

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)

**INTRODUCTORY MEMORANDUM TO THE WRITTEN DIRECT STATEMENT OF
APPLE INC.**

Pursuant to 17 U.S.C. § 803(b)(6)(C) and 37 C.F.R. § 351.4, Apple Inc. (“Apple”) hereby submits this Introductory Memorandum in support of its Written Direct Statement to the Copyright Royalty Judges in the above-captioned proceeding.

I. SUMMARY OF POSITION

Music has inherent value. It has value to the public, which benefits from listening to the creativity of artists. It has value to artists, not only as an outlet for their creativity, but as a source of financial support for their continued creation. And it has value to the services like Apple Music, whose important role in innovatively bringing together the public and artists also must be recognized by any rate structure. The music compositions embodied in interactive streams are protected under the U.S. Copyright Act, and the publishers and songwriters who create these works have a constitutional right to be compensated for their use. The business model designed and used by a distributor of these musical works does not diminish the value of the music. In recognition of this fact, Apple is proposing an all-in royalty rate of \$0.00091 per

stream (or 1/100th of the current rate for downloads) for all interactive streaming services.¹ This rate is more favorable to copyright owners than the conversion rate used by Billboard for its Billboard 200 chart and is consistent with the UK Official Single Chart's 100:1 ratio for converting streams to downloads. Moreover, as described in more detail below, this rate proposal accomplishes the four statutory objectives for setting Section 115 royalty rates in a manner that is fair, simple, and transparent. In short, Apple's proposal safeguards the benefits to the public, and therefore to songwriters and publishers, by avoiding fluctuations in value resulting from variant interactive streaming business models.

First, Apple's rate proposal for interactive streaming is fair to both copyright owners and copyright users. Although music is the backbone of the interactive streaming industry, the current royalty structure (or any percentage of revenue rate structure) encourages the growth of interactive streaming services at the expense of copyright owners. Apple's proposal would address this imbalance. As explained in Dr. Anindya Ghose's expert report, under Apple's proposal, the copyright owner would receive a predictable amount per stream, independent of the streaming services' business decisions. This approach recognizes the central role publishers and songwriters play in the music industry by paying them commensurate with the demand for their songs while shielding them from the risks associated with percentage of revenue rate structures. Those risks include the possibility that compensation will not increase with demand, the value of a song per-stream will decrease over time, and services will adopt loss-leader strategies at the expense of music creators.

¹ Under Apple's proposal, the mechanical royalty rate shall be equal to the all-in royalty less any performance royalty payments the service owes for the musical work being streamed.

Apple's proposal also is fair to interactive streaming services. As detailed in Dr. Jui Ramaprasad's expert report, there is little doubt that interactive streaming services make many contributions to the music industry, including increasing consumer access to a wide range of music and providing opportunities for music artists to reach a larger audience. Interactive streaming services also take on many costs and risks in order to provide these services. As Dr. Ghose explains, under Apple's proposal these services would be rewarded for their innovation and compensated for the risks they assume because they would be able to retain any incremental increases in revenue that they generate by, for example, developing better sound quality or user interfaces, which may allow services to charge higher advertising prices or subscription rates. That same opportunity to retain all incremental increases in revenue does not exist under percentage of revenue models because, under those models, services must share a percentage of their revenues with the copyright owners.

Apple's proposal is particularly fair in light of the current economic conditions in the streaming industry. As Dr. Ramaprasad explains, the percentage of revenue royalty structure for interactive streaming was adopted as part of a settlement in 2008 when the interactive streaming market was in its infancy. This royalty structure was designed to facilitate the growth of new music platforms, such as interactive streaming, by limiting the risks to music services, which would not have to pay publishers for interactive streams until they earned revenue. Since 2008, the interactive streaming industry has changed significantly and, as Dr. Ramaprasad explains, interactive streaming now plays a central role in digital music consumption. The percentage of revenue model thus is outdated. A per-play rate is best suited for the current interactive streaming market.

