PUBLIC

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)**

WRITTEN REBUTTAL TESTIMONY OF PAUL VOGEL

(On behalf of Spotify USA Inc.)

Introduction

1. My name is Paul Vogel. I am Vice President, Head of Global Financial Planning and Analysis and Investor Relations at the Spotify group of companies ("Spotify"). I previously provided testimony during the direct phase of this proceeding.

2. I offer this rebuttal testimony to address several issues raised in the written direct statements submitted by the National Music Publishers' Association and Nashville Songwriters Association International (collectively, "Copyright Owners"), and to describe the effects of the Copyright Owners' and the Digital Services' rate proposals on Spotify's royalty payments and U.S. earnings before interest and taxes ("EBIT").[1] I discuss these with respect to the Copyright Owners' proposal and other proposals.

1 [redacted]

3. Unless otherwise noted, all calculations refer to the period from [redacted] which I will refer to as the "analysis period."

Background

4. To provide context, I will begin by recapping a number of points from my written direct testimony.

5. Spotify offers two types of streaming music services: a free-to-users ad-supported service, which I will refer to as the "ad-supported" service, and a paid subscription service, which I will refer to as the "paid" service.[3]

6. Both services pay three types of royalties:[4]

(1) royalties to record labels for the use of sound recordings;

(2) royalties to performing rights organizations ("PROs")[5] for the public performance of compositions, which I will refer to as "performance royalties;" and

(3) mechanical royalties to publishers.[6]

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[2] [redacted]

[3] I use the words "service" and "tier" interchangeably in this context.

[4] Unless I specifically say otherwise, my statements in this document refer to our U.S. business.

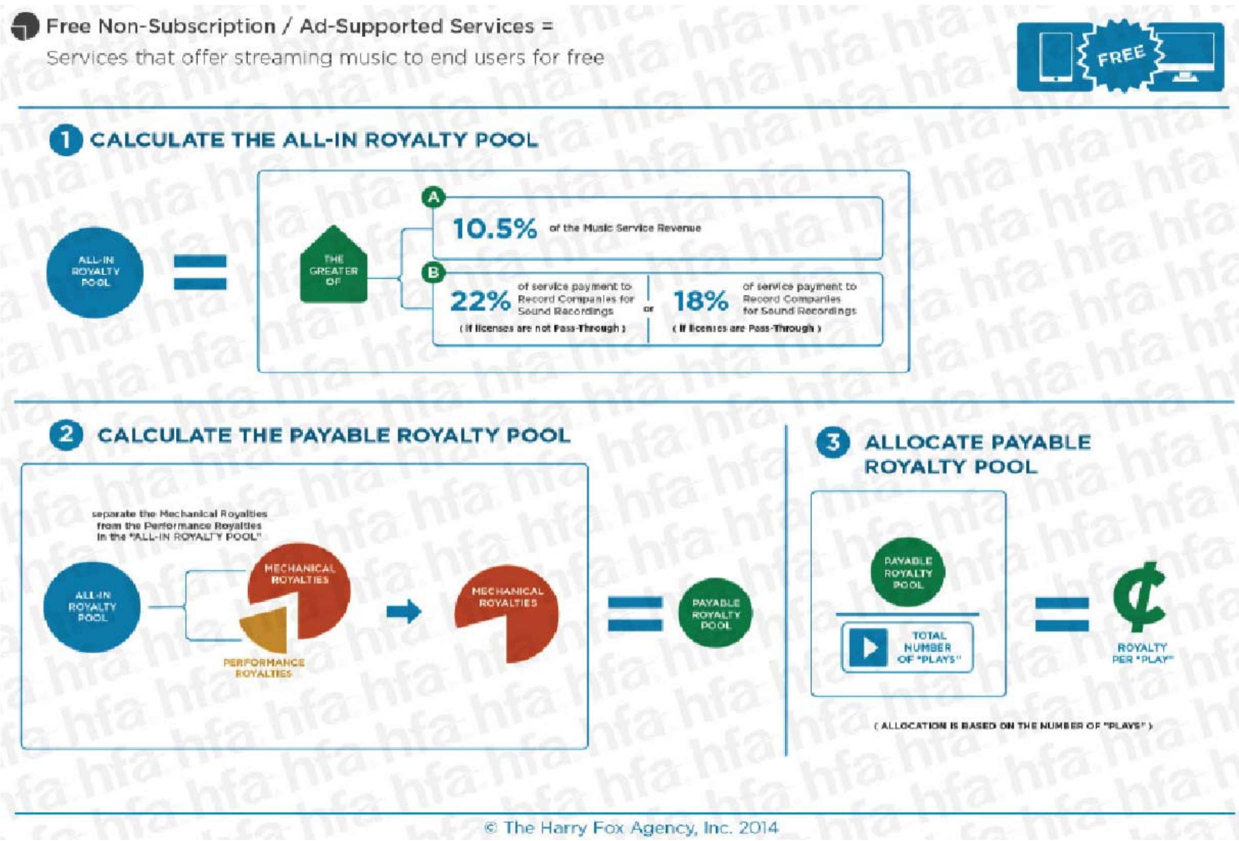
[5] Spotify pays public performance royalties to [redacted].

