per-song revenue of $1.10. Trial Ex. 1065, Marx WDT ¶ 113. Using these per-song rates and revenue data from the RIAA and Spotify, Dr. Marx calculated the weighted average musical works royalty paid per song for CDs [redacted] and PDDs [redacted] Trial Ex. 1065, Marx WDT ¶¶ 113-114. She then calculated that, if Spotify paid these same royalties, its mechanical royalty rate would be [redacted] (based on CD rate) or [redacted] (based on PDD rate). Trial Ex. 1065, Marx WDT ¶¶ 113-114.

c. *Conclusions Reached from CD/PDD Benchmark Analyses*

SPFF83. [redacted]

[redacted]." Trial Ex. 1065, Marx WDT ¶¶ 165-166; 3/20/17 Tr. 1853:5-8, 1856:11-15 (Marx). [redacted]

[redacted]. 3/20/17 Tr. 1857:24-1858:1; 1853:5-8 (Marx).

d. *Existing Interactive Streaming Statutory Rate Benchmark and Conclusions Reached*

SPFF84. As a second benchmark, Dr. Marx used existing statutory rates for interactive streaming. Trial Ex. 1065, Marx WDT ¶ 91. Although this benchmark was a helpful starting point, Dr. Marx's analysis of the current rate structure concluded that the mechanical-only per-user floor was economically inefficient. Trial Ex. 1065, Marx WDT ¶¶ 14, 103, 135; Section V.C). From this, Dr. Marx concluded that "any movement away from existing rates should be in the direction of lower rates and away from the $0.50 per-subscriber minimum." Trial Ex. 1065, Marx WDT ¶¶ 14, 103.

2. *Benchmarks that Dr. Marx Used Are Appropriate*

SPFF85. The benchmark rates used by Dr. Marx were put in place as a result of settlements, with the CD/PDD mechanical royalty rates established in 2016 and the current interactive streaming mechanical royalty rates established in 2012. 3/20/17 Tr. 1843:8-20; (Marx); 3/29/17 Tr. 3618:11-3619:4, 3717:8-14 (Israelite). All of these rates are appropriate and useful benchmarks because the Section 801(b) factors, including notions of fairness, were reflected in those settlements. 3/20/17 Tr. 1844:7-13 (Marx); *see also* 3/29/17 Tr. 3884:4-3885:1 (Israelite). In particular, if the copyright owners and copyright users failed to reach an agreement, the parties would have had access to the Board to set the mechanical royalty rates; the Board would have done so under the Section 801(b) factors. 3/20/17 Tr. 1844:1-6 (Marx).

SPFF86. Current mechanical royalty rates for interactive streaming are a particularly appropriate benchmark to use because the parties to the settlement agreements were aware that interactive streaming was going to be a prevalent form of music delivery. *See, e.g.*, 3/29/17 Tr. 3831:19-21 (Israelite); 3/28/17 Tr. 3405:4-15 (Timmins); JPFF Section V.E. The settling parties were also similarly situated (with the exact same parties on the side of the

Copyright Owners), negotiating over the exact same rights and under the same regulatory regime as exists today. Further, many of the same business models and service offerings that exist today were present in the market and considered in settlement negotiations (*e.g.*, free-to-the-user services, bundling). 3/29/17 Tr. 3824:9-3836:20 (Israelite); 3/8/17 Tr. 161:15-19, 306:8-308:9; (Parness). These settlements were also heavily invested in by the Copyright Owners and the terms were hard fought. [redacted] 3/29/17 Tr. 3650:4-12 (Israelite). Importantly, the 2012 settlement agreement was [redacted], making it a particularly good benchmark to use to assess the reasonableness of proposed future rates. *Id.* at 3777:12-16 (Israelite); *see* JPFF Section V.E; *compare* Trial Ex. 6013, *with* Trial Ex. 6014 ([redacted].

SPFF87. The 2016 Subpart A settlement is also an appropriate benchmark to ascertain reasonable mechanical royalty rates because the rights implicated in that settlement—permanent digital downloads—are quite similar to streaming. In the case of both PDDs and streaming, the end user is able to listen to music on demand as often as they like, and in both cases users are paying for this right to access musical works. 3/15/17 Tr. 1098:22-1099:16 (Leonard). The musical works at issue are also the same, and the licensors in both cases are the same for all relevant intents and purposes. 3/15/17 Tr. 1098:15-21, 1099:17-25 (Leonard).

SPFF88. Additionally, the Subpart A settlement was very recent (2016) and was entered into in economic circumstances that are similar to those that exist today. *Id.* at 1100:1-7 (Leonard). As Dr. Leonard testified, as between the *Phonorecords I* and *Phonorecords II* settlements, the latter is a better benchmark because it is closer in time. *Id.* at 1093:25-1094:6

(Leonard). The same concept applies to the 2016 settlement, which is even closer in time than the settlements in either *Phonorecords I* or *Phonorecords II*.

SPFF89. The Copyright Owners allege that they were willing to enter into a settlement for the Subpart A rates and litigate with respect to Subpart B rates because they believe that "economically in the five-year period it's…the streaming rate that will matter, not the physical or download rate." 3/29/17 Tr. 3717:8-14 (Israelite). This position does not square with the realities of the marketplace. In 2015, revenues from digital downloads was $2.3 billion—hardly insignificant. 3/29/17 Tr. 3717:24-3818:6 (Israelite); Trial Ex. 6017 (impeachment). Total revenues from interactive streaming for this same time period were $1.6 billion. Trial Ex. 1065, Marx WDT Appendix B, Figure 31. Further, despite the fact that the price of downloads has gone up in recent years, the digital download market is still robust, such that sales revenue for PDDs *increased* in 2016. 3/22/17 Tr. 2592:1-2 (Ramaprasad); 3/15/17 Tr. 1116:19-22 (Leonard). As admitted by NMPA CEO David Israelite, physical and digital mechanical income derived by rightsholders in recent years "is far greater" than that received from streaming. 3/29/17 Tr. 3875:21-3876:11 (Israelite); Trial Ex. 306; 3/20/17 Tr. 1687:23-1689:7 (Page) (stating that publishers "have a broad portfolio of revenues in contrast to the record labels"); Trial Ex. 1061, Page WDT ¶ 37 (discussing the multiple sources of publisher revenues, including performance, mechanical and synchronization revenues).

SPFF90. Notably, the Copyright Owners' purported reason for settling the Subpart A rates in this proceeding—that these rates do not matter because CDs and PDDs are purportedly on the decline—is inconsistent with the Copyright Owners' approach to the *Phonorecords I* proceeding. In *Phonorecords I*, the Copyright Owners recognized that CD sales were decreasing,

but they argued for an increase in Subpart A rates anyway. 3/29/17 Tr. 3819:2-9 (Israelite). When questioned about this on cross examination, Mr. Israelite responded as follows:

> Q. And even in a diminishing market, you felt that it was worthwhile to seek an increase in the rate in *Phonorecords I* for Subpart A activity, correct?
>
> A. Absolutely, yes.

3/29/17 Tr. 3819:10:14 (Israelite).

B. Shapley Value Provides Further Support for an Overall Imputed Mechanical Rate [redacted].

SPFF91. To inform her analysis of reasonable royalty rates, Dr. Marx conducted a Shapley value analysis to corroborate her benchmarking analysis.[3] Trial Ex. 1065, Marx WDT ¶ 136. In economics literature, the Shapley outcome has been given the interpretation of being an embodiment of fairness, which is not a uniquely defined term in economics. 3/20/17 Tr. 1826:7-9 (Marx); Marx WDT ¶ 137. The Shapley method has been recognized by the Board as a reliable and valid way to carry out the statutory mandate of setting royalties. Trial Ex. 1065, Marx WDT ¶ 138. Importantly, the Shapley value is not used to set a market rate, to determine what the actual rate should be, or to approximate market outcomes. 3/20/17 Tr. 1832:4-13 (Marx). Rather, it is used as a tool to adjust whatever rate is found in the market upwards or downwards to comport with the notion of fairness and to reflect the relative roles of the parties coming together to create value. 3/20/17 Tr. 1832:14-19 (Marx).

SPFF92. Dr. Marx used a Shapley analysis to give an economic interpretation to the second and third Section 801(b) factors (which are discussed more fully in the Joint PCL, and below), which discuss the notions of fair return and income and the relative roles of copyright owners and copyright users. 3/20/17 Tr. 1825:24-1826:12 (Marx). The Shapley value analysis

[3] From his Shapley analysis, the Copyright Owners' expert Dr. Watt ultimately arrives at a similar conclusion—the total royalties paid by Spotify should go down. *See* JPFF Section X.C.

informs a fair division of surplus/value between copyright holders and copyright users based on their relative contributions. 3/20/17 Tr. 1826:3-12 (Marx); Trial Ex. 1065, Marx WDT ¶¶ 136-137; 3/27/17 Tr. 3056:20-3057:7 (Watt) (stating that "it's wonderful that this Shapley modeling is being embraced by both [sides]…the Shapley model accommodates two of these [Section 801(b)] factors perfectly, the second and third"); 3/30/17 Tr. 3970:15-22 (Gans) (stating that "I opined that the Shapley value approach could actually be applied fruitfully for thinking about the level—level of interactive streaming rates"). Dr. Marx used Shapley value to assess the direction in which current royalty rates should be adjusted (if any) to ensure that each market player receives a fair return based on their marginal contribution to the total surplus.[4] This analysis provides a comparison of current rates to a hypothetical market with a "fair" allocation of surplus, which reveals the direction in which royalty rates should be adjusted. Trial Ex. 1065, Marx WDT ¶¶ 136-137. In this sense, the Shapley value considers all of the value that is being created by the combination of copyright owners and copyright users and distributes that value so that each of the players has a profit level that reflects their Shapley value. 3/20/17 Tr. 1869:5-11 (Marx).

SPFF93. Dr. Marx conducted two separate Shapley analyses using slightly different structures for her models. Trial Ex. 1065, Marx WDT ¶ 147. By conducting two analyses, Dr. Marx was able to test the robustness of her baseline model and the insights about the directional change for fair royalty rates relative to current values suggested by that model. Trial Ex. 1069, Marx WRT ¶ 187. Both Dr. Marx's "baseline model and [her] alternative model suggest that

[4] Dr. Marx did not use the exact numerical values calculated in her Shapley analysis because the Shapley value often suffers from data availability problems where some of the inputs can only be estimated imprecisely. Trial Ex. 1065, Marx WDT ¶ 139. Accordingly, Dr. Marx investigated the sensitivity of the Shapley results to a reasonable range of estimates and used Shapley value to provide insights about the appropriate directional change for fair royalty rates relative to current values to corroborate the results of her benchmarking analysis. Trial Ex. 1065, Marx WDT ¶¶ 136, 139.

interactive streaming's mechanical royalty rates should be reduced from their current level." Trial Ex. 1069, Marx WRT ¶ 185.

SPFF94. To conduct both Shapley analyses, Dr. Marx included both actual revenue generated and costs incurred from available data to generate that revenue by copyright owners and copyright users because both inputs are necessary to assess the value created by all participants. 3/20/17 Tr. 1870:9-24 (Marx); Trial Ex. 1065, Marx WDT ¶ 147; *compare id.*; *with* 3/30/17 Tr. 4123:10-24 (Gans) (using global growth projections to estimate revenue, instead of actual revenue, and estimated future costs instead of actual cost numbers for Shapley inputs), *and* 3/27/17 Tr. 3140:9-20 (Watt) (using projected costs based on assumptions for Shapley inputs). Using actual revenues and costs is superior to projected revenues and costs because it requires less assumptions and more accurately reflects the relative contribution of the parties. *See* 3/20/17 Tr. 1867:14-20 (Marx); Trial Ex. 1069, Marx WRT ¶¶ 124, 127, 183.

SPFF95. The first Shapley analysis that Dr. Marx conducted was a baseline Shapley analysis with three players: one upstream music copyright holder (*i.e.*, combining record labels and publishers into one upstream entity), interactive streaming services and other distribution types. 3/20/17 Tr. 1871:9-14 (Marx). This model appropriately incorporated the "possibility of substitution that interactive streaming affects the revenues that are available to other distribution types." 3/20/17 Tr. 1871:15-19 (Marx). This allows the notion of opportunity cost to be captured, of which cannibalization is one of those costs. 3/20/17 Tr. 1871:18-19 (Marx). By modeling copyright owners as a single market player upstream and interactive streaming services and other distribution types as two separate downstream players, Dr. Marx also adjusted the model for

monopoly power.[5] Trial Ex. 1065, Marx WDT Figure 32, Appendix B; 3/20/17 Tr. 1862:24-1863:8 (Marx) (stating that she tried to "develop a model that models a fair market -- I am going to try to model the market in a way that is not going to be affected, not going to have asymmetries in the market power of the players in my model").

SPFF96. [redacted] 3/20/17 Tr. 1879:12-19 (Marx). [redacted]. Trial Ex. 1065, Marx WDT ¶ 161. Thus, the fairness component of the Section 801(b) factors suggests that interactive streaming's mechanical rates should be reduced from their current levels. Trial Ex. 1065, Marx WDT ¶ 161.

SPFF97. The second Shapley analysis conducted by Dr. Marx broke out the rightsholders into two separate players, publishers and labels, and kept the remainder of the model the same as in her baseline model. 3/20/17 Tr. 1881:17-1882:9 (Marx). Breaking out the rightsholders was necessary to separately allocate musical works and sound recording royalties and to address the bargaining power issue. 3/20/201 Tr. 1872:2-10 (Marx). Since the two rightsholders provide complementary rights, it was expected that the total royalties in this second Shapley analysis would be higher: As both parties have veto power (*i.e.*, no value is created unless both musical works and sound recording copyrights are provided) and provide a necessary and complementary input, the total value that is captured/provided by those complementary players was increased in this analysis. 3/20/17 Tr. 1883:16-1884:9 (Marx).

[5] Market power needs to be adjusted for in any Shapley value analysis—as Dr. Marx did and as the Copyright Owners' expert Dr. Richard Watt's admits in his academic publication (Trial Ex. 1713)—to yield a distribution of surplus that is consistent with the second and third objectives of the Section 801(b)(1) factors. 3/20/17 Tr. 1863:3-1864:5 (Marx).