The proposed \$0.00091 rate also is fair and reasonable. As Dr. Ramaprasad explains, based on academic literature and industry standards for converting streams to downloads, the appropriate rate for interactive streaming is between \$0.00061 and \$0.00091 per stream. Apple is proposing the number at the top end of this range, while still providing incentives to interactive streaming services. As David Dorn, Apple’s Senior Director of Apple Music, explains, this rate is low enough that RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III). Because Apple’s proposal recognizes the copyright owners’ and copyright users’ contributions to the music industry, and provides both with a fair return on their investments and the incentives necessary to continue making music available to the public, the Section 17 U.S.C. § 801(b)(1)(A)–(C) objectives are satisfied.

Second, Apple’s proposal also is simple. To calculate the all-in royalty under Apple’s proposal, a service would need to track only one piece of user data: the number of times each song is streamed on its service for thirty seconds or longer. Then, to calculate the mechanical royalty, the service would just need to subtract out its performance royalties for that stream. As shown below, the calculations required are straightforward:

$$\begin{array}{l} \text{Total Royalty Paid to} \\ \text{Publishers/Songwriters for Song A} \\ \text{(mechanical + performance)} \end{array} = \$0.00091 \times \begin{array}{l} \text{\# times song A streamed} \\ \text{on the service for 30} \\ \text{seconds or longer} \end{array}$$

$$\begin{array}{l} \text{Mechanical} \\ \text{Royalties for} \\ \text{Song A} \end{array} = \left(\$0.00091 \times \begin{array}{l} \text{\# times song A} \\ \text{streamed on the} \\ \text{service for 30} \\ \text{seconds or longer} \end{array} \right) - \begin{array}{l} \text{Public performance} \\ \text{royalties for the musical} \\ \text{work paid for Song A} \end{array}$$

This is in sharp contrast to the current statutory rate, RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III), which requires a service to engage in a multi-step calculation and make confusing determinations regarding what constitutes a service provider’s “revenue” in order to determine the royalty it owes. Moreover, Apple’s simple per-play royalty structure is consistent with that used for many other music delivery methods. For example, royalties for downloads are paid on a per-download basis and webcasts are paid on a per-play basis. Given the extraordinary growth in interactive streaming, it makes sense to bring the royalties for interactive streaming in line with those for other types of services, particularly downloads, as Dr. Ramaprasad explains. Further, because the industry already is using per-play or per-unit rates in other areas, it would not be difficult or disruptive to adopt a per-play rate structure for interactive streaming. Thus, the Section 17 U.S.C. § 801(b)(1)(D) objective also is satisfied.

Third, Apple’s proposal provides transparency. As Dr. Ramaprasad explains, there is considerable confusion among songwriters and publishers as to why they are being paid the amounts they are being paid. Indeed, even when one is given access to revenue and streaming information, it can be difficult to understand how a particular service’s revenue translates into payments for songwriters and publishers. Apple’s proposal solves this problem and would help eliminate the confusion that exists among songwriters and publishers regarding royalty payments.

For the foregoing reasons, Apple’s proposal is the most appropriate rate and rate structure for interactive streaming. It is fair to both copyright owners and copyright users and corrects many problems with the current rate structure, including, among other things, the decoupling of rate payments from demand and the lack of predictability regarding the value of a stream from month-to-month and service-to-service. Moreover, it reflects the current state of the interactive

streaming industry as a robust, well-established market in which consumers are paying for music (just as they have done throughout history). Further, it brings royalty payments in the interactive streaming market in line with those for other forms of music distribution. Accordingly, Apple respectfully requests that the Copyright Royalty Board (“CRB”) adopt its rate proposal for interactive streaming royalties in the above-captioned proceeding. For similar reasons, it requests that the CRB adopt its rate proposal for music lockers as well.

II. SUMMARY OF WRITTEN TESTIMONY

A. Fact Witnesses

1. David Dorn

David Dorn is the Senior Director of Apple Music at Apple. His testimony focuses on five points. First, he **RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III)**

Second, Mr. Dorn explains some of the most significant and innovative Apple Music features, including (1) the combination of many disparate music consumption experiences in a single platform, (2) the personalized recommendation system and playlists, which enhance the discovery of new music, and (3) the social features that allow artists to connect with fans and Apple Music subscribers to share songs and playlists with one another. These features draw consumers to Apple Music and help the music industry grow by exposing consumers to new songs and deepening their connections with artists. As Mr. Dorn explains, through these and other features, interactive streaming services have become an important asset to the music industry.