[6] Spotify works with a third-party agent, the Harry Fox Agency ("HFA"), to administer its mechanical royalty payments in the U.S.

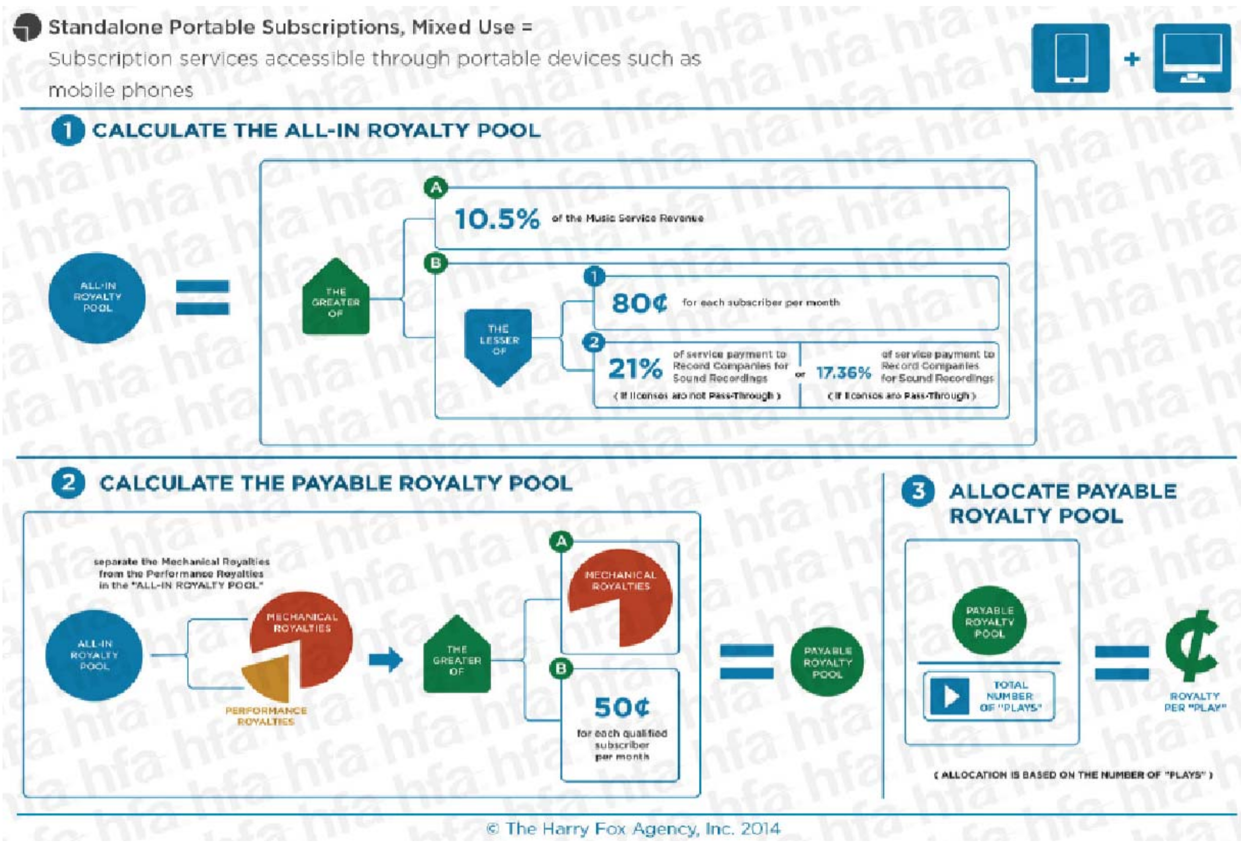
7. Both performance royalties and mechanical royalties flow to publishers and songwriters, and both are for the use of compositions. I will refer to the sum of these as "total composition royalties."