SPFF98. The alternative Shapley value analysis [redacted]. 3/20/17 Tr. 1883:16-1884:9 (Marx). This analysis reinforces "the benchmarking analysis conclusion that royalty rates for interactive streaming should decrease from current levels." 3/20/17 Tr. 1884:22-25 (Marx).

SPFF99. [redacted]. In light of the economic inefficiency of the per-subscriber floor (*see* Section V.C, *infra*), Dr. Marx opined that one way to lower royalties is to remove the current mechanical-only floor. 3/20/17 Tr. 1833:25-1834:5 (Marx); Trial Ex. 1065, Marx WDT ¶ 165. Removing the mechanical-only floor achieves the objectives of the second and third Section 801(b) factors while minimizing disruption consistent with the fourth factor.

V. SPOTIFY'S RATE PROPOSAL BEST ALIGNS INCENTIVES BETWEEN COPYRIGHT OWNERS AND THE SERVICES

In addition to the sound economic justifications for Spotify's rate proposal Spotify's proposed revised backstops provide appropriate protection to Copyright Owners.

A. For Portable Standalone Subscription Services, Spotify's Proposed Subminima Serve as Additional Protections for Copyright Owners

SPFF100. For the reasons discussed above, a percentage of revenue royalty structure promotes price discrimination among low willingness-to-pay consumers. *See* Section III.A, *supra*. The Copyright Owners object on the basis that a percentage of revenue structure puts them at the mercy of the Services' business models. Spotify's proposal for its paid service

addresses this concern by defining the all-in royalty pool as the *greater of* (A) 10.5% of service revenue and (B) a backstop defined by the lesser of 80¢ per subscriber (with student and family plan discounts) and 21% of total content costs ("TCC"). *See also* Section VI.C.1, *infra* (discussing the necessity of student and family plan discounts).

SPFF101. Spotify's rate proposal balances downside protection to the Copyright Owners and benefits all of the parties by allowing the Services to engage in price discrimination. In particular, the formula ensures that Copyright Owners realize a fair return even if Services use interactive streaming as a loss leader (which Spotify does not do), while also allowing the Services to utilize price discrimination to maximize revenue and royalties paid. 3/20/17 Tr. 1833:22-1834:5 (Marx). In addition, retaining the 80¢ subminimum in the royalty structure protects the Services against a substantial increase in label rates from current levels. *Id*. Notably, as described below, this backstop is reasonable from an economic perspective so long as it serves as a protection mechanism and is not typically binding on the Services. 3/13/17 Tr. 561:5-563:7 (Katz).

1. *A Per-User Backstop in a Percentage of revenue Rate Structure is Appropriate and Serves as a Proper Backstop to the 10.5% of Revenue Calculation*

SPFF102. A per-user backstop—as opposed to a per-play backstop—is appropriate because a per-user backstop does not increase the marginal cost of a stream above zero so as to create incentives for the Services to limit streaming and user engagement. *See* Section III.A, *supra*. At the same time, a per-user backstop protects the Copyright Owners from the possibility that the Services will set prices too low, reducing royalties owed under a pure percentage of revenue structure. 3/20/17 Tr. 1967:7-11 (Marx) ("[redacted]

[redacted]

[redacted]"). Further, the per-user backstop directly correlates to the Services' unit of monetization for subscription services, the per-user per month fee.

SPFF103. The Copyright Owners' own economic expert agrees that the unit of importance for subscription services is the number of *users*, not the number of streams. 3/27/17 Tr. 3036:8-13 (Watt) ("So it seems to me rather than streams being the -- the unit that is of importance here, it's consumers, it's subscribers, the whole -- it seems to me, at least my understanding is that pricing is -- is done in respect of -- of subscribers. So a unit would be a subscriber rather than a stream."). Conversely, any per-play backstop would be "a kind of bundle of really bad incentives." 3/21/17 Tr. 2021:20-21 (Marx). In particular, a per-play backstop

> goes in the direction of encouraging the Services to charge per play. And that creates deadweight loss, and that's the kind of thing we've just been talking about. In addition, it provides incentives for them to cap usage. And that's reducing quantity. That's also creating additional deadweight loss. It provides incentives for them to manipulate things, for example, by streaming longer songs, by inserting delays between songs, by reducing investment in cuing [*sic*] up songs efficiently in order to get more streams per hour to a listener. It provides incentives for them to be more aggressive about making sure there's actually a listener -- that you are actively listening, so more hassle cost of reassuring the system that you're still there. So there's this set of incentives that I -- I think are unfortunate and would be better to be avoided.

Id. at 2021:23-2022:16 (Marx).

SPFF104. As such, the 80¢ per-subscriber ensures a fair return to Copyright Owners. 4/7/17 Tr. 5578:14-5579:7 (Marx) ([redacted]); 4/6/17 Tr. 5258:18-5259:5 (Leonard); 4/6/17 Tr. 5302:14-17 (Vogel) ([redacted]

[redacted]). If 10.5% of revenue should ever fall below the backstop, the "greater of" calculation overrides, and the Copyright Owners will receive 21% of TCC (as discussed immediately below), up to a maximum of 80¢ per-subscriber (with appropriate student and family discounts, *see* Section VI.C, *infra*). 4/7/17 Tr. 5583:1-10 (Marx) (describing the backstop "relative to the 10 and a half percent of revenue," such that were the 10 and a half percent of revenue ever to go below 80 cent per-subscriber, "then the 80 cent per-subscriber would kick in," thus "protect[ing] the Copyright Owners against the possibility of revenue mis-measurement").

SPFF105. The 80¢ per-subscriber subminimum also provides protection for the Copyright Owners that are calculated independently of the Services' revenue. As explained by Dr. Marx, "[t]he Copyright Owners would be much worse off without the 80 cent prong, if there were revenue mis-measurement because then they would get only 10 and a half percent of mis-measured revenue." 4/7/17 Tr. 5583:16-19 (Marx); *see also* 3/20/17 Tr. at 1833:25-1834:3 ("the 80 cent per-subscriber minimum protects against a substantial increase in rates from current levels and addresses revenue measurement…"); Trial Ex. 1065, Marx WDT ¶ 78. The 80¢ per-subscriber minimum also helps the Services by providing an effective cap to the amount the Copyright Owners can receive as a percentage of sound recording royalties. 4/7/17 Tr. 5582:6-8 (Marx) ("So [the 80¢ per-subscriber minimum] provides protection to the Services in that sense, that they are less vulnerable to a manipulation of the sound recording royalties."); 3/13/17 Tr. 686:5-17 (Katz); 3/15/17 Tr. 1200:4-8 (Leonard).

SPFF106. [redacted] 3/20/17 Tr. 1901:7-1902:20 (Marx) [redacted]

[redacted]

2. *The 21% TCC Subminimum Further Protects The Copyright Owners*

SPFF107. Next, the 21% of TCC minimum provides a floor based on the percentage of music label payments, which, like the 80¢ per-subscriber minimum, protects Copyright Owners from depressed revenues. Trial Ex. 1065, Marx WDT ¶ 134 fn. 137. Moreover, Spotify's proposed 21% of TCC minimum [redacted], thus further alleviating the Copyright Owners' concerns with revenue deferment, revenue hiding, or revenue mis-measurement issues. *See* Trial Ex. 924, SPOTCRB0006029, Agreement between [redacted] (2013); Trial Ex. 925, SPOTCRB0006218, Agreement between [redacted] (2011); Trial Ex. H-2765, SPOTCRB0005548, Agreement between [redacted] (2013).

SPFF108. In essence, the 21% of TCC works toward a fair return to the Copyright Owners by protecting them against revenues that are too low and do not provide that fair return. 3/13/17 Tr. 685:8-686:1 (Katz).

SPFF109. Taken together, the "lesser of" 80¢ per-subscriber and the 21% of TCC minima within the "greater of" formula is an elegant solution that protects the Copyright Owners from falling Service revenues and the Services from runaway content costs. 3/13/17 Tr. 598:22-599:13 (Katz) (explaining how the Copyright Owner would want a guaranteed return on licensing out the musical works, and the minima help provide that return); *see also* 3/15/17 Tr. 1200:4-16 (Leonard) (explaining how the minimum would kick in to protect the Copyright Owners should the revenue, including paid service revenue declines to a certain point); 4/6/17 Tr. 5257:2-18 (Leonard).

3. *Spotify's Proposed Subminima Also Provide Protection Against Any Revenue Mismeasurement or Loss Leader Strategies*

SPFF110. The Copyright Owners argue that a percentage of revenue structure is fraught with unfairness and cannot provide a fair return to the rightsholders because of revenue displacement or revenue deferment. 3/30/17 Tr. 4222:3-21; 4225:7-9 (Rysman). As discussed in more detail throughout, there is no evidence that Spotify has deferred revenue, tried to cross-sell other services or products, or in any way avoided fully monetizing its offerings. *See* Sections III.A.3 & 4, *supra*; *see also* Trial Ex. 695, Leonard WRT ¶¶ 83-86; 4/6/17 Tr. 5263:2-10 (Leonard) ("Opportunistic is what you're talking about -- the service is sitting there saying if all I do is I just stick the money over here and I hide it here and I don't put it here -- when I said there's no evidence of that, I mean, I literally have seen no evidence that that's what's going on."). Even Dr. Rysman, one of the Copyright Owners' experts, admits that [redacted]. 4/3/17 Tr. 4255:1-7 (Rysman).

SPFF111. For the same reasons that Spotify's proposal protects against low monetization, the subminima protect Copyright Owners from any kind of revenue mis-measurement. Marx WDT ¶ 14; 4/7/17 Tr. 5581:13-5584:20 (Marx) (explaining how the "lesser of" calculation between 21% of TCC and 80¢ per-subscriber minimum, embedded in the "greater of" calculation (greater of 10.5% of revenue or 21% of TCC capped at 80¢ per-subscriber) protects against revenue mis-measurement in the portable mixed-use category); *see also* 3/13/17 Tr. 598:5-21 (Katz) (the "primary reason" to keep the minima in the current rate structure "is because of the measurement issues that can come up when having royalties based on a [] percentage of revenues because there can be issues of how to appropriately assign revenues to a service."). The reasons for low revenue may vary, but whatever the reason, Spotify's proposal protects the Copyright Owners. *See, e.g.*, 3/8/17 Tr. 233:16-21 (Levine) ([redacted]); 3/13/17 Tr. 598:22-599:13 (Katz) (minima protect the Copyright Owners from services with low rates of monetization); 4/7/17 Tr. 5584:9-13 (Marx) (minima protect against revenue mis-measurement).

SPFF112. The Copyright Owners' own expert, Dr. Rysman, in contrast, ignores the subminima derived from the sound recording rights (21% of TCC) and the per-subscriber per-month minimum rates (80¢ per-subscriber minimum), which would protect rightsholders against any revenue measurement or transparency issues. Trial Ex. 695, Leonard WRT ¶ 86; 4/5/17 Tr. 5168:15-5169:6 (Leonard) ([redacted]). Further, any argument that the Services can hide revenue under the 21% of TCC is a red herring because there is no evidence that any of the Services, particularly, Spotify, engages in any kind of revenue gamesmanship. *See* Section III.A, *supra*.

B. Spotify's Proposed TCC Prong For Ad-Supported Protects Against Revenue Deferment

SPFF113. As discussed above, there is no evidence in the record that Spotify is actually using its ad-supported tier to defer revenue or to cross-sell other services or products. *See*, *e.g.*, 3/28/17 Tr. 3468:15-3470:24 (Barry) (testimony stating that Mr. Barry has not seen anything indicating that Spotify uses its streaming service to cross-sell other services or products, nor has he seen any evidence that Spotify will do so in the future).

SPFF114. But to further protect Copyright Owners, Spotify's rate proposal for its ad-supported tier consists of a "greater of" 22% of TCC *or* 10.5% of revenue, to provide additional protection to Copyright Owners. *See* 3/13/17 Tr. 598:11-21 (Katz) (minimas can protect Copyright Owners from issues on how to appropriately assign revenue to a service in a percentage of revenue rate structure); *id.* at 598:22-25 (minimas also protect Copyright Owners from services with low rates of monetization). Both Drs. Leonard and Marx agree that a TCC (derived from payments to sound recording owners) is a reasonable back-stop for the percentage of revenue calculation in the case of uncertain revenue allocations or other revenue displacement issues. *See* 4/7/17 Tr. 5600:2-11 (Marx); 4/6/17 Tr. 5226:5-12 (Leonard); *see also* ¶ 107, *supra*. And in fact, Spotify has previously [redacted]. *See* Vogel WDT ¶ 13.

C. Elimination of the Mechanical-Only Floor Allows for Price Discrimination

SPFF115. As discussed in detail in the Joint Proposed Findings of Fact, [redacted]. *See* JPFF Section V.C. Rather, the per-user floor was included in the 2012 settlement as a threat to prevent *voluntary* agreements wherein a Service offered to pay a PRO a high performance royalty rate

and thereby reduce or eliminate its mechanical royalty obligations, *not* because of some idea that a certain percentage of the total publishing royalty should be "mechanical only." *See, e.g.*, 3/8/17 Tr. 259:12-260:7 (Levine).

SPFF116. And indeed, [redacted]. *See* 3/13/17 Tr. 623:2-624:12 (Katz) ([redacted]); 3/15/17 Tr. 1084:24-1085:13 (Leonard) ([redacted]).

SPFF117. In fact, the 50-cent floor is inefficient precisely because it is *mechanical-only*. As Dr. Leonard explains:

> To the extent streaming requires both mechanical and public performance rights, they are complementary rights, with one having little or no value absent the other. This creates a "Cournot complements" problem, whereby independent sellers of complementary products may each price inefficiently high because each does not take into account the negative externality on the other of increasing its price. When the Cournot complements problem exists, joint selling of a package consisting of the complementary products leads to a lower overall price, greater output, and increased economic efficiency. The analogous action here is to sell a package of the mechanical and public performance rights for an all-in rate. *If the sum of the rates for separately negotiated mechanical and public performance rights was greater than the all-in rate, that would represent a relatively inefficient outcome.* Thus, it makes sense to limit the total payments to the publisher to the all-in rate and eliminate the mechanical-only floor fees.

