**Public Version**

**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

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| In the Matter of:<br><br>Digital Performance in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

# PROPOSED FINDINGS OF FACT OF SOUNDEXCHANGE, INC.


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## I. INTRODUCTION

1. The purpose of this proceeding is to set the rates and terms for the digital public performance of sound recordings by non-interactive statutory webcasting services, and for the making of ephemeral copies in furtherance of these performances, for the 2011-2015 period. The Copyright Act requires the Judges to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B); 17 U.S.C. § 112(e)(4).

2. While there are hundreds of webcasting services operating under the statutory licenses, about forty of which originally filed petitions to participate here, the overwhelming majority of them chose not to litigate this proceeding. Many of the commercial webcasting services that did not participate chose instead to opt into two settlement agreements reached under the Webcaster Settlement Acts of 2008 and 2009 ("WSA") -- the NAB Agreement and the Commercial Webcasters Agreement. The purpose of the WSA was to foster settlements, and SoundExchange was largely successful in achieving Congress's objective. Indeed, hundreds of webcasters (accounting for thousands of stations or channels), representing more than 50% of the statutory royalties paid to SoundExchange for 2008, have opted into those agreements. SoundExchange also reached a settlement with noncommercial educational webcasters under the WSA, and although the opt-in period for the rates in that agreement has not yet begun, numerous noncommercial webcasters have indicated their support for that agreement.

3. Ultimately, only two entities decided to litigate this proceeding on behalf of webcasters: (1) Live365, Inc., a company that willfully violated the statutory license for over two years by refusing to pay at the royalty rates set in *Webcasting II* -- even though it was profitable

at those rates, and (2) Intercollegiate Broadcasting System, Inc., an organization that advised its members that they could choose not to comply with the rates set in *Webcasting II.*

4. The parties took very different approaches to proposing rates and terms. SoundExchange relied on a benchmark analysis -- consideration of actual marketplace transactions -- to determine its rate proposal. SoundExchange's rate proposal is derived in large part from the testimony of its expert witness, Dr. Michael Pelcovits. As he did in *Webcasting II*, Dr. Pelcovits used an interactive services benchmark, adjusted for differences between the interactive and non-interactive markets, as a basis for determining a rate that meets the willing buyer/willing seller standard.

5. Dr. Pelcovits's interactive services benchmark analysis is consistent with the benchmarking approach that this Court has used in past proceedings, including *Webcasting II* and *SDARS*, to set rates. In fact, the benchmark that Dr. Pelcovits used in this proceeding is essentially the same benchmark that he used -- and that this Court relied on as the basis for rates in -- *Webcasting II.*

6. In this proceeding, Dr. Pelcovits, guided by this Court's precedent, set out to estimate a per-performance royalty rate that would prevail in the hypothetical market for non-interactive webcasting. His benchmark analysis relied on data from marketplace transactions between the record companies and interactive, on-demand audio streaming services. He reviewed over 200 agreements between the record companies and interactive webcasting services, including agreements from all four major record companies and multiple webcasters. The interactive, on-demand market shares important characteristics with the statutory webcasting market. But because there are also differences between the interactive, on-demand market and

the hypothetical statutory webcasting market, Dr. Pelcovits, as he did in *Webcasting II*, made a number of adjustments to the rate he observed in the interactive market.

7. By making a number of adjustments, including those related to the value of interactivity, differences in listening intensity between the markets, and the potential for increased substitution for CD sales in the interactive market, Dr. Pelcovits derived an appropriate per-performance rate for statutory webcasting.

8. To confirm the results of his benchmark analysis and to establish a range of reasonable rates, Dr. Pelcovits also considered the rates negotiated between SoundExchange and two groups of webcasters: broadcasters represented by the National Association of Broadcasters ("NAB Agreement"), and commercial webcasters represented by Sirius XM Radio for its Internet radio service ("Commercial Webcaster Agreement").

9. These two voluntary license agreements offer highly probative evidence of the bargaining range that would exist in the hypothetical market. The strengths of these agreements include the following facts: they are recent, voluntary, cover the same performance rights and statutory webcasting services at issue in this proceeding, and were negotiated on both sides between entities with an important stake in establishing rates. These agreements are particularly useful evidence because hundreds of webcasters that paid more than 50 percent of the webcasting royalties received by SoundExchange in 2008 have opted into them. In other words, they offer crucial insight into the rates that willing buyers and willing sellers will agree to, as the hypothetical market contemplates.