8. The current formulas set forth in Subpart B for mechanical royalties for Spotify's ad-supported and paid services (respectively) are illustrated below.

<u>Current formula for the ad-supported service:</u>



Current formula for the paid service:



Methodology

9. The table below summarizes the elements of the rate proposals I included in my analysis.

Proposal	**Elements included in calculations**
Copyright Owners	Greater of $1.06 per user per month or $0.0015 per stream,[7] for all users and all streams regardless of whether the users and streams are on the ad-supported or paid service, regardless of whether the users are active users of Spotify, and regardless of the length of the streams.
Apple	$0.00091 per stream 30 seconds or longer, for all such streams regardless of whether they are on the ad-supported or paid service, less performance royalties.
Amazon	Continue current rate structure, counting family plans as 1.5 users and student plans as 0.5 users for per-user rates in steps 1 and 2 of the formulas.
Pandora	Continue current rate structure, counting family plans as 1.5 users and student plans as 0.5 users for per-user rates in step 1 and eliminating any per-user floors in step 2.
Spotify	Continue current rate structure, counting family plans as 1.5 users and student plans as 0.5 users for per-user rates in step 1 and eliminating any per-user floors in step 2 (*same as Pandora*).
Google	Continue current rate structure, counting family plans as 1.5 users for per-user rates in step 1, lowering Record Company royalty-based payment floors in step 1 to 13.5% of such payments, and eliminating any per-user floors in step 2.

10. Notably, unlike ***all*** of the other proposals, the Copyright Owners' proposal does not allow any deduction for performance royalties, which flow to the same publishers and songwriters as mechanical royalties.

11. For each rate proposal, I describe what the effect would have been on Spotify's royalty rates [redacted] over the analysis period ([redacted]).

[7] Unless otherwise noted, I will use "play" and "stream" interchangeably.

The Copyright Owners' Proposal Would [redacted]

12. As stated above, the Copyright Owners' proposal would require services to pay the maximum of $1.06 per "end user" per month or $0.0015 per "play," adding together all streams and all users regardless of whether they are ad-supported or paid.

13. It is my understanding that the proposal defines a "play" as "the digital transmission of any portion of a musical work" (*Copyright Owners' Proposed Rates and Terms* at B-7 to -8, B-13) and an "end user" as "each unique individual or entity that has access" via a user name and a password (*i.e.*, each registered user) on a service (*id*. at B-6, B-12). I will discuss issues with both the per-end user and per-play parts of the rate below.

14. Under the Copyright Owners' proposal, Spotify would have owed [redacted].

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8 [redacted].

15. The following table summarizes this information:

[redacted]

16. The effect of the Copyright Owners' proposal on Spotify's [redacted] over the analysis period is shown in the following table:

[redacted]

17. There are a number of issues with the Copyright Owners' rate proposal and the assumptions underlying it.

18. [redacted].

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9 [redacted]

10 [redacted].

11 [redacted].

19. The publishers' executives argue that Spotify could simply run more ads. *See, e.g.*, Written Direct Testimony of Marc Rysman ("Rysman WDT") ¶ 96. [redacted].[13]

[12] To determine this number, I applied the following calculations:

[redacted]

[13] [redacted].

20. [redacted]. This balances revenue per user[14] with user growth to maximize total revenue growth.

21. Ad revenue can be increased by charging more *per advertisement*. However, the market for advertisements is competitive. Spotify must compete with other media, such as television and radio, as well as internet advertisements and a host of other competitors. [redacted]. Advertisers want to see engagement, recall, and interaction with the product before they will pay more.

22. This additional value is lost if there are a glut of ads on the service. There has to be a supply of advertisers interested in advertising on your medium. [redacted]. The advertising market needs time to mature and see that interactive streaming is a great way [redacted]. This is happening and will continue to happen, [redacted]

23. Thus, service cannot simply choose to run X times more ads and expect X times more ad revenue. [redacted]

[14] Revenue per user includes not only revenue per ad-supported user but also revenue from users converting to the Premium service.

24. Despite the challenges, Spotify is increasing its overall revenue and ad revenue yield from the ad-supported tier. For example, comparing [redacted], Spotify's U.S. ad-supported RPM, or revenue per thousand music listening hours, increased more than [redacted].[15] Under the current rate structure, this is resulting in additional payouts to the Copyright Owners.