Trial Ex. 695, Leonard WDT ¶ 56 (emphasis added); *accord*, Trial Ex. 885, Katz WDT ¶¶ 87-88, 93-94 (same, and also noting that a "triggering of the mechanical-only floor [due to fragmentation in the performance rights marketplace after 2012] would have nothing to do with an increase in the intrinsic value of performance rights or mechanical rights. Rather, 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"); 3/15/17 Tr. 1191:24-1192:6 (Leonard); 3/13/17 Tr. 587:13-588:24, 602:1-604:25 (Katz); *see also* 3/13/17 Tr. 562:23-563:7 (Katz) (no economic justification for the existence of the mechanical floor).

SPFF118. In addition, the 50-cent mechanical-only floor is unnecessary to protect the Copyright Owners from loss leader pricing strategies and revenue mis-measurement because the TCC and its respective 80¢ floor also protect them. *See* Sections V.A & V.B, *supra*; 3/20/17 Tr. 1963:5-14, 1833:22-1834:5 (Marx); 3/13/17 Tr. 598:2-25 (Katz).

SPFF119. [redacted] *See, e.g.*, 4/7/17 Tr. 5571:21-23 (Marx) [redacted]); 4/6/17 Tr. 5302:4-6 (Vogel) [redacted]); Trial Ex. 1062, Vogel WDT ¶¶ 18-20; Trial Ex. 1065, Marx WDT ¶ 76; Trial Ex. 1060, McCarthy WDT ¶ 66.

SPFF120. In 2015, Spotify paid an effective mechanical royalty rate of [redacted] for its paid subscription service. Trial Ex. 1065, Marx WDT ¶ 79; Trial Ex. 1062, Vogel WDT ¶ 18. Combined with its PRO payments of [redacted] this yields a total effective musical works rate of [redacted] of revenue, which [redacted]. *Id.* Likewise, for its ad-supported service, because Spotify's effective rates are [redacted], its mechanical royalties in 2015 were [redacted] of revenue, and total effective musical works rate was [redacted] of revenue, which is again [redacted] *Id.* at ¶ 86; Trial Ex. 1062, Vogel WDT ¶ 13. And 2015 was not an outlier—Spotify regularly

pays [redacted] minima in the rate formula, principally [redacted]. *See* ¶¶ 17-18, 20.

SPFF121. [redacted] Trial Ex. 1062, Vogel WDT ¶ 18 (paid tier); Trial Ex. 1060, McCarthy WDT ¶¶ 65-66 (both tiers). ([redacted]. *See, e.g.*, Trial Ex. 1062, Vogel WDT ¶¶ 13, 17).

SPFF122. [redacted]. Trial Ex. 1062, Vogel WDT ¶¶ 28-29, 31; Trial Ex. 1060, McCarthy WDT ¶ 69. However, as discussed above, these discounted student and family plans enable Spotify (and other Services) to capture segments of the market willing to pay more than zero, but unwilling or unable to pay the full cost of an undiscounted subscription. *See* Section III.A, *supra*; *see also, e.g.*, Trial Ex. 1062, Vogel WDT ¶¶ 30-32; Trial Ex. 1060, McCarthy WDT ¶ 67 ([redacted]; *id.* at ¶¶ 67-68 ([redacted]); *id.* at ¶ 69 ("[redacted]

[redacted]); *id.* at ¶ 78 [redacted]).

SPFF123. Thus, the per-user floor unfairly sets a higher effective mechanical rate for lower-priced plans, such as student and family plans, which increases the costs of these different pricing schemes. Trial Ex. 1062, Vogel WDT ¶ 28; *see also* 4/6/17 Tr. 5301:23–5302:3 (Vogel) (describing how elimination of the mechanical-only floor would allow Spotify the flexibility to offer different pricing schemes aimed towards students and families with lower willingness-to-pay). Capturing these segments of the market grows the overall pie (and eliminates deadweight loss). *See generally* Section III.A, *supra*.

SPFF124. [redacted] For example, in 2015, Spotify's average all-in royalty rate for its paid service, before applying [redacted]. Trial Ex. 1062, Vogel WDT ¶ 17. Removing the mechanical-only floor, in combination with Spotify's proposed accommodations for student and family plans, allows Spotify greater pricing flexibility, enabling it to capture segments of the market willing and able to pay more than free, but less than $9.99 per month. *See* Trial Ex. 1062, Vogel WDT ¶ 32; Trial Ex. 1060, McCarthy WDT ¶ 67; 4/6/17 Tr. 5301:23–5302:3 (Vogel) ("A lot of those [student and family] subscribers are subscribers that we believe will pay for something greater than zero, but would not be willing to pay $9.99. So this would allow us to have the flexibility where we could grow those subscribers in a profitable way."). This allows Spotify to make music available to lower willingness-to-pay consumers and

mitigate deadweight loss. *See* Trial Ex. 1065, Marx WDT, fig. 25; 3/21/17 Tr. 2018:6–12 (Marx) (discussing Figure 25's portrayal of how to best maximize total surplus to the consumer).

SPFF125. Elimination of the 50-cent floor would achieve nearly a [redacted] reduction in mechanical royalty rates, which is a small step towards achieving Spotify's target gross profit margin of [redacted] or, a reasonable state of financial health. *See* 4/6/17 Tr. 5294:21-25 (Vogel); 3/21/17 Tr. 2051:19-2052:9 (McCarthy).

D. Spotify's Rate Proposal Gives It a Chance at Viability

SPFF126. The record reflects that Spotify's revenue has grown rapidly, resulting in increased payments to rightsholders. 3/21/17 Tr. 2039:22-2040:15 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶¶ 4-8, 11. It is an undisputed fact, however, that despite Spotify's growth, it loses money, and as Spotify has grown, its losses have only increased. 3/21/17 Tr. 2040:16-19, 2041:16-25 (McCarthy) ([redacted]); Trial Ex. 1060, McCarthy WDT ¶¶ 16-17; *see also* 3/28/17 Tr. 3420:15-18 (Timmins) (admitting Spotify is not currently profitable). [redacted]. Trial Ex. 1060, McCarthy WDT ¶¶ 18-19 ([redacted]). [redacted]. 3/21/17 Tr. 2045:24-2046:1 (McCarthy) ([redacted]).

SPFF127. Spotify has been able to finance these losses to date, but the company would have no ability to do so if investors were to no longer believe in the viability of the business (*i.e.*, that the business over time will become profitable). 3/21/17 Tr. 2043:10-21 (McCarthy); *see also* 4/6/17 Tr. 5300:4-15 (Vogel) [redacted]

[redacted]); 3/22/17 Tr. 2371:5-2372:13 (Pakman) (tweaking the mechanical royalty rate, and thus, shifting gross margin somewhat in either direction, is meaningful to a venture investor's decision about whether a company can become profitable). [redacted] *See, e.g.*, 3/21/17 Tr. 2043:22-2044:1 (McCarthy); *see also* JPFF ¶ 202 (the Copyright Owners' proposal would virtually guarantee that Spotify would not have a viable business in the United States).

SPFF128. [redacted]. 3/21/17 Tr. 2044:25-2045:11 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶ 28; *see also* 3/21/17 Tr. 2044:2-24 (McCarthy) ([redacted]. 3/21/17 Tr. 2078:8-14 (McCarthy). *Compare id.*; *with* McCarthy WDT ¶ 18 [redacted]).

SPFF129. [redacted] (Trial Ex. 1060, McCarthy WDT ¶ 29) [redacted] (3/21/17 Tr. 2045:12-16 (McCarthy) [redacted] (3/21/17 Tr. 2131:9-2132:8 (McCarthy)). *See also* 4/6/17 Tr. 5299:10-24 (Vogel) [redacted]).

[redacted]. *See, e.g.*, 3/21/17 Tr. 2045:12-23 (McCarthy).

SPFF130. [redacted]. *See id.*; 3/21/17 Tr. 2045:24-2046:11 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶ 29; *see also* Trial Ex. 1060, McCarthy WDT ¶¶ 21, 23-25; 3/21/17 Tr. 2044:2-24 (McCarthy) ([redacted]); Trial Ex. 1060, McCarthy WDT ¶¶ 31-34 ([redacted]).

SPFF131. [redacted]. Trial Ex. 1060, McCarthy WDT ¶ 29; *see* 3/21/17 Tr. 2047:1-2048:9 (McCarthy) ([redacted]); *id.* at 2048:10-23 ([redacted]); *see also id.* at 2070:15-2071:14 [redacted]); Trial Ex. 1060, McCarthy WDT ¶¶ 30-54 ([redacted]); *cf.* 3/14/17 Tr. 876:15-21 (Herring) ([redacted]).

SPFF132. [redacted] 3/21/17 Tr. 2050:2-2051:3 (McCarthy); Trial Ex. 1068, Vogel WRT ¶ 15 ([redacted]).

SPFF133. [redacted]. *See, e.g.*, 4/6/17 Tr. 5299:15-24 (Vogel).

SPFF134. [redacted] (*id.*); [redacted]. *See, e.g.*, 3/21/17 Tr. 2052:6-22 (McCarthy); *see also* 4/6/17 Tr. 5301:7-5302:6 (Vogel) ([redacted]); 4/7/17 Tr. 5577:15-24 (Marx) ([redacted]).

SPFF135. Spotify has never been profitable, and as Mr. McCarthy testified, [redacted]. 3/21/17 Tr. 2040:16-19 (McCarthy) (explaining that the [redacted] as revenues increased); *see* Trial Ex. 1060, McCarthy WDT ¶¶ 24, 28-30, 55. Over [redacted] of Spotify's total spending consists of royalty costs. *See* 3/21/17 Tr. 2045:24-2046:1 (McCarthy). And as explained in detail in the Joint Proposed Findings of Fact, Section VIII.C, Spotify cannot [redacted]. *See* 3/21/17 Tr. 2047:4-2048:13 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶¶ 31-45, 47-54, 55-58. Thus, in order to achieve Spotify's target gross profit margin of approximately [redacted] in royalty rates (including mechanical, performance, and sound recording royalties). *See* 4/6/17 Tr. 5293:8-15 (Vogel); 3/21/17 Tr. 2046:2-11 (McCarthy).

SPFF136. [redacted]

[redacted] 3/21/17 Tr. 2052:6-22 (McCarthy).

VI. SPOTIFY'S PROPOSED TERMS ARE REASONABLE AND CALCULATED TO ACHIEVE THE STATUTORY OBJECTIVES

Under Spotify's proposal, the royalty payments flowing to the Copyright Owners will grow as the company's revenue grows, benefiting the Services and the Copyright Owners alike. 3/21/17 Tr. 2065:21-2066:1 (McCarthy). Every part of Spotify's proposal is motivated by and in line with the 801(b) factors, as detailed below.

A. Spotify's Proposed Definition of Revenue Ensures Fair Returns to Copyright Owners

SPFF137. The fact is that the percentage of revenue royalty structure works. *See* Section III.A, *supra*. As discussed in the Services' Joint Findings of Fact, Sections I, II, and III, revenue for the Copyright Owners has steadily increased, more music than ever is being consumed, and the music industry itself is facing a renaissance. In fact, it was the percentage of revenue rate structure that was specifically bargained for in the *Phonorecords I* and *Phonorecords II* settlements because the participants knew it allowed for predictable costs and flexibility in pricing; it is a rate structure that can easily adapt to ever-fluctuating consumer demands. *See, e.g.*, 3/8/17 Tr. 171:1-5 (Levine) ("[A]dditionally we like percentage of revenue because it's -- there is a proportion to how much revenue that we get. So it is -- it enables us to grow our business with some predictability of what our cost structure will be."); *id*. at 237:19-24 ([redacted]

[redacted]

[redacted]

[redacted]).

SPFF138. Doing away with the percentage of revenue rate structure simply to prevent potential revenue measurement issues is indeed tantamount to "throwing the baby out with the bathwater." Any perceived inequities of Copyright Owners can be addressed through a more precise definition of "service revenue." Spotify's proposal does just that, and therefore closes the loophole created by the current definition in the regulation. Specifically, the proposed language defines an "Service Revenue" as it relates to the only kind of bundling in which Spotify engages, is

> (6) 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, and where at least one of the products or services are offered by a party *unaffiliated* with the party offering the 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 *net revenue realized by the party offering the music service*, unless such revenue also contains revenue realized for one or more non-music products or services, in which case recognized revenue shall be calculated as in part (5), above. (emphasis added).

Spotify's proposed revisions to the regulations leave no room for the revenue mismeasurement in third-party bundles that the Copyright Owners complain of.

SPFF139. Currently, "Service Revenue" is "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…." 37 C.F.R. § 385.11. The Copyright Owners' expert, Dr. Rysman, claims that this definition of "Service Revenue" allows a service to subtract certain amounts from its recognized revenue for a third-party bundle like the New York Times/Spotify bundle.

See Rysman WRT ¶¶ 36-37. This purported "issue" the Copyright Owners proclaim to identify can easily be solved with a slight tweak to the current definition of service revenue. Under Spotify's proposed definition, the net revenue realized (rather than recognized, from an accounting standpoint) from the third party bundle ("where at least one of the products or services are offered by a party *unaffiliated* with the party offering the music service engaged in licensed activity") (emphasis added) means the portion of revenue that Spotify actually retains from the bundling deal. Because there is no accounting adjustment to realized revenues, the definition ensures that the Copyright Owners are getting their fair share of royalties from exactly the net amount of revenue Spotify is actually receiving for the bundle.

SPFF140. By accounting for net realized revenue for Spotify's third-party bundles, Spotify's proposed change to the definition of "Service Revenue" ensures that Spotify cannot attribute zero revenue to any third-party bundle that it uses to foster sales for its music streaming business, and any potential revenue mismeasurement concerns are obviated.