10. Dr. Pelcovits thoroughly detailed the economic theory that supports his consideration of these agreements and his determination that they are highly probative of the rate that would be reached in the hypothetical marketplace. In fact, Dr. Pelcovits and Dr. Janusz

Ordover both testified about the ways in which these two agreements represent the low-end of the range of rates that might occur in the hypothetical marketplace. Drs. Pelcovits and Ordover explained that for a variety of reasons, including the NAB's and Sirius XM's need for the catalogs of all four major record companies, the increased popularity and value of custom radio services, and the existence of the regulatory framework, the agreements form a strong basis for setting a rate in this proceeding and in fact, delimit the lower bound of what a reasonable rate would be without any adjustment.

11. Ultimately, Dr. Pelcovits concluded that SoundExchange's proposed per-performance rate for commercial webcasters falls within the range of reasonable rates that would possibly occur in the hypothetical marketplace as demonstrated in the following table:

| *Year* | *WSA Agreement Rates* | *SoundExchange Rate Proposal* | *Interactive, On-Demand Rates (No Substitution Adjustment)* |
|---|---|---|---|
| 2011 | $0.00175 | **$0.0021** | $0.0036 |
| 2012 | $0.00200 | **$0.0023** | $0.0036 |
| 2013 | $0.00215 | **$0.0025** | $0.0036 |
| 2014 | $0.00225 | **$0.0027** | $0.0036 |
| 2015 | $0.00245 | **$0.0029** | $0.0036 |

Even the top of SoundExchange's proposed rate structure -- $0.0029 in 2015 -- falls well below the top of the range of reasonable rates determined by Dr. Pelcovits. Rather than propose its highest rate for all five years of the statutory term, SoundExchange has proposed that the rates should increase gradually in $0.0002 increments per year during the course of the statutory period, ending at the highest rate. This is consistent with the rate structures found in the WSA agreements submitted as evidence.

12. Live365, by contrast, rejected the use of a benchmark analysis. Instead, Live365's proposed flat rate of $0.0009 per-performance is based on the testimony of Dr. Mark Fratrik, who used a flawed modeling approach under which he tried to model the value of

copyrighted material to commercial webcasters. In a less-than-rigorous analysis, Dr. Fratrik combined webcasting costs, revenues, and a proposed operating margin in order to determine the value of copyrighted works, which he thereby used to calculate a per-performance royalty rate.

13. Dr. Fratrik's model rests on wholly unsupported assumptions, and it was thoroughly dismantled on cross-examination and through rebuttal testimony. His model suffers from the following problems, among others.

14. First, Dr. Fratrik assumed that Live365 is a typical webcaster with respect to its costs. But he made no attempt to verify whether Live365's costs are typical. In fact, the evidence shows that Live365's business model is in many respects unique, and that there is a wide variety of business models for webcasters in the webcasting industry.

15. Second, Dr. Fratrik assumed that commercial webcasters are entitled to at least a 20% operating margin. This assumption does not withstand even the slightest scrutiny. It is not based on any information from the webcasting industry. Rather, it is based on the operating margins reported by several publicly-held terrestrial broadcasting companies, and Dr. Fratrik failed to explain why the operating margins should be comparable. In fact, the evidence showed, among other things, that webcasters have lower barriers to entry than terrestrial broadcasters, which suggests that their operating margins would be lower, too.

16. Third, he assumed that two industry reports from AccuStream and ZenithOptimedia show the lower and upper bounds of industry-wide advertising revenue measurements. These two reports published advertising revenue data that widely diverged from Live365's numbers, as well as each other. Dr. Fratrik's use of these reports was unsound because they significantly undermine his assumption that Live365 is typical and the notion that

his model arrives at a rate that would be negotiated by a typical webcaster. Additionally, Dr. Fratrik also failed to examine or explain why those reports reached such different figures.