Third, Mr. Dorn explains the key costs and risks associated with entering the interactive streaming market. He testifies that **RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III)**, he believes there is no reason to treat interactive streaming services differently from other other types of businesses. The services should have to pay a fixed amount for the inputs, *i.e.* the songs, on which they rely to operate their businesses. Moreover, Mr. Dorn explains that **RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III)**

Fourth, Mr. Dorn explains that Apple’s proposed all-in rate is consistent with the UK Official Charts Company’s 100:1 ratio for converting streams to downloads and more favorable to songwriters and publishers than the Billboard conversion rate.

Fifth, Mr. Dorn explains that Apple’s proposal for music locker royalties of an all-in rate of \$0.17 per subscriber per month for paid locker services and a zero royalty rate for purchased content locker services also is fair and reasonable. The \$0.17 per subscriber per month rate comes from the current statutory minimum and, like the per-stream rate, is simple to calculate. The zero royalty rate for purchased content locker services is fair and reasonable because copyright owners are compensated for music stored in purchased content lockers at the time the music is purchased. Thus, the copyright owners do not need to be compensated a second time.

2. Rob Wheeler

Rob Wheeler is Apple’s iTunes Controller. In his testimony, Mr. Wheeler explains how Apple’s current royalty payments for interactive streaming are calculated. As Mr. Wheeler explains, **RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III)**

RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022)
(Phonorecords III)

Many problems, such as the lack of transparency, also are inherent to a percentage of revenue structure, regardless of whether the structure also includes a minimum or a “greater of” analysis. A per-play rate would make royalty calculations much simpler and easier to understand, which is beneficial for both copyright users and copyright owners. Mr. Wheeler also provides testimony regarding Apple’s costs, revenue and royalty payments for Apple Music since its launch.

B. Expert Witnesses

1. Dr. Jui Ramaprasad

Dr. Ramaprasad is an Associate Professor in Information Systems at McGill University’s Desautels Faculty of Management, where she teaches a variety of courses including “The Treble Cliff: The Business of Music.” Her research focuses on the music industry, digital music consumption, IT-enabled business models and the impact of technology and social media on the music industry and other digital goods industries, and has been published and presented in the top journals and conferences of her field. Dr. Ramaprasad holds a Ph.D. in Information Systems from the Paul Merage School of Business at the University of California, Irvine.

Dr. Ramaprasad provides testimony regarding the music industry, trends in music consumption, and the reasons why Apple's per-play rate proposal is a compelling fit for these industry trends. Her testimony begins with a description of digital download, ringtone, interactive streaming, and music locker services and identifies some of the services in each category. She then explains the various rates Apple and the other services are proposing, based on their initial disclosures. After providing this background, Dr. Ramaprasad explains that Apple's proposal offers simplicity and eliminates confusion in rate calculations,

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Dr. Ramaprasad then explains the current economic conditions in the interactive streaming industry, with a particular focus on the growth of the interactive streaming market both in terms of revenue and usage numbers. According to Dr. Ramaprasad's research, paid music subscriptions have grown six-fold since 2011 and total revenue from interactive streaming grew from about \$234 million in 2010 to \$1.6 billion in 2015. As Dr. Ramaprasad testifies, this evidence suggests that the interactive streaming industry should be treated as a robust industry. Dr. Ramaprasad also explains the contributions that streaming services make to the music industry and to music consumers by, for example, providing consumers with access to a wide variety of songs and providing artists with more opportunities to be discovered.

Based on her analysis of the current state of the music industry, and the role songwriters and services play in the digital music market, Dr. Ramaprasad concludes that Apple's per-play rate proposal is appropriate for the industry. First, as she explains, because interactive streaming has grown significantly and is replacing other forms of digital music consumption, particularly downloads, it is fair to adopt a royalty rate that is consistent with royalty payments for downloads. Interactive streaming services do not need to be "protected." Second, she testifies

that Apple's proposal would provide a fair return to both songwriters and streaming services. Third, she explains that Apple's proposal is consistent with industry benchmarks and academic literature for converting streams to downloads. Based on her research into this ratio, she concludes that the all-in per-stream royalty rate for songwriters should fall between \$0.00061 and \$0.00091. Apple's proposal is at the top end of this range.