B. Spotify's Proposed Audit Right Provides Further Protection to Publishers

SPFF141. The Copyright Owners' witnesses have acknowledged that audit rights are beneficial to publishers. 3/27/17 Tr. 3219:24-3220:8 (Kokakis) ([redacted]). The Copyright Owners' alleged concerns regarding a percentage of revenue rate structure doesn't require an overhaul of the rate structure—it could instead be simply addressed with revisions to the existing terms, like the addition of an audit

right. *See* 3/29/17 Tr. 3844:6-3845:19 (Israelite) (discussing whether the Copyright Owners have ever proposed any further protection in the form of an audit right in the event they wanted to be able to verify that revenue was being properly designated or attributed).

SPFF142. Spotify currently has [redacted]. 4/3/17 Tr. 4486:6-11 (Brodsky). Sony/ATV has [redacted] Mr. Brodsky submitted sworn testimony in this proceeding accusing Spotify of improperly calculating the TCC prong. *See* Brodsky WDT ¶ 71.

SPFF143. Therefore, this Board should adopt Spotify's proposed audit right provision, thus addressing any concerns with potential lack of transparency in revenue calculations. 3/20/17 Tr. 1961:9-16 (Marx).

C. Discounts for Family and Student Plans in the Per-Subscriber Subminimum Appeal to Lower Willingness-to-Pay Consumers

1. *Student and Family Plans Benefit Copyright Owners*

SPFF144. Student discounts provide more income to Copyright Owners, as it captures those consumers further down on the demand curve—a fact acknowledged by other rightsholders. *See* Trial Ex. 1060, McCarthy WDT ¶ 67 (discussing how Spotify shared data on demand among lower willingness-to-pay users for a discounted student tier with labels, and labels agreed to share in this additional revenue source). As Mr. McCarthy testified, Spotify had [redacted] 3/21/17 Tr. 2053:22-2054:6 (McCarthy); 3/21/17 Tr. 2053:22-2054:6 (McCarthy); *see also* 3/21/17 Tr. at 2189:7-14 (Hubbard) (expanding the customer base by offering services at different price points increases the total

revenue pool for Copyright Owners); 3/15/17 Tr. at 1224:7-1225:2 (Leonard) (discussing how bundling sorts customers according to willingness-to-pay by moving down the demand curve, and getting as many consumer through the door as possible at different price points generates revenue for the Copyright Owners).

SPFF145. Although students are avid consumers of music, they may have smaller spending budgets. 3/15/17 Tr. 1323:1-3 (Mirchandani); 3/14/17 Tr. 892:23-24 (Herring). Through student plans, these young listeners develop the habit of paying for music, rather than turning to free services or piracy. 3/14/17 Tr. 892:25-893:2 (Herring); 3/15/17 Tr. 1323:5-6, 1325:13-16 (Mirchandani). When these students graduate and enter the job market, the Services can convert them from a student plan to regular paid subscription plans. 3/14/17 Tr. 893:2-6 (Herring).

SPFF146. Similarly, family plans attract both younger and older audiences, traditionally segments of the population that are extremely difficult to monetize through advertising, into the habit of listening to music and adding to the revenue pie. 3/14/17 Tr. 893:7-894:8 (Herring). A typical family would be highly unlikely to add a full-price streaming plan for each teenager in the house, but more likely to pay an extra $5 per month to allow all the household members to stream music. Accordingly, family plans deliver more revenue, which gets passed on to the Copyright Owners, than can be achieved through individual plans. 3/15/17 Tr. 1322:17-21 (Mirchandani).

2. *Discounts Grow the Pie for All by Monetizing Lower Willingness-to-Pay Consumers*

SPFF147. Student and family plans exist to target consumers with lower willingness-to-pay. *See, e.g.*, 3/20/17 Tr. 1894:19-1895:2 (Marx); 3/22/17 Tr. 2457:17-2459:11 (Dorn). Significantly, these plans attract more users into the music ecosystem and increase the likelihood

of converting those low willingness-to-pay listeners into future regular subscribers. 3/22/17 Tr. 2457:17-2459:11 (Dorn); 3/15/17 Tr. 1322:17-21, 1323:6-12 (Mirchandani). Effective price discrimination can efficiently monetize consumers and grow the pie for everyone involved. *See* ¶¶ 54, 56-57, *supra*.

SPFF148. Spotify's proposal is designed to incentivize this type of efficient downstream price discrimination. In particular, Spotify proposes to retain the 80¢ per-user subminimum in step 1 of the current royalty structure, but to adjust it to reflect a deduction for the price discrimination for student and family plans by adjusting this subminimum for these categories to 40¢ and $1.20, respectively. Spotify's Rate Proposal, Appendix A; 4/6/17 Tr. 5301:17-23 (Vogel). In particular, with each student account considered as 0.5 a subscriber (a 40¢ minimum) and each family account considered as 1.5 subscribers (a $1.20 minimum), [redacted] efficiently. *See* Section III.B, *supra*.

SPFF149. The 80¢ per-user subminimum effectively destroys value for the Services, rightsholders, and potential listeners because it [redacted], even though these plans increase profit to rightsholders (both initially and when the students/family members eventually become regular subscribers) and increase the overall amount of music consumed on the service. Trial Ex. 1060, McCarthy WDT ¶¶ 67, 69; Trial Ex. 1062, Vogel WDT ¶ 28; Trial Ex. 1065, Marx WDT ¶ 14 ("A high per-subscriber rate structure discourages interactive streaming services from expanding the market to consumer groups, such as students, with a higher elasticity of demand for streaming."). The per-user floor also introduces pricing risk [redacted]

[redacted]. Trial Ex. 1062, Vogel WDT ¶ 28. In fact, though the discounts apply to a certain subset of accounts (student or family), the net increase in royalties provides overall increased royalties to the Copyright Owners. 4/3/17 Tr. 4406:24-4407:14 (Rysman) (agreeing that each and every user, including those students and families receiving discounts, contributes to an increase in historical royalties); 3/21/17 Tr. 2052:23-2053:6 ([redacted]).

SPFF150. Reducing the 80¢ per-user subminimum for student and family plans would result in more money to the Copyright Owners because it will enable the type of pricing flexibility to enable monetizing these traditionally hard-to-reach consumers. In this way, Spotify's proposal supports the first 801(b) factor. *See* Section VIII.A, *infra*. The second and third fairness 801(b) factors are also served by Spotify's proposal because the Copyright Owners are receiving royalties commensurate with the value that the customer is ascribing to the musical work. *See* Section VIII.B, *infra*. Also, because the student and family plans are adding incremental subscribers to the pool, the Copyright Owners are receiving royalties that would otherwise be left uncaptured. 3/14/17 Tr. 893:7-894:8 (Herring) (explaining that from family plans allow the Services to "monetiz[e] in a subscription environment an audience that would otherwise not subscribe" and capture an audience that is very hard to monetize from advertising, thereby increasing overall royalty payments to the Copyright Owners).

D. Deductions for Carrier Billing and App Store Fees Benefits Everyone in the Value Chain

SPFF151. Under the current rate structure, certain costs are borne by only the Services, even though those costs, which are prerequisites for enabling certain distribution channels, benefit all of the parties in the value chain. Therefore, all parties should share in those costs. 3/15/17 Tr. 1328:15-17 (Mirchandani) ("I look at [carrier and app store] costs as

distribution costs, which really help us expand our customer base."). In particular, mobile carriers and app stores allow the Services to reach a broader customer base, which benefits everyone in the chain, including rightsholders. *Id.* at 1326:4-11 (Mirchandani) ("So we distribute our services both through app stores and mobile carriers. These are important distribution channels. They allow us to reach a much broader customer base. They also make it easier for customers to pay for their subscriptions, which reduces friction.").

SPFF152. Mobile carriers are necessary not only to provide access to a wider potential audience for the Services' music offerings, but also to facilitate ease of payment, by allowing customers the option to add costs of purchase (*e.g.*, subscription purchases) to their next mobile phone bill. Trial Ex. 1, Mirchandani WDT ¶ 88. Meanwhile, app stores are required for customers to make digital music-related purchases, including streaming service subscription purchases, both through the app stores and through certain specific apps as in-app purchases. *Id.* Credit card commissions and other similar payment process charges are also costs that expand the subscriber base by allowing customers to pay for purchases, such as subscriptions, via electronic methods in a technologically-savvy and cashless society. Trial Ex. 695, Leonard WDT ¶ 75; *see also* 3/15/17 Tr. 1155:13-1156:5 (Leonard) (explaining that bargaining with the credit card company for lower fees on subscriptions would be difficult). Facilitating streaming through mobile carriers and app stores further maximizes the availability of creative works to the public, thereby further advancing the first 801(b) factor.

SPFF153. However, the fees and commissions associated with maximizing the availability of the works on these distribution channels can be costly, if not cost-prohibitive to the Services, who are the only ones currently responsible for these costs. For example, [redacted]

. 3/16/17 Tr. 1400:14-20 (Mirchandani) (

. *Id.* at 1400:21-1401:3 (

); *id.* at 1402:1-7 (

).

SPFF154. In essence, the Services are paying distribution fees for the Copyright Owners' musical works, to the benefit of the Copyright Owners, who are receiving royalties for services that would not have been accessed *but for* the existence of the carriers, app stores, and electronic payment options. *See* Amazon Trial Ex. 1, Michandani WDT ¶¶ 88-89; Trial Ex. 695, Leonard WDT ¶ 77.

. 3/20/17 Tr. 1870:16-24 (Marx). Placing the burden entirely on the Services flies in the fact of the second and third 801(b) factors for two reasons. First, the Services alone bear the costs of the distribution channels for

streaming; the Copyright Owners do not contribute to these costs but do receive a return on their works. Second, the Services' investments, particularly in opening new markets for creative expression, are not taken into account.

SPFF155. The more equitable approach is to share the burden of the carrier billing costs, app store commissions, credit card commissions, and similar payment processing charges with the rightsholders through a deduction. *See* 3/15/17 Tr. 1326:23-1327:5 (Mirchandani) ("I think those are unique channels that when we access, they allow us to bring many more customers into our service. They also introduce a new cost of distribution. And I think that, I think it is worthwhile for everyone in the value chain to absorb that cost because of the ability to expand the number of customers we reach."). This is exactly what Spotify's rate proposal offers. Further, any deduction is capped at 15% of revenue, which ultimately provides protection to the Copyright Owners. *See* Trial Ex. 1, Mirchandani WDT ¶¶ 88-89; Trial Ex. 695, Leonard WDT ¶ 77.

E. Limiting "Plays" to Those of 30 Seconds or More (Excluding Under-30-Second Tracks) Is Standard Industry Practice

1. [redacted]

SPFF156. [redacted] *See, e.g.*, Trial Ex. 924, SPOTCRB0006029, [redacted]; Trial Ex. 925, SPOTCRB0006218, [redacted]; Trial Ex. 2765, SPOTCRB0005548, [redacted].

SPFF157. For example, in Spotify's agreement with [redacted] Trial Ex. 924 at p. 16 (emphasis added). [redacted] Trial Ex. 2765 at p. 14 [redacted] (emphasis added). Also instructive are similar provisions in other [redacted] label agreements [redacted]. *See* Trial Ex. 925 at p. 8 [redacted] (emphasis added).

SPFF158. As further evidence, other services, including [redacted] have agreements with record labels memorializing the industry standard. Trial Ex. 2736, AMZN00063084, Agreement between [redacted] and [redacted] at p. 4 ("Play" is defined as "[redacted]"); Trial Ex. 2739, AMZN00004685, Agreement between [redacted] at p. 28 ("Play" is defined as "[redacted]").

2. *Publishing Agreements Are In Accord that Under-30s Plays Receive No Royalties*

SPFF159. Other Services also have *publisher* agreements that abide by this industry standard. For example, pursuant to its license agreements with the major publishers, [redacted]. 3/22/17 Tr. 2529:14-23 (Dorn); *see also* Trial Ex. 1612R, Dorn WRT ¶ 30; Trial Exs. 1432R-1435R. Specifically, in [redacted]. Trial Ex. 1432R at p. 4. Further, in [redacted] Trial Ex. 2787 at p. 2. Apple's agreement with [redacted] also includes a provision that [redacted] Trial Ex. 3386 at p. 2; *see also id*. at p. 4 [redacted]).

3. *And Indeed, the "30 Second" Rule Is A Widely-Known Industry Standard, As It Accurately Tracks Consumer Demand for On-Demand Plays*

SPFF160. It is an accepted industry standard that only streams of 30 seconds or longer constitute royalty-bearing activity. 3/22/17 Tr. 2505:23-2506:5 (Dorn) ("So equal or greater to 30 seconds, 30 seconds is an industry standard at this point...."); Trial Ex. 1617R Ghose WDT ¶¶ 54, 60 nns. 94, 108 (citing "Royalties: How Many Seconds Counts As A Stream?," Spotify Community, August 16, 2013, https://community.spotify.com/t5/Newcomers-

and-Contribution/Royalties-How-many-secondscounts-as-a-stream/td-p/505614; Trial Ex. 1569, Richard Smirke, "U.K. Singles Chart To Incorporate Music Streams For First Time," *Billboard*, June 23, 2014, http://www.billboard.com/articles/columns/chart-beat/6128763/uk-singles-chart-to-incorporate-music-streams-for-first-time).

SPFF161. In fact, Billboard expressly provides that "[a] song has to be listened to for 30 seconds in order to register as a qualified stream." Trial Ex. 1569. Nor can the Copyright Owners disavow Billboard as *the* industry standard—several of the Copyright Owners' own witnesses referred to it as an industry standard in their own testimony. For example, David Kokakis, Executive Vice President and Head of Business and Legal Affairs, Business Development, and Digital and Universal Music Publishing Group ("UMPG"), describes [redacted]. 3/27/17 Tr. 3267:23-3268:2 (Kokakis). Moreover, a stream of a track that lasts for less than 30 seconds (excluding tracks that are, in their entirety, under 30 seconds) does not constitute user engagement or an active listening experience. 3/22/17 Tr. 2506:3-22 (Dorn); 3/23/17 Tr. 2869:24-2870:15 (Ghose) ("Well, because when you have streaming that is less than 30 seconds, there could be any number of reasons, not genuinely linked to accurate demand. So they could be an accidental click from a consumer that is charged for streaming, only for the person to realize he or she did not intend to click on it. There could be a consumer who decides to click on it, but after 15 seconds, stops because he or she realizes this is not the kind of music or song that he or she wanted to listen to.").