25. [redacted].

26. [redacted].

27. [redacted]

[15] Spotify's ad RPM was [redacted] in [redacted], and it grew to [redacted] in [redacted]. RPM is a common metric for examining how effective advertisements are in generating revenue. Since advertising is seasonal, comparing the same [redacted]-month periods in consecutive years helps control for any seasonality fluctuations in ad revenue.

[redacted].

28. [redacted].[16]

[16] [redacted]

29. In addition to [redacted] included in the Copyright Owners' proposal, it has numerous structural flaws, which I will discuss next. These would persist even if the per-user or per-stream rates [redacted].

30. **Problems with the per-user rate.** The Copyright Owners' proposal states that:

> *End user* means each unique individual or entity that has access to an offering whether by virtue of the purchase of a subscription to access the offering or otherwise. Licensees or service providers shall be required to obtain from each individual or entity that wishes to access an offering a unique user name and valid e-mail address, and to provide each such individual or entity with a unique password or identifier, prior to granting such access.

Copyright Owners' Proposed Rates and Terms at B-6, B-12.

31. Under the Copyright Owners' definition, "users" includes *all* registered users, whether or not they actively use the service. For example, if a user signed up for Spotify's ad-supported service and listened to one song — or zero songs, for that matter — years ago, Spotify would be required to pay $1.06 per month for that user, even if he or she never signed in again.

32. The Copyright Owners suggest that *mere access* to the musical works available on Spotify is of value. *See, e.g.*, Israelite WDT ¶ 42 ("Each end user account has an inherent value. The user is secure in knowing that all the songs offered by the Digital Service can be accessed at any time or place.").

33. But a Spotify ad-supported account does not provide a user with any additional "security" than someone who does not have an account. A user can create a Spotify ad-supported account in a matter of *seconds* by clicking on a button and using his or her Facebook login, with

no need to enter any additional information.[17] It takes more time to tune to a radio station. The fact that the user has clicked a button to create such an account does not suddenly make him or her "secure in knowing that all the songs offered by the Digital Service can be accessed at any time or place." That security comes from the very existence of the ad-supported service. Thus, to assign a $1.06 per month value to musical works copyright owners for each and every user that has ever clicked such a button or registered is completely unfair.

34. Unlike the paid service, where the price users pay is a monthly fee to have an account, the price users "pay" for the ad-supported service is listening to ads; thus, when users are not active, they do not generate ad revenue. This means that for ad-supported users, Spotify cannot monetize mere access to pay royalties that are assessed on a per-user basis. In this way, the ad-supported service is akin to radio: the price the user pays is listening to ads; the account itself does not generate any value and only the use of the account leads to ad revenue.

35. [redacted]. Many of these ad-supported users are casual listeners that would otherwise not pay for music but may, after spending some time learning the benefits of music streaming, convert to a paid account.

36. [redacted]

[17] Alternately, the user can choose a username and password, which takes but a moment longer.

[redacted].

37. A per-user rate also means less money for Spotify and rights holders from the paid service, because, for example, such a rate disincentivizes the use of different pricing schemes (such as student discounts and family plans) as growth levers. *See* Written Direct Testimony of Paul Vogel ("WDT") ¶¶ 28-32; Written Direct Testimony of Barry McCarthy ("McCarthy WDT") ¶¶ 67-71. [redacted]. Without providing any foundation for their speculation, the Copyright Owners argue that Spotify is not "truly focused" on conversion. *See* Written Direct Testimony of Peter Brodsky ("Brodsky WDT") ¶ 66. But this is exactly what these results-driven pricing plains aim to achieve, and the Copyright Owners' proposal would undermine our ability to offer them. The reality of the music market is that there are different segments with differing levels of engagement (from casual and infrequent listeners to super-fans) and differing willingness to pay (as low as zero for some segments). Everybody wins when we charge an appropriate price and deliver an appropriate product to each segment.

38. Even if the Copyright Owners backed off of their proposal to apply a per-user rate to all ad-supported accounts and only applied it to recently active ad-supported accounts, my conclusions would not change. [redacted]

[redacted].

18 [redacted].

[redacted]

39. **Problems with the per-play rate.** [redacted]. Specifically, the Copyright Owners' proposal defines a "play" as "the digital transmission of *any* portion of a sound recording of a musical work in the form of an interactive stream or limited download" (*Copyright Owners' Proposed Rates and Terms* at B-7, B-13 (emphasis added). [redacted].