Finally, Dr. Ramaprasad evaluates Apple's per-subscriber rate proposal for paid locker services and zero-rate for purchased content locker services. She explains that, like the interactive streaming proposal, the locker service proposal also offers simplicity. Further, Apple's proposal of a zero-rate for purchased content lockers is reasonable and appropriate because any content stored in these lockers already has been purchased. Thus, songwriters and publishers already have been compensated for this content and do not need to be paid again.

2. Dr. Anindya Ghose

Dr. Ghose is a Professor of Information, Operations, and Management Sciences and Professor of Marketing at New York University's Leonard N. Stern School of Business. He also is the Director of NYU Stern's Center for Business Analytics. His research focuses on electronic commerce, mobile apps, digital advertising and marketing, and the economic consequences of the Internet on industries and markets, among other things. He has received numerous awards for his work, including several best paper awards, and AnalyticsWeek ranked him as one of the "Top 200 Thought Leaders in Big Data and Business Analytics" in 2014. Mr. Ghose holds a Ph.D. in Information Systems from Carnegie Mellon University and an MBA in Finance, Marketing, and Information Systems from Indian Institute of Management.

Dr. Ghose explains why Apple’s proposed rates for downloads, ringtones, interactive streaming, and music locker services best satisfy the four statutory objectives for setting Section 115 royalty rates. With respect to downloads and ringtones, Dr. Ghose explains that Apple’s proposed royalty rates are appropriate because (1) they are consistent with the CRB’s prior determination regarding the proper rates for downloads and ringtones, (2) the CRB’s prior assessment continues to apply in today’s music industry, and (3) there is no compelling reason to introduce change. **RESTRICTED — Subject to Protective Order in Docket No. 16-CRB-0001-PR (2018-2022) (Phonorecords III)**

With respect to Apple’s proposal concerning rates for interactive streaming, Dr. Ghose begins his analysis by explaining the roles copyright owners and copyright users play in the interactive streaming industry. As Dr. Ghose testifies, songs are a “critical input” for streaming services, and songwriters should be compensated for the value of their creations commensurate with the demand for their creations. If they are not compensated properly, their incentives to create music will decrease. Streaming services create innovative products and features that add value for music consumers. They also must be rewarded for their contribution to the music industry and the risks they take in entering the interactive streaming market.

After considering these two interests and the important role that both music creators and streaming services play, Dr. Ghose concludes that Apple’s per-play rate is the most appropriate structure for interactive streaming royalties **RESTRICTED — Subject to Protective Order in Docket No 16 CRB 0001 PR (2018 2022)**

With a per-play rate, copyright owners are compensated in accordance with demand for their music. As demand increases, the total amount paid to copyright owners is guaranteed to increase. With percentage of revenue models, this is not always the case. Moreover, under the per-play rate model the all-in amount paid per stream is consistent from service-to-service and is

independent of a streaming service's financial performance. Dr. Ghose testifies that the per-play rate structure also properly compensates services because they can retain all incremental revenues associated with the value they create. Under percentage of revenue structures, in contrast, a portion of this value is shared with songwriters and publishers.

In addition to providing appropriate compensation to, and incentives for, both copyright owners and copyright users, Dr. Ghose highlights two other reasons why a per-play rate should be adopted in this proceeding. First, it is consistent with royalty rate structures for other prominent forms of music distribution. Indeed, as Dr. Ghose explains, many of the reasons the CRB has given for adopting a per-unit royalty for downloads apply equally to interactive streaming. Second, a per-play rate is easier to compute and understand than many other proposals, and eliminates the ambiguities associated with calculating royalties that exist under the current rate structure.

Finally, Dr. Ghose considers Apple's proposal for music locker rates. Dr. Ghose concludes that Apple's proposed all-in per-subscriber rate for paid locker services is appropriate for many of the same reasons that the per-play rate is appropriate for interactive streaming.

Dated: November 1, 2016

Respectfully submitted,

A handwritten signature in blue ink that reads "Dale M. Cendali" with a date "11/01/16" written at the end.

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