SPFF162. To this end, the 30 seconds rule relates directly to what is considered a meaningful listening experience, free from skips, accidental plays, searching, and the like. 3/22/17 Tr. 2506:5-22 (Dorn) ("We believe that anything below 30 seconds is not really a

listening experience. Beyond 30 seconds, we believe that the music fan is actually engaged and listening and that is an active listening experience"); *see also* 3/23/17 Tr. 2869:24-2870:15 (Ghose); *see also* Trial Ex. 1066, McCarthy WRT ¶ 61. The entire industry has adopted this standard: the record labels, publishers, and Services all agree that only streams of 30 seconds or more are royalty-bearing. *See* ¶¶ 157-160, *supra*.

4. *Fairness Also Dictates That the Definition of "Play" Should Exclude Under-30-Second Streams (Unless a Track Is, In Its Entirety, Under 30 Seconds)*

SPFF163. Fairness is a tenet of both the second and third 801(b) factors (discussed in more detail in the Joint Conclusions, and below) and has been touted by the Copyright Owners themselves as an important consideration for royalty payments. 3/30/17 Tr. 3991:3-15 (Gans) (explaining that every economist has considered the fairness objectives embodied in the Section 801(b)(1) factors); *see also* 3/20/17 Tr. 1825:24-1826:12 (Marx) ("The second and third factors talk about fair return and fair income and that the royalty payments should reflect the relative roles of the copyright owners and copyright user…."); *id*. at 1831:19-1832:3 (Marx); 4/5/17 Tr. 4929:3-8 (Katz) ([redacted]).

SPFF164. When a song is streamed for a *de minimis* period of time, there is a clear implication that the consumer did not want to hear the song and "skipped" it, and a further implication that the consumer is not getting any value from that song. *See* Trial Ex. 1611R, Dorn WDT ¶ 87 ("Because streaming a song for less than 30 seconds signals that a consumer does not want to hear that song, the copyright owner should not be paid a royalty for that song because there is no demand for the song."); *see also* Trial Ex. 1066, McCarthy WRT ¶ 61 [redacted]

[redacted]). Under the current rate structure, paying royalties for these skips shifts compensation between individual copyright owners by unfair means, where certain songs can be overcompensated through numerous skips or fraudulent streams (both of which have no consumer value), and other songs can be undercompensated even where consumers are actually listening to and enjoying those songs. Fairness thus dictates that rightsholders should not receive royalties from fraudulent streams and skips. *Id.*

5. *A "Play" Should Also Exclude Fraudulent Streams*

SPFF165. Finally, the proliferation of new technologies, such as bots, to drum up royalties through fraudulent plays dictates that the definition of "Play" should be made explicitly clear to exclude any such attempts to game the system. 3/23/17 Tr. 2870:16-21 (Ghose) (describing bots that can essentially automate the process of starting streaming, resulting in, for example, 50 continuous replications of the same stream from the same device, all of which are not meaningful streams and should not be counted as such). Notably, the Copyright Owners' proposal does not exclude, much less address such fraudulent streams in their rate proposal. *See generally* Trial Ex. 1677R, Copyright Owner's Proposed Rates and Terms.

SPOTIFY PROPOSED CONCLUSIONS OF LAW

The Services have jointly submitted a Joint Proposed Conclusions of Law ("JPCL" or "Joint Conclusions"), setting forth the legal conclusions that bear upon the determination of rates and terms at issue in this proceeding The following Spotify Proposed Conclusions of Law apply the relevant legal principles to facts (detailed above) that are specific to Spotify, and to Spotify's own proposed rates and terms in this proceeding.

VII. SPOTIFY'S BENCHMARKS ARE THE MOST RELEVANT AND APPROPRIATE BECAUSE THEY ARE BETWEEN COMPARABLE PARTIES AND FOR THE EXACT SAME RIGHTS

SPCL1. The key to benchmarking is comparability. *See* JPFF Section IX (discussing Dr. Eisenach's inappropriate benchmark analysis); *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1012 (D.C. Cir. 2014) (affirming Board's rejection of benchmarks based on insufficient comparability); *Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding*, 74 Fed. Reg. 4510, 4519 (Jan. 26, 2009) ("Phonorecords I") ("Potential benchmarks are confined to a zone of reasonableness that excludes clearly noncomparable marketplace situations."); *id.* (rejecting the synch license benchmark because "the musical works inputs in the synch market are used in very different ultimate consumer products by different input buyers as compared to the target market and the input sellers may have different degrees of market power in the benchmark market as compared to the target market").

SPCL2. As discussed in the Joint Conclusions, the Copyright Owners' expert, Dr. Eisenach's, use of a benchmark ratio using the relative value of sound recording and musical works rights is flawed precisely because it imports the uneven bargaining power, the different

buyers, different sellers, and different *products* being sold in the sound recording context into this one. *See* JPFF Section IX.B.1. Likewise, the various inputs to Dr. Eisenach's ratio, consisting of performance licenses negotiated with Pandora after publishers withdrew from the PROs, as well as YouTube licenses for *user-generated content* and synch licenses, are simply noncomparable—the last one for the most obvious reason that it was flat-out rejected in the only other *Phonorecords* proceeding. *See* JPFF Section IX.C.3. As the *Phonorecords I* Board recognized, the *mere fact that a musical work is used as an input in both the proposed benchmark market and the target market is not sufficient to overcome…fundamental differences between the proposed benchmark market and the target market even in a purely relative value analysis*." *Phonorecords I*, 74 Fed. Reg. at 4519. Because the Copyright Owners' benchmarks are flawed, so, too, are their use in support of a higher rate level. *See generally* JPFF Section IX.

SPCL3. On the other hand, Dr. Marx's benchmarks best support Spotify's proposed rate structure and rate levels because they involve similarly-situated buyers, the exact same sellers, the exact same rights (mechanicals), and are closest in time to the current proceeding. That is, the Subpart A rates that Dr. Marx uses as a benchmark are the product of a settlement that the parties arrived at *in this very proceeding*. Likewise, the similar circumstances surrounding the negotiation of the *Phonorecords II* settlement is described in detail in the JPFF Section V.D.

SPCL4. [redacted]

[redacted]. This Panel has previously rejected rate structure proposals where the benchmark agreements did *not* support the rate structure advocated for. *See Web IV*, 81 Fed. Reg. at 26,325 (May 2, 2016) ("Additionally, the agreements, or portions of agreements, relied upon by SoundExchange in support of a greater of rate structure, are not contained within the benchmarks relied on by SoundExchange. SoundExchange, through Dr. Rubinfeld, looked at agreements *other than* this benchmark agreements to find rate structures with a percentage of revenue prong. In other words, the agreements that SoundExchange contends are most reflective of the marketplace value of the copyright owners' rights under the statutory licenses do not contain a greater of rate structure.").

SPCL5. Applying Dr. Marx's benchmarks therefore necessitates a downward adjustment to current rate levels, as both benchmarks arrive at an imputed mechanical royalty rate of between [redacted]—much lower than Spotify's current effective mechanical rates of between [redacted]. *See* Marx WDT Figure 24; Figure 16; Figure 21.

SPCL6. Thus Dr. Marx's benchmarks—indeed, the balance of all the relevant benchmark evidence in this proceeding—supports Spotify's proposal of continuing use of a percentage of revenue rate structure, and further counseling against any increase in rate levels.

VIII. SPOTIFY'S PROPOSAL BEST SATISFIES THE OBJECTIVES OF SECTION 801(B)

Not only does benchmark analysis favor adoption of Spotify's proposed rates and terms, but Spotify's proposal also comports with, and best achieves, the objectives of Section 801(b)(1).

A. Maximizing Availability of Creative Works

SPCL7. The first policy objective of the 801(b) factors is to "maximize the availability of creative works to the public." 17 U.S.C. 801(b)(1)(A). This factor is not strictly, nor even primarily, focused on the creation of creative works. Rather, it is to maximize the "*availability*" of works to the public, which means both creation and *public access*. This can only be achieved with a rate structure that creates the greatest access to creative works by the greatest number of consumers, while also maintaining the incentive for songwriters to create those works. For the reasons stated below, Spotify's rate proposal does just that.

1. *Spotify's Proposed Rate Structure Ensures The Greatest Possible Access to As Many Types of Consumers As Possible*

SPCL8. For the reasons discussed in Spotify's Proposed Findings of Fact, *see* Section III, *supra*, maximizing the availability of creative works is best achieved with a rate structure that accommodates different service offerings, which effectively target different consumers with varying willingness-to-pay, and allow the service provider to earn revenue (and generate royalties) at an appropriate level for each of those different groups.

SPCL9. For example, a rate structure that allows for service offerings at different price points—such as through ad-supported services, bundled services, discounted student plans, or optimally-priced family plans—creates access and availability for those consumers who cannot pay $9.99 per month to listen to music. *See* SPFF Section III, *supra*; 3/15/17 Tr. at 1124: 16–1125: 10 (Leonard) (discussing the advantages of being able to offer different types of plans

via price discrimination at the access point, to attract consumers with different willingness-to-pay).

SPCL10. A percentage of revenue rate structure is required for Spotify (and other services) to have the flexibility to employ this type of price discrimination to target these consumers with varying price sensitivities. In addition, Spotify's proposal seeks to make music available to additional consumers by eliminating the subscriber-based floor and adding discounts for student and family plans.

SPCL11. A preservation of the percentage of revenue rate structure also helps maximize availability of music by incentivizing user engagement and active streaming activity rather than disincentivizing it. Under a percentage of revenue rate structure, the marginal cost to Spotify, both of technologically delivering a stream and in royalties for each additional stream, is zero. But under a per-stream royalty structure, such as that advocated by the Copyright Owners, each stream bears a cost, effectively punishing active use of the service and increased listening by consumers. *See* SPFF Section III.A.1, *supra*; 3/15/17 Tr. at 1122:19-1123:25 (Leonard) ("[T]he incremental cost or marginal cost to a musical works rights owner of having one more stream is…zero…. [T]he right way to price it is to…price for access to the library and then let somebody listen as much as they want….you really don't want to punish the usage because, again, the marginal cost is zero"). By divorcing royalty costs from the number of streams, the current percentage of revenue structure allows Services to encourage more streaming, in turn maximizing dissemination of creative works to consumers.

SPCL12. In addition to creating the right incentives to encourage music listening, the percentage of revenue rate structure Spotify proposes also maintains the right incentives for a service like Spotify to continue to promote music *discovery* by its users. Discovery Weekly,

Fresh Finds, Release Radar, Daily Mix, curated mood and other algorithmic and human curated playlists are all tools Spotify provides for users to discover music that is new to them. As noted above, Spotify introduces an artist to a new fan about [redacted] times every month. SPFF ¶ 24. Often these are lesser-known ("long tail") songs. *See* SPFF Section I.C, *supra.* And social features of Spotify's service encourage users to easily share music recommendations with friends, further disseminating the discovered music and exposing artists to more potential fans. SPFF ¶ 27. These tools therefore help maximize the dissemination of musical works, making a much broader range of musical works more accessible to a broader audience. This is the very essence of the first 801(b) factor.

2. *Current Royalty Structures and Rates Preserve Incentive for the Creation of Musical Works*

SPCL13. Even focusing on the creation of musical works by songwriters and publishers, the record shows that the current rate structure and mechanical rate levels continue to incentivize the creation of musical works. The Copyright Owners have not set forth any evidence to the contrary. At best, Copyright Owners have repeated a series of anecdotal stories that they have been telling since *Phonorecords I* (in which CDs were paying a flat penny rate). *See, e.g.*, 3/23/17 Tr. 2955:1-24 (Herbison).

SPCL14. Indeed, to the extent that there has been any decrease in the number of active professional *songwriters* since the last rate determination proceeding, there is no evidence that the decrease is the result of interactive streaming under the current rate structure and rate levels. *See, e.g., id.* at 2954: 25; 2956: 5-7 (confirming that Mr. Herbison does not ascribe "any large percentage" of the loss of songwriters to streaming). As the Copyright Royalty Board has acknowledged, there are *many* reasons that the songwriting occupation is "financially tenuous," and that the statutory rates "alone neither can nor should seek to address" all of these issues. *See*

Phonorecords I, 74 Fed. Reg. at 4523-4524 ("We find no persuasive evidence in the record to support the notion that the current mechanical royalty rates are leading to a shortage of musical compositions. Furthermore, while we acknowledge that the mechanical royalty rate is an important source of income for songwriters, we find no persuasive evidence in the record that an undiminished nominal mechanical rate will fail to ensure adequate incentives for songwriters and publishers over the course of the license period in question."). This is especially true because songwriters and publishers have many different income streams beyond mechanical royalties. *See* JPFF ¶ 56.

SPCL15. Moreover, there is evidence in the record that under current rates, the number of *songs* is actually *increasing*, suggesting that current rates have spurred this growth—or at least not *dis*incentivized the creation of musical works. *See, e.g.*, Trial Ex. 1067, Page WRT ¶¶ 13–15; *see generally* JPFF Section III. This is not surprising, as a percentage of revenue rate structure captures revenue from different consumer groups and maximizes the total revenue the Services can earn from consumers—an upside that is shared with Copyright Owners under a percentage of revenue rate structure.

SPCL16. Thus, Spotify's proposal—based on a percentage of revenue structure and building in discounts for family and student plans—maintains incentive for the creation of works, and maximizes the availability of those works by capturing the broadest possible audience and encouraging the most active engagement and streaming activity—all of which grows the pie for everyone, including the Copyright Owners. Spotify's proposal therefore gives effect to the objective in Section 801(b)(1)(A).

B. Affording the Copyright Owner a Fair Return and the Copyright User a Fair Income

SPCL17. As discussed more fully in the Joint Conclusions, and critical to this analysis, "fair return" to the Copyright Owner *does not mean* "market value"—and it certainly doesn't mean subjective value determined arbitrarily by a copyright owner. *See* JPCL Section XIII.B.1. Yet this is precisely the justification used by the Copyright Owners in their attempt to overhaul the current rate structure in favor of a flat per-play or per-user fee.