19 [redacted]

20 [redacted]

21 [redacted].

40. [redacted] Thus, the Copyright Owners' proposal that Spotify pay a fixed per-play rate is as unreasonable as its proposal that Spotify pay a fixed per-user rate.

41. The Copyright Owners' proposal would also incentivize Digital Services to minimize royalty payments [redacted]. For example, Digital Services would be incentivized to include fewer lesser-known "long tail" artists and songwriters in their curated playlists, and to bias their recommendations against these artists and songwriters. For terrestrial radio, there is a large risk associated with playing an unknown song: many listeners may dislike it, [redacted] With Spotify, no such risk exists. [redacted] This would diminish music exploration, one of the defining benefits of the music streaming revolution.

42. Of course, introducing listeners to new music and providing a platform for lesser known artists and songwriters are key components of Spotify's business model, as described by my colleagues Will Page and James Lucchese in their Written Direct Testimony. For example, Spotify offers a broad range of music discovery products weighted towards the "long tail" of artists and songwriters (such as Discover Weekly and Fresh Finds), and in 2017 is expected to spend [redacted] on its Creator group's products and services aimed at artists and songwriters.

43. In addition, the per-play rate would incentivize the Digital Services to discourage engagement with the service, such as by instituting listening caps. [redacted]. More generally, lower user engagement results in lower willingness to pay, which increases user attrition. I understand that my colleagues Barry McCarthy and Will Page discuss this further in their Written Rebuttal Testimony.

44. In sum, both the size of the Copyright Owners' increase in rates and the structure of their proposal would be highly disruptive [redacted] to the industry generally.

Apple's Proposal Would [redacted]

45. Apple also proposes a flat rate per stream; however, unlike the Copyright Owners' rate, Apple's rate (a) does not have a per-user floor, (b) includes both mechanical royalties and performance royalties; (c) only applies to streams 30 seconds or longer, and (d) is $0.00091 per stream, not $0.00150 per stream. [redacted].

46. [redacted].

47. [redacted].

48. The following table summarizes this information:

[redacted]

49. The effect of Apple's proposal on [redacted] over the analysis period is shown in the following table:

[redacted]

50. [redacted]

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[22] [redacted]

[23] [redacted].

[24] [redacted].

[redacted].

51. In addition to having a lower per-stream rate, Apple's proposal slightly lessens two of the problems of the Copyright Owners' proposal: it does not include a per-user minimum, [redacted]. As such, it does not punish services for infrequent listeners or [redacted] as harshly as the Copyright Owners'. However, it still has all of the other problems of a per-stream rate. In addition, by having a singular per-stream rate applicable to both ad-supported and paid services, it fails to recognize that ad-supported services work by funneling users away from piracy and other low-paying alternatives such as terrestrial radio. This means that [redacted].

52. [redacted]

[25] [redacted].

[26] [redacted].

[redacted].

The Other Parties' Proposals Would Result in [redacted]

53. The other parties' rate proposals are generally similar to each other, with some variations as shown in the table in paragraph 9 of this document. The effects of each proposal on royalty rates and [redacted] over the analysis period are shown in the tables below. Given the elements of each proposal considered (see above), Pandora's and Spotify's proposals have an equivalent effect on Spotify's financials, and only Google's proposal results in changes for the ad-supported tier.

Amazon's Proposal

[redacted]

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[27] [redacted]

[28] [redacted].

[29] [redacted].

<u>Pandora's/Spotify's Proposals</u>

[redacted]

<u>Google's Proposal</u>

[redacted]

54. As shown in the tables, [redacted]

30 [redacted]

31 [redacted].

32 [redacted].

[redacted], and none would disrupt Spotify's business.

55. In addition, Pandora's, Spotify's, and Google's proposals would eliminate the value-destroying "second step" per-user floor (*see* WDT ¶ 9) in the current rate formula. As discussed in my written direct testimony, eliminating this floor grows the pie for everybody (*e.g.*, by incentivizing the Digital Services to capture the segments of the market willing to pay more than free but less than $9.99 per month). *See* WDT ¶¶ 28-32; *see also* McCarthy WDT ¶¶ 67-71. Further, these proposals would result in a modest [redacted].

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DECLARATION OF PAUL VOGEL

I, Paul Vogel, declare under penalty of perjury that the statements contained in my Written Rebuttal Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information, and belief. Executed this 15 day of February 2017 in New York, United States.

Paul Vogel