SPCL18. Instead, Section 801(b)(1)(B) seeks 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." *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25,394, 25,409 (May 8, 1998) ("Librarian PSS Determination"). The objective of Section 801(b)(1)(B) is to "regulate[] the price of music" to "permit any [licensee] to enter the market at will." *Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates*, 46 Fed. Reg. 10,466, 10480 (Feb. 3, 1981). Unlike the Copyright Owners' proposal, Spotify's percentage of revenue rate structure, set at an appropriate rate, can best achieve the statutory objections of a fair return and income for both the Copyright Owners and Services, for the reasons discussed below.

1. *Spotify's Proposed Rate Structure Provides A Fair Return to Copyright Owners and a Fair Income to Spotify.*

SPCL19. A revenue-based rate structure links revenue growth for the Services with revenue growth for the Copyright Owners, which ensures that the Copyright Owners are capturing as much value as they can without denying the Services a fair income. *See, e.g.*, 3/21/17 Tr. 2065:21-2066:1 (McCarthy) ("[Spotify's] proposal is as we grow, so grows our license fee payments to…Copyright Owners on a percentage basis."); 4/6/17 Tr. 5296:20-5297:1

(Vogel) (stating that Spotify "ha[s] incentives to grow. And as we grow, they'll just grow right along with us."); *id*. at 5302:10-13 ("[W]e believe that as we continue to grow our revenue, which we have every intention to do, the publishers will benefit as our revenue grows."). *See generally* SPFF Section III.A.2, *supra.*

SPCL20. Digital Services are like any other business—they need to grow revenue in order to maximize profits to shareholders. *E.g.*, 4/6/17 Tr. 5299:10-13 (Vogel) ("[A]s any business, our incentive is to grow revenue for business because that's what's healthy for shareholders."); *see also* 4/6/17 Tr. 5238:23-5239:4 (Leonard) ("[L]ook, the service wants to make a lot of revenue. That's, of course in a percentage of revenue setup going to lead to more royalties as well. So there's…a good aligning of incentives.").

SPCL21. Spotify's proposed rate structure would help maximize those revenues—for both services and Copyright Owners—by allowing services to offer different types of plans to consumers with different price sensitivities further down the demand curve. *See* SPFF Section III.A; 3/14/17 Tr. at 885:12-16 (Herring) (Copyright Owners share in upside in a percentage of revenue model through overall growth of the pie); 3/21/17 Tr. at 2189:7-14 (Hubbard) (expanding the customer base by offering services at different price points increases the total revenue pool for Copyright Owners); 3/15/17 Tr. at 1224:7-1225:2 (Leonard) (discussing how bundling sorts customers according to willingness-to-pay by moving down the demand curve, and getting as many consumers through the door as possible at different price points generates revenue for the Copyright Owners).

SPCL22. Record evidence shows that the current percentage of revenue rate structure is working: it is growing the pie for all parties. *See* SPFF Section III.A, *supra*. This includes the Copyright Owners, [redacted]

[redacted] *See* JPFF Section III.A. The Copyright Owners have adduced no evidence whatsoever that Spotify or any other service has "hid" revenue or that current bundling practices have made the current rate structure unfair, unworkable, or impracticable; indeed there is no evidence in the record to support an overhaul of the revenue-based structure, which has been generating for Copyright Owners more than their fair share of income.

SPCL23. Moreover, a percentage of revenue rate fixes royalty costs (as a total percentage of Service costs) so that at least there can be *some* predictability for the Services in their cost structures. *See* JPFF VII.C; 3/8/17 Tr. 171:1-5 (Levine). This is crucial for the Services, including Spotify, whose costs and risks are extremely high. *See* Trial Ex. 1060, McCarthy WDT ¶¶ 24-25, 54; PFF IV.A, VII.B. It also allows for new entrants to enter the market more easily, as it allows content costs to scale as the service grows, rather than making content costs enormous up-front entrance costs. *See* Trial Ex. 1069, Marx WRT ¶ 42.

SPCL24. And other aspects of Spotify's proposal, such as the addition of the per-user and TCC minima backstops for the portable standalone subscription services rate, as well as the audit right and a revised definition of Service revenue, help secure a minimum level of royalties to the Copyright Owners, further assuring a fair return to the Copyright Owners.

SPCL25. For all of these reasons, the statutory objectives set forth in 801(b)(1)(B) support Spotify's proposed rate structure.

2. *A Decrease in Royalty Rates Would Best Effectuate A Fair Income Balanced Against a Fair Return*

SPCL26. In order for Spotify and the other Services to earn a fair income, royalty rates *cannot* go up. Rather, the evidence suggests that royalty *decreases* are needed to effectuate a fair income for the Services, including, especially, Spotify.

SPCL27. The record shows that while the Copyright Owners' revenues are increasing, the Services are struggling to make a profit under the *current rates*—and that many have exited the market. *See* JPFF Section IV. Spotify has *never* made a profit to date, nor have the other stand-alone streaming services been to achieve sustained profitability on a standalone basis—primarily due to the high royalty costs under the current regulations. *See id.*

SPCL28. Dr. Marx also explained how, based on the Shapley value, the current royalty rates do not allow Spotify to earn a fair income, such that rate decreases are warranted. Shapley value is a tool that is used to adjust whatever rates are found in the marketplace upwards or downwards to comport with notions of fairness reflecting the relative roles of parties in a market coming together to create value. SPFF Section IV.B, *supra.* As recognized by this Board, Shapley value is an economically sound way of carrying out the statutory mandate of setting royalty rates. *Id.*

SPCL29. Dr. Marx performed a Shapley analysis to give an economic interpretation to both the second and third 801(b) factors (801(b)(1)(C) is discussed below). Her analyses yielded reasonable royalty rates for sound recording and musical works combined of between [redacted] of revenue and musical works royalties of between [redacted] of revenues, with mechanical royalties in the case of Spotify between [redacted] of revenue. SPFF Section IV.B, *supra*. This represents a decrease from current levels. *Id.*

SPCL30. While the tenuous conditions for growth that the Services currently face suggest that rates should be *decreased*, they show conclusively that a rate [redacted]. The evidence confirms that increasing current rate levels [redacted]. *See* JPFF Section VIII.A. Indeed, [redacted]

[redacted]. JPFF Section VIII.D; *see also* Trial Ex. 1060, McCarthy WRT ¶ 26 (even if the Copyright Owners limited per-user rate to monthly active users, it would still increase mechanicals for the ad-supported service more than [redacted]); Trial Ex. 1068, Vogel WRT ¶ 19 n.13, ¶ 28 n.16 (if the Copyright Owners dropped the per-user rate from their proposal so that the per-stream rate applied to the ad-supported tier, mechanical royalties would [redacted]). Such consequences simply cannot be squared with the goal of providing a fair income to the services.

SPCL31. The evidence clearly shows that Spotify (like other services), [redacted], and in [redacted]. 3/21/17 Tr. 2040:16-19, 2043:3-9 (McCarthy); Trial Ex. 1060, McCarthy WDT ¶¶ 17-19; *see also* JPFF Section IV.B.4. [redacted] are driven primarily by content costs. *Id.* To the extent that the Copyright Owners seek to rely on investor valuation to suggest that Spotify is making a fair income under existing rates (or worse, under proposed rate increases), they misconstrue the nature of this capital. Put simply, investor valuation is based on expectation of future profits; [redacted]. SPFF ¶ 127.

SPCL32. If anything, the Board should move the rate *down* to levels such that the industry—and Spotify in particular—can earn a fair income and [redacted].

C. Reflecting the Relative Roles of the Copyright Owner and the Copyright User in the Product Made Available to the Public

SPCL33. 17 U.S.C. § 801(b)(1)(C) provides that a reasonable royalty rate must "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." Importantly, the "product made available to the public" is not simply the musical work (or collection of musical works); instead, the "product made available to the public" is the ***digital music service in its entirety***. *See Librarian PSS Determination*, 63 Fed. Reg. at 25,408 (CARP's finding that "'product made available to the public' applied to both the sound recordings and the entire digital music service"). *See also* JPCL ¶¶ 42-44.

SPCL34. This factor of the Section 801(b) analysis brings into sharp relief the importance of adopting Spotify's rate proposal. Spotify has been at the forefront of technical contribution, and innovation, in building the industry-leading interactive streaming service. To do so, it has taken on massive costs and risk, and invested enormous amounts of capital, for the very purpose of opening up this new market for the use of musical works, and developing the media for such use. *See* SPFF Section I.B, *supra* (discussing costs and risks borne by Spotify, including technology infrastructure investment in excess of [redacted]). And Spotify continues to enhance and improve its service product, at significant cost, for the benefit of all parties. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080, 4096 (Jan. 24, 2008) ("Satellite I") (concluding that the "relative contribution" factor "may weigh in favor of a discount from the market rate because of the SDARS' demonstrated need to continue to make substantial new investments to support the satellite technology necessary to continue to provide this specific service during the relevant license period"); *Librarian's PSS Determination*, 63 Fed. Reg. at 25,407 (crediting determinations that the PSS had undertaken substantial costs and risks associated with creating

an entirely new market for music services, the very first digital music services, and that market conditions made it unclear whether the PSS could survive).

SPCL35. Spotify has also made significant creative contributions, such as creating innovative discovery tools to bring new music to users, and curating playlists to encourage user engagement. *See* SPFF Section I.C, *supra*; *cf. Librarian PSS Determination*, 63 Fed. Reg. at 25,407 (describing as a key finding that "the Services contribute more to the opening of new markets for creative expression through the development of the digital audio services" because such services "expose the public to a broader range of music than does traditional over-the-air radio. Unlike traditional radio, the Services offer multiple channels for classical, jazz, traditional, alternative, and ethnic formats."). *Id.*

SPCL36. Indisputably, Spotify's discovery tools *alone* offer far greater advancements over the creative tools that were found to weigh in favor of the Services in the *PSS* proceeding. *See* SPFF Section I.C, *supra* (discussing how Spotify's innovative discovery tools remove the barriers to discovery that radio posed through spectrum scarcity, instead offering *each individual user her own, personalized radio station, recommending millions of songs to millions of fans at any given time*). Further, the promotional value of such offerings have, in prior proceedings, been found to actually *decrease* the risk borne by the copyright owners, further tilting the third factor in favor of Spotify's rate proposal. *See Librarian PSS Determination*, 63 Fed. Reg. at 25,408. The variety of ways in which Spotify's music discovery tools promote songwriters, both by "breaking out" new artists and helping them route live tours (which pay performance royalties, among other benefits) are discussed in detail above. SPFF Section I.C, *supra.*

SPCL37. In contrast, the Copyright Owners have contributed nothing technologically to the development of this important market and platform.

SPCL38. Therefore, the third guideline under Section 801(b) heavily supports Spotify's rate proposal, which will allow it to continue to develop this valuable new medium for listening to, discovering, and engaging with digital music. *See Librarian's PSS Determination*, 63 Fed. Reg. at 25,410 (affirming CARP's determination that the third factor supported a PSS rate at the low end of the range because the PSS, by the very development of the first digital music services, contributed more to the opening of new markets for creative expression and new media for their communication).

D. Minimizing Any Disruptive Impact on the Structure of the Industries Involved and On Prevailing Industry Practices

SPCL39. Finally, Section 801(b)(1)(D) requires the setting of "a reasonable rate that minimizes the disruptive impact on the structure of the industries involved and on generally prevailing industry practices." As prior panels have concluded, continuing currently-operative rate structures best avoids disruption. *See Phonorecords I*, 74 Fed. Reg. at 4525; *see also Satellite I*, 73 Fed. Reg. at 4087 (preserving percentage of revenue rate structure where the parties in those proceedings were "most familiar, and perhaps most comfortable, with the operation of" those rate structures, noting that the "value of such familiarity lies in its contribution towards minimizing disputes and, concomitantly, keeping transaction costs in check"); *see generally Web IV*, 81 Fed. Reg. at 26,325 (determining "not to adopt a greater of rate structure" and instead continuing the currently-operative rate structure). In fact, the Board's preference for continuing currently-operative rate structures is so well-established that not a single rate-setting has ever, to date, completely overhauled the rate structure governing that

specific type of service (i.e., per-play for Section 114 services, percentage of revenue for satellite services).

SPCL40. Adoption of Spotify's rate proposal, which essentially continues the status quo with some minor changes to eliminate inefficiencies, will minimize disruptive impact to a music ecosystem that is seeing massive consumer demand for interactive streaming services, a rise in the number of creative works readily accessible by the public, and growing publisher revenue in a post-piracy world. *See generally* JPFF Sections I-III.

SPCL41. By contrast, the Copyright Owners' rate proposal attempts to completely gut the currently-existing structure and move to an entirely new regime. Moving to an entirely new rate structure that sets flat per-play, per-user rates is per se disruptive as it forces changes to generally prevailing industry practices, Spotify's business model and tiers of service, and potentially the very nature of interactive streaming.

SPCL42. The Services, including Spotify in particular, currently rely on user engagement and the all-you-can eat pricing structure as its value proposition to consumers. 3/8/17 Tr. 174:11-175:20 (Levine); 3/21/17 Tr. 2064:6-2065:23 (McCarthy). As Spotify's own evidence reflects, user engagement is the driver for paid subscription growth and customer retention. 3/21/17 Tr. 2058:13-2059:22 (McCarthy); Trial Ex. 1066, McCarthy WRT ¶¶ 58-59. Moving to a flat per-stream rate would set a highly-variable cost on Spotify's core value proposition to consumers. 3/14/17 Tr. 901:9-903:5 (Herring); Trial Ex. 880, Herring WRT ¶ 17; Trial Ex. 1069, Marx WRT ¶ 30 fn. 17; Trial Ex. 1068, Vogel WRT ¶¶ 50-51; Trial Ex. 1066, McCarthy WRT ¶ 40.

SPCL43. In addition, Spotify has relied on its "freemium" model, which utilizes different service tiers to capture consumers with low or no willingness-to-pay for music and shift

them away from piracy first to an ad-supported service and, for [redacted] of its users, a paid subscription service. [cite PFF] A flat, indiscriminate per-user or per-play fee—and the Copyright Owners' proposal in particular—[redacted] that has grown not only the company, but the music industry as a whole. [redacted] the fourth policy guideline under Section 801(b)(1), which requires the setting of a rate level that does not "cause one or all of the Services to abandon the business." *See Librarian PSS Determination*, 63 Fed. Reg. at 25,408.

SPCL44. Indeed, the Copyright Owners' proposal would not merely force Spotify to move away from its [redacted] and promotion of listener engagement; the record reflects that, if the Copyright Owners' proposal were adopted, Spotify's ad-supported tier would be [redacted]. And their proposal would all [redacted] as long as that rate hike is in effect. *See* Trial Ex. 1066, McCarthy WRT ¶ 45; 3/21/17 Tr. 2048:6-9 (McCarthy); *see also* Trial Ex. 1066, McCarthy WDT ¶¶ 20, 31-32; 3/21/17 Tr. 2062:24-2063:19 (McCarthy); Trial Ex. 1068, Vogel WRT ¶ 16. The [redacted]. 4/7/17 Tr. 5501:12–15 (Marx); Trial Ex. 1069, Marx WRT ¶ 37 & Figs. 8, 9, and 38. The disruptive impact of such a change can hardly be overstated. Cf. *Satellite I*, 73 Fed. Reg. at 4097 (determining that a royalty rate could have a disruptive impact "if it directly produce[d] an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either the [services] or the copyright owners to adequately adapt to the changed circumstances produced by the rate change.")

SPCL45. For context, the Panel in *Satellite I* found that increasing what the services were paying from 2.0 to 2.5% of revenues to 13% of revenues—about a 4-fold increase—was disruptive. *Id.* Here, Spotify's evidence shows that Spotify's mechanical royalties would increase [redacted] were the Copyright Owners' rate levels to be adopted. *See* JPFF ¶ 196. Under the reasoning of *Satellite I*, this fourth factor *strongly* counsels against adoption of Copyright Owners' proposal.

SPCL46. Viewed another way, previous Panels have weighed the disruption factor in favor of the services where the impact of rate increases would negatively impact a digital service's ability to "attain[] a sufficient subscriber base." *Satellite I*, 73 Fed. Reg. at 4097. This concern could not possibly apply with more force here, where the evidence reflects that the proposed rate increases would result in [redacted]. And this result would be the same regardless of whether the Copyright Owners change their rate proposal to define streams as those of 30 seconds or more, and users as only encompassing monthly active users. 3/21/17 Tr. 2056:17-2057:7 (McCarthy); 4/6/17 Tr. 5320:7-14, 5326:11-17 (Vogel); 4/7/17 Tr. 5488:12-24, 5490:8-16 (Marx).

SPCL47. Previous Panels have also weighed the disruption factor in favor of the services' proposals where the impact of rate increases would negatively impact a digital service's ability to "generate[] sufficient revenues to reach consistent Earnings Before Interest, Taxes, Depreciation and Amortization profitability or positive free cash flow." *Satellite I*, 73 Fed. Reg. at 4097. Because the Copyright Owners' rate proposal will result in an astounding [redacted], *see* Trial Ex. 1068, Vogel WRT ¶ 16, there can be no question as to the disruptive impact of the Copyright Owners' rate proposal.

SPCL48. Such disruption should be avoided especially where, as here, Copyright Owners have failed to justify their proposed overhaul with any evidence that this disruption would help achieve any other 801(b) policy objective, or is supported by any relevant benchmarks. *See* JPFF IX & JPCL XIV.

SPCL49. Thus, in sum, the fourth 801(b) factor weighs in favor of setting a conservative rate that essentially continues the current rate structure. *See Librarian PSS Determination*, 63 Fed. Reg. at 25,409 (affirming "Panel's determination that the best way to minimize the disruptive impact on the structure of the industries is to adopt a rate from the low range of possibilities").

Dated: May 11, 2017

Respectfully submitted,

MAYER BROWN LLP

/s/ A. John P. Mancini /AYL

A. John P. Mancini
Xiyin Tang
Florina Yezril
1221 Avenue of Americas
New York, New York 10020-1001
Telephone: (212) 506-2295
jmancini@mayerbrown.com
xtang@mayerbrown.com
fyezril@mayerbrown.com

Richard M. Assmus
Kristine M. Young
71 South Wacker Drive
Chicago, Illinois 60606
Telephone: (312) 701-8623
rassmus@mayerbrown.com
kyoung@mayerbrown.com

Anita Y. Lam
Peter O. Schmidt
1999 K St NW
Washington, DC 20006
Telephone: (202) 263-3492
pschmidt@mayerbrown.com
alam@mayerbrown.com

Counsel for Spotify USA Inc.

APPENDIX A

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In the Matter of **DETERMINATION OF RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (PHONORECORDS III)**	)	**Docket No. 16–CRB–0003–PR (2018–2022)**

SECOND AMENDED PROPOSED RATES AND TERMS OF SPOTIFY USA INC.

Pursuant to 37 C.F.R. § 351.4(b)(3), Spotify USA Inc. ("Spotify") proposes the following rates and terms for making and distributing phonorecords under the statutory license provided by 17 U.S.C. § 115 during the period January, 1, 2018 through December 31, 2022.

I. ROYALTY RATES

A. Calculation of Minimum Royalty Rates for All-in Royalty

1. Minimum Royalty Rate

For standalone non-portable subscriptions—streaming only, Spotify requests that the minimum for use as currently set forth in step 1 of 37 C.F.R. § 385.12(b)(1) and 37 C.F.R. § 385.13(a)(1) remain the same.

For standalone portable subscriptions, Spotify requests that the minimum for use as currently set forth in step 1 of § 385.12(b)(1) and 37 C.F.R. § 385.13(a)(3) remain the same.

For free ad-supported users, Spotify requests that the minimum for use as currently set forth in step 1 of § 385.12(b)(1) and 37 C.F.R. § 385.13(a)(5) remain the same.

2. Applicable Percentage of Service Revenue

Spotify proposes that the applicable percentage of service revenue as currently set forth in 37 C.F.R. § 385.12(c) remain the same.

B. Subtraction of Performance Royalties

Spotify proposes that the subtraction of royalties for public performance of musical works from the all-in royalty amount (as set forth currently in 37 C.F.R. § 385.12(b)(1)), shall remain as currently set forth in step 2 of 37 C.F.R. § 385.12(b)(2).

C. Subscriber-Based Royalty Floor

For all licensed activity, Spotify requests a removal of the subscriber-based royalty floor as currently set forth in step 3 of 37 C.F.R. § 385.12(b)(3)(ii) and 37 C.F.R. § 385.13(a)(1) & (3) (for standalone non-portable subscription—streaming only and standalone portable subscription service, respectively).

II. TERMS

A. Late Fees

37 C.F.R. § 385, Subpart B (which applies to interactive streaming services like Spotify) does not include a provision instituting a late fee for payments received by copyright owners after the due date. Spotify proposes that the new rates and terms likewise do not incorporate a late fee component for interactive streaming services.

B. Audit Right

Spotify proposes that an audit right for publishers (upon satisfying a minimum aggregated interactive service share of at least 15%, i.e., a "Qualifying Publisher") be included, subject to elimination of the current self-audit certification obligations as reflected in 37 C.F.R. § 201.16.

Such an audit right for publishers will be subject to the following standard limitations: (1) such audit must be conducted by a Qualified Auditor (i.e., an independent CPA that is licensed in the jurisdiction in which it conducts the verification and is not an employee of a

publisher); (2) a Qualifying Publisher cannot conduct an audit more than once during any 12-month period; (3) the audit would be limited to any or all of the prior 3 calendar years provided that no calendar year will be subject to an audit more than once; and (4) the audit may not be conducted on a contingency fee basis.

C. Definition of Service Revenue

Spotify proposes a revision of the definition of "service revenue" in 37 C.F.R. § 385.11 to include reductions for app store, carrier billing, and credit card transaction fees. Additionally, the definition of "service revenue" will include a section regarding third-party bundles where at least one of the products or services are offered by a party unaffiliated with the party offering the music service engaged in licensed activity. The definition of "service revenue" otherwise remains the same.

D. Family and Student Plans

Spotify proposes certain discounts for family and student plans. The attached proposed rates and terms provide more detail on the applicable definitions of "Revenue" and computation of subscribers for purposes of determining the minimum, among others. Other than the changes shown below in redline, Spotify proposes that the terms currently set forth in 37 C.F.R. § 385 Subpart B be continued.

E. Definition of Play

Spotify proposes a definition for "Play" in 37 C.F.R. § 385.11 to be limited to an interactive stream or limited download play of 30 seconds or more, except a track that is, in its entirety, under 30 seconds, which is a "play" if it is streamed by the end user for the entire duration of the track. A "Play" will also exclude a "Fraudulent Stream."

F. Definition of Fraudulent Stream

Spotify proposes a definition for "Play" in 37 C.F.R. § 385.11 to be defined as a stream that has not been initiated or requested by a human user, where if a single end user plays the same track more than 50 straight times, all plays after play 50 shall be deemed fraudulent.

37 C.F.R. Part 385

[PROPOSED CHANGES FROM CURRENT REGULATIONS IN REDLINE]

Subpart A – Physical Phonorecord Deliveries, Permanent Digital Downloads and Ringtones

§ 385.4 Late Payments

A Licensee under this Subpart A shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment received by the Copyright Owner after the due date set forth in § 201.19(e)(7)(i) of this title. Late fees shall accrue from the due date until payment is received by the Copyright Owner.

Subpart B—Interactive Streaming, Other Incidental Digital Phonorecord Deliveries 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:

Actual carrier billing cost means the sum of amounts paid by the service provider to the applicable wireless carrier (or retained by such wireless carrier as the case may be) during the applicable month for providing an integrated billing system for a particular customer utilizing such applicable service integrated billing system to access a service during such month. The actual carrier billing cost for any particular customer shall in no event be deemed to exceed 10% of the applicable service retail price.

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 multiple end users for a single discounted fee payable via one form of payment.

Fraudulent Stream means a stream that has not been initiated or requested by a human user. 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 track 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 the track. A Play excludes Fraudulent Streams.

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,

(i) Include 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 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)~~ 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) R~~r~~evenue 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, the following kinds of revenue shall be excluded:

(A~~i~~) 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~~ii~~) 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~~iii~~) 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) A~~a~~dvertising, ~~or~~ 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, similar payment process charges, and actual carrier billing cost), 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, and where all products or services are offered by the party offering the 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.

(6) 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, and where at least one of the products or services are offered by a party unaffiliated with the party offering the 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 net revenue realized by the party offering the music service, unless such revenue also contains revenue realized for one or more non-music products or services, in which case recognized revenue shall be calculated as in part (5), above.

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 account means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college geographically located in the United States.

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~~, 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 3 in paragraph (b)(3~~4~~) of this section, using the same alternative methodology as provided in step 3~~4~~.

(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) *Step 4:*~~ 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~~3~~ in paragraph (b)(2~~3~~) 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~~3~~ 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~~4~~ 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 34 in paragraph (b)(34) 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.

[74 FR 4529, Jan. 26, 2009, as amended at 78 FR 67943, Nov. 13, 2013]

§ 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 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 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. A Student account shall be treated as 0.50 subscribers per month, prorated in the case of a Student account 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 [Reserved]

§ 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.

37 CFR Part 210

[PROPOSED CHANGES FROM CURRENT REGULATIONS IN REDLINE]

§ 210.12 Definitions.

As used in this subpart:

…

A Qualified Auditor is an independent CPA that is licensed in the jurisdiction in which it conducts the verification and is not an employee of a Copyright owner.

A Qualifying Publisher is a Copyright owner who has satisfied a minimum aggregated service provider share of 15%.

§ 210.16 Monthly statements of account.

…

(v) Step 5: Multiply by the statutory royalty rate. The total monthly royalty payment is obtained by multiplying the subtotal from Step 3, as adjusted if necessary by Step 4, by the statutory royalty rate set forth in § 385.3 or other provisions of part 385 of this title as applicable.

(3) Phonorecords subject to a percentage rate royalty structure. For phonorecords subject to part 385, subparts B or C of this title, or any other applicable royalties computed on a percentage-rate basis, the amount of the royalty payment shall be calculated as provided in § 385.12, § 385.22, or other provisions of part 385 of this title as applicable. The calculations 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 this section~~. The following additional provisions shall also apply:

(i) A licensee may, in cases where the final public performance royalty has not yet been determined, compute the public performance royalty component based on the interim public performance royalty rate, if established; or alternatively, on a reasonable estimation of the expected royalties to be paid in accordance with GAAP. Royalty payments based on anticipated payments or interim public performance royalty rates must be reconciled on the Annual Statement of Account, or by complying with § 210.17(d)(2)(iii) governing Amended Annual Statements of Account.

(ii) When calculating the per-work royalty allocation for each work, as described in § 385.12(b)(4), § 385.22(b)(3), or any similar provisions of part 385 of this title as applicable, an

actual or constructive per-play allocation is to be calculated to at least the hundredth of a cent (i.e., to at least four decimal places).

(e) Clear statements. The information required by paragraphs (b) and (c) of this section requires intelligible, legible, and unambiguous statements in the Monthly Statements of Account without incorporation of facts or information contained in other documents or records.

~~(f) Certification. (1) Each Monthly Statement of Account shall be accompanied by:~~

~~(i) The printed or typewritten name of the person who is signing and certifying the Monthly Statement of Account.~~

~~(ii) A signature, which in the case of a compulsory licensee that is a corporation or partnership, shall be the signature of a duly authorized officer of the corporation or of a partner.~~

~~(iii) The date of signature and certification.~~

~~(iv) If the compulsory licensee is a corporation or partnership, the title or official position held in the partnership or corporation by the person who is signing and certifying the Monthly Statement of Account.~~

~~(v) One of the following statements:~~

~~(A) I certify that (1) I am duly authorized to sign this Monthly Statement of Account on behalf of the compulsory licensee; (2) I have examined this Monthly Statement of Account; and (3) all statements of fact contained herein are true, complete, and correct to the best of my knowledge, information, and belief, and are made in good faith; or~~

~~(B) I certify that (1) I am duly authorized to sign this Monthly Statement of Account on behalf of the compulsory licensee, (2) I have prepared or supervised the preparation of the data used by the compulsory licensee and/or its agent to generate this Monthly Statement of Account, (3) such data is true, complete, and correct to the best of my knowledge, information, and belief, and was prepared in good faith, and (4) this Monthly Statement of Account was prepared by the compulsory licensee and/or its agent using processes and internal controls that were subject to an examination, during the past year, by a licensed Certified Public Accountant in accordance with the attestation standards established by the American Institute of Certified Public Accountants, the opinion of whom was that the processes and internal controls were suitably designed to generate monthly statements that accurately reflect, in all material respects, the compulsory licensee's usage of musical works, the statutory royalties applicable thereto, and any other data that is necessary for the proper calculation of the statutory royalties in accordance with 17 U.S.C. 115 and applicable regulations.~~

~~(2) If the Monthly Statement of Account is served by mail or by reputable courier service, certification of the Monthly Statement of Account by the compulsory licensee shall be made by handwritten signature. If the Monthly Statement of Account is served electronically, certification~~

~~of the Monthly Statement of Account by the compulsory licensee shall be made by electronic signature as defined in section 7006(5) of title 15 of the United States Code.~~

§ 210.17 Annual statements of account.

(f) ~~Certification. (1) Each Annual Statement of Account shall be accompanied by:~~

~~(i) The printed or typewritten name of the person who is signing the Annual Statement of Account on behalf of the compulsory licensee.~~

~~(ii) A signature, which in the case of a compulsory licensee that is a corporation or partnership, shall be the signature of a duly authorized officer of the corporation or of a partner.~~

~~(iii) The date of signature.~~

~~(iv) If the compulsory licensee is a corporation or partnership, the title or official position held in the partnership or corporation by the person signing the Annual Statement of Account.~~

~~(v) The following statement: I am duly authorized to sign this Annual Statement of Account on behalf of the compulsory licensee.~~**Audit.** (1) A Qualifying Publisher may conduct one audit during the fiscal year, subject to the following limitations:

(i) The audit must be conducted by a Qualified Auditor;

(ii) The audit is limited to any or all of the prior 3 calendar years provided that no calendar year will be subject to an audit more than once; and

(iii) The Audit may not be conducted on a contingency fee basis.

37 C.F.R. Part 385

[PROPOSED CHANGES FROM FIRST AMENDED PROPOSAL IN REDLINE]

Subpart A – Physical Phonorecord Deliveries, Permanent Digital Downloads and Ringtones

§ 385.4 Late Payments

A Licensee under this Subpart A shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment received by the Copyright Owner after the due date set forth in § 201.19(e)(7)(i) of this title. Late fees shall accrue from the due date until payment is received by the Copyright Owner.

Subpart B—Interactive Streaming, Other Incidental Digital Phonorecord Deliveries 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:

Actual carrier billing cost means the sum of amounts paid by the service provider to the applicable wireless carrier (or retained by such wireless carrier as the case may be) during the applicable month for providing an integrated billing system for a particular customer utilizing such applicable service integrated billing system to access a service during such month. The actual carrier billing cost for any particular customer shall in no event be deemed to exceed 10% of the applicable service retail price.

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 multiple end users for a single discounted fee payable via one form of payment.

Fraudulent Stream means a stream that has not been initiated or requested by a human user. 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 track 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 the track. A Play excludes Fraudulent Streams.

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,

(i) Include 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 the value of any barter or other nonmonetary consideration; and

(iii) ~~(iv)~~ 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, 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, similar payment process charges, and actual carrier billing cost), 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, and where all products or services are offered by the party offering the 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.

(6) 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, and where at least one of the products or services are offered by a party unaffiliated with the party offering the 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 net revenue realized by the party offering the music service, unless such revenue also contains revenue realized for one or more non-music products or services, in which case recognized revenue shall be calculated as in part (5), above.

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 account means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college geographically located in the United States.

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—

(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 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 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. A Student account shall be treated as 0.50 subscribers per month, prorated in the case of a Student account 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 [Reserved]

§ 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.

37 CFR Part 210

[PROPOSED CHANGES FROM FIRST AMENDED PROPOSAL IN REDLINE]

§ 210.12 Definitions.

As used in this subpart:

…

A Qualified Auditor is an independent CPA that is licensed in the jurisdiction in which it conducts the verification and is not an employee of a Copyright owner.

A Qualifying Publisher is a Copyright owner who has satisfied a minimum aggregated service provider share of 15%.

§ 210.16 Monthly statements of account.

…

(v) Step 5: Multiply by the statutory royalty rate. The total monthly royalty payment is obtained by multiplying the subtotal from Step 3, as adjusted if necessary by Step 4, by the statutory royalty rate set forth in § 385.3 or other provisions of part 385 of this title as applicable.

(3) Phonorecords subject to a percentage rate royalty structure. For phonorecords subject to part 385, subparts B or C of this title, or any other applicable royalties computed on a percentage-rate basis, the amount of the royalty payment shall be calculated as provided in § 385.12, § 385.22, or other provisions of part 385 of this title as applicable. The calculations 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). The following additional provisions shall also apply:

(i) A licensee may, in cases where the final public performance royalty has not yet been determined, compute the public performance royalty component based on the interim public performance royalty rate, if established; or alternatively, on a reasonable estimation of the expected royalties to be paid in accordance with GAAP. Royalty payments based on anticipated payments or interim public performance royalty rates must be reconciled on the Annual Statement of Account, or by complying with § 210.17(d)(2)(iii) governing Amended Annual Statements of Account.

(ii) When calculating the per-work royalty allocation for each work, as described in § 385.12(b)(4), § 385.22(b)(3), or any similar provisions of part 385 of this title as applicable, an actual or constructive per-play allocation is to be calculated to at least the hundredth of a cent (i.e., to at least four decimal places).

(e) Clear statements. The information required by paragraphs (b) and (c) of this section requires intelligible, legible, and unambiguous statements in the Monthly Statements of Account without incorporation of facts or information contained in other documents or records.

§ 210.17 Annual statements of account.

(f) ~~**Self a**~~**Audit.** (1) A Qualifying Publisher may conduct one audit during the fiscal year, subject to the following limitations:

(i) The audit must be conducted by a Qualified Auditor;

(ii) The audit is limited to any or all of the prior 3 calendar years provided that no calendar year will be subject to an audit more than once; and

(iii) The Audit may not be conducted on a contingency fee basis.

37 C.F.R. Part 385

[CLEAN]

Subpart A – Physical Phonorecord Deliveries, Permanent Digital Downloads and Ringtones

§ 385.4 Late Payments

A Licensee under this Subpart A shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment received by the Copyright Owner after the due date set forth in § 201.19(e)(7)(i) of this title. Late fees shall accrue from the due date until payment is received by the Copyright Owner.

Subpart B—Interactive Streaming, Other Incidental Digital Phonorecord Deliveries 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:

Actual carrier billing cost means the sum of amounts paid by the service provider to the applicable wireless carrier (or retained by such wireless carrier as the case may be) during the applicable month for providing an integrated billing system for a particular customer utilizing such applicable service integrated billing system to access a service during such month. The actual carrier billing cost for any particular customer shall in no event be deemed to exceed 10% of the applicable service retail price.

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 multiple end users for a single discounted fee payable via one form of payment.

Fraudulent Stream means a stream that has not been initiated or requested by a human user. 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 track 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 the track. A Play excludes Fraudulent Streams.

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,

(i) Include 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 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, 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, similar payment process charges, and actual carrier billing cost), 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, where all products or services are offered by the party offering the 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.

(6) 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, and where at least one of the products or services are offered by a party unaffiliated with the party offering the 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 net revenue realized by the party offering the music service, unless such revenue also contains revenue realized for one or more non-music products or services, in which case recognized revenue shall be calculated as in part (5), above.

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 account means an individual subscription that meets at least the following criteria: the individual is enrolled in at least one course at a college geographically located in the United States.

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—

(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 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 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. A Student account shall be treated as 0.50 subscribers per month, prorated in the case of a Student account 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 [Reserved]

§ 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.

§ 210.12 Definitions.

As used in this subpart:

…

A Qualified Auditor is an independent CPA that is licensed in the jurisdiction in which it conducts the verification and is not an employee of a Copyright owner.

A Qualifying Publisher is a Copyright owner who has satisfied a minimum aggregated service provider share of 15%.

§ 210.16 Monthly statements of account.

…

(v) Step 5: Multiply by the statutory royalty rate. The total monthly royalty payment is obtained by multiplying the subtotal from Step 3, as adjusted if necessary by Step 4, by the statutory royalty rate set forth in § 385.3 or other provisions of part 385 of this title as applicable.

(3) Phonorecords subject to a percentage rate royalty structure. For phonorecords subject to part 385, subparts B or C of this title, or any other applicable royalties computed on a percentage-rate basis, the amount of the royalty payment shall be calculated as provided in § 385.12, § 385.22, or other provisions of part 385 of this title as applicable. The calculations 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). The following additional provisions shall also apply:

(i) A licensee may, in cases where the final public performance royalty has not yet been determined, compute the public performance royalty component based on the interim public performance royalty rate, if established; or alternatively, on a reasonable estimation of the expected royalties to be paid in accordance with GAAP. Royalty payments based on anticipated payments or interim public performance royalty rates must be reconciled on the Annual Statement of Account, or by complying with § 210.17(d)(2)(iii) governing Amended Annual Statements of Account.

(ii) When calculating the per-work royalty allocation for each work, as described in § 385.12(b)(4), § 385.22(b)(3), or any similar provisions of part 385 of this title as applicable, an actual or constructive per-play allocation is to be calculated to at least the hundredth of a cent (i.e., to at least four decimal places).

(e) Clear statements. The information required by paragraphs (b) and (c) of this section requires intelligible, legible, and unambiguous statements in the Monthly Statements of Account without incorporation of facts or information contained in other documents or records.

§ 210.17 Annual statements of account.

(f) **Audit.** (1) A Qualifying Publisher may conduct one audit during the fiscal year, subject to the following limitations:

(i) The audit must be conducted by a Qualified Auditor;

(ii) The audit is limited to any or all of the prior 3 calendar years provided that no calendar year will be subject to an audit more than once; and

(iii) The Audit may not be conducted on a contingency fee basis.

CERTIFICATE OF SERVICE

I hereby certify that on May 11, 2017, I caused a copy of the foregoing PUBLIC version of Spotify USA Inc.'s Proposed Findings of Fact and Conclusions of Law to be served by email to the following parties listed below:

SERVICE LIST

Michael S. Elkin Thomas Patrick Lane Daniel N. Guisbond Stacey Foltz Stark Winston & Strawn, LLP 200 Park Avenue New York, NY 10166 melkin@winston.com tlane@winston.com dguisbond@winston.com sfstark@winston.com *Counsel for Amazon Digital Services, Inc.*	R. Bruce Rich Todd D. Larson Benjamin E. Marks David R. Singh Jennifer Ramos Jacob Ebin Weil, Gotshal & Manges LLP 767 Fifth Avenue New York, NY 10153 bruce.rich@weil.com todd.larson@weil.com benjamin.marks@weil.com david.singh@weil.com jennifer.ramos@weil.com jacob.ebin@weil.com Gary Greenstein Wilson Sonsini Goodrich & Rosati PC 1700 K Street, NW, Fifth Floor Washington, DC 20006-3817 ggreenstein@wsgr.com *Counsel for Pandora Media, Inc.*

Dale Cendali Johanna Schmitt Mary Mazzello Claudia Ray Kirkland & Ellis LLP 601 Lexington Avenue New York, NY 10022 dale.cendali@kirkland.com johanna.schmitt@kirkland.com mary.mazzello@kirkland.com claudia.ray@kirkland.com *Counsel for Apple Inc.*	Kenneth Steinthal Joseph Wetzel Katherine E. Merk Ivana Dukanovic King & Spalding LLP 101 Second Street, Suite 2300 San Francisco, CA 94105 ksteinthal@kslaw.com jwetzel@kslaw.com kmerk@kslaw.com idukanovic@kslaw.com J. Blake Cunningham King & Spalding LLP 401 Congress Avenue Suite 3200 Austin, TX 78701 bcunningham@kslaw.com David P. Mattern King & Spalding LLP 1700 Pennsylvania Avenue Suite 200 Washington, D.C. 20006 dmattern@kslaw.com *Counsel for Google Inc.*

Donald S. Zakarin Frank P. Scibilia Lisa M. Buckley Benjamin K. Semel James A. Janowitz William L. Charron Marion R. Harris Joshua Weigensberg Kaveri Arora Dasha Chestukhin Pryor Cashman LLP 7 Times Square New York, New York 10036-6569 dzakarin@pryorcashman.com fscibilia@pryorcashman.com lbuckley@pryorcashman.com bsemel@pryorcashman.com jjanowitz@pryorcashman.com wcharron@pryorcashman.com mharris@pryorcashman.com jweigensberg@pryorcashman.com karora@pryorcashman.com dchestukhin@pryorcashman.com *Counsel for National Music Publishers Association (NMPA) and Nashville Songwriters Association International (NSAI)*	Steve Bene Pandora Media, Inc. 2100 Franklin St., Suite 700 Oakland, CA 94612 sbene@pandora.com *Pandora Media, Inc.*
Elizabeth Miles Robert Windom David Weiskopf Apple Inc. 1 Infinite Loop MS 169-41SM Cupertino, CA 95014 elizabeth.miles@apple.com windom@apple.com dweiskopf@apple.com *Apple Inc.*	Google Inc. 1600 Amphitheatre Parkway Mountain View, CA 94043 kevingm@google.com *Google Inc.*

David M. Israelite Danielle M. Aguirre Erich C. Carey 975 F Street, NW Suite 375 Washington, DC 20004 disraelite@nmpa.org daguirre@nmpa.org ecarey@nmpa.org *National Music Publishers Association (NMPA)*	Barton Herbison Jennifer Turnbow 1710 Roy Acuff Place Nashville, TN 37203 bart@nashvillesongwriters.com *Nashville Songwriters Association International (NSAI)*
George Johnson GEO Music Group 23 Music Square East, Suite 204 Nashville, TN 37203 george@georgejohnson.com *GEO Music Group*	

/s/Anita Lam
Anita Lam