17. Fourth, Dr. Fratrik assumed that advertising and subscription revenue represent the entire universe of income streams for webcasters. He inexplicably chose to ignore all other ways that webcasters earn revenue. For example, the evidence shows that some webcasters earn revenue by using their webcasting services to drive traffic to other revenue-producing websites or portions of their websites, or to attract customers to other products or services. Dr. Fratrik's model does not account for this variety in the market. In fact, Dr. Fratrik's model disregards the synergistic nature of Live365's business model, which uses webcasting to generate revenues in its intertwined business of providing so-called broadcasting services to the individual webcasters it considers its customers. This is a substantial source of revenues that Dr. Fratrik simply ignores.

18. Putting these problems aside, the inescapable fact is that Live365 has been profitable under the statutory rates for several years, and the evidence shows that Live365 would almost certainly be profitable at SoundExchange's proposed rates. Even if Dr. Fratrik's flawed model is accepted at face value, it demonstrates that Live365 would have been profitable in 2008 at rates that were higher than the statutory rates and more than double the rate proposed by Dr. Fratrik. Indeed, based on the total revenues generated through Live365's wholly-integrated business model, it appears that Live365 can be profitable at the rates proposed by SoundExchange.

19. Finally, unlike the actual marketplace transactions that Dr. Pelcovits analyzed, Dr. Fratrik's model does not even attempt to contemplate the cost or revenue factors that would impact a willing seller in the hypothetical marketplace, as his analysis is devoid of any

consideration about the willing sellers' business models or negotiating dynamics. In short, Dr. Fratrik's analysis -- like the rest of the evidence submitted by Live365 and discussed herein -- does not justify Live365's rate proposal.

20. With respect to the rate for noncommercial services, SoundExchange presented extensive evidence in support of its proposal, while IBS presented virtually none. SoundExchange has proposed an annual $500 royalty per station or channel with usage in excess of 159,140 ATH in any month paid at SoundExchange's proposed commercial per-performance rates, which is the same structure that this Court adopted for noncommercial services in *Webcasting II.* In reality, most noncommercial webcasters do not exceed the ATH cap and pay only $500. The evidence, including the voluntary license agreement with CBI for noncommercial educational webcasters (the very kind of services that IBS purports to represent), shows that noncommercial services are willing and able to pay SoundExchange's proposed rates.

21. Moreover, according to IBS's most recent version of its rate proposal, IBS agrees with SoundExchange's rate proposal for noncommercial webcasters with more than 15,914 ATH per month. *See Amplification of IBS' Restated Rate Proposal*, at 2 (July 28, 2010). Thus, the only dispute between the parties relates to IBS's proposal that so-called "small" and "very small" noncommercial webcasters should pay only $50 or $20 a year in royalties respectively. There is no evidence in the record to support that proposal. To the contrary, the evidence shows that SoundExchange's average administrative costs per webcasting station or channel exceed $800 a year, and that noncommercial services tend to impose disproportionate costs on SoundExchange. On the facts in evidence, no willing seller would agree to such low rates.

22. SoundExchange's Proposed Findings of Fact set forth the evidence related to the aforementioned issues, and the evidence related to the minimum fee, terms and other matters at issue in this proceeding.

## II. BACKGROUND

### A. The Parties

#### 1. SoundExchange

23. SoundExchange is a 501(c)(6) nonprofit performance rights organization established to ensure the prompt, fair and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for the use of sound recordings over, among other things, the Internet, wireless networks, cable and satellite television networks, and satellite radio services via digital audio transmissions. Corrected Written Direct Testimony of Barrie Kessler WDT at 2, SX Trial Ex. 5 ("Kessler WDT").[1]

24. SoundExchange has "operated as the royalty collection and distribution entity since the beginning of the statutory licenses involved in this proceeding." *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, *Final Rule and Order*, 72 Fed. Reg. 24,084, 24,104 (May 1, 2007) ("*Webcasting II*").

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[1] In these Findings, "WDT" refers to a witness's written direct testimony, as admitted by the Court during the direct trial (e.g., "Kessler WDT"). "WRT" refers to a witness's written rebuttal testimony, as admitted by the Court during the rebuttal trial (e.g., "Ordover WRT"). Citations to "WDT" and "WRT" will be preceded by the relevant witness's last name and followed by the page number being cited and the trial exhibit number that was assigned to the written testimony at trial (e.g., "Pelcovits WDT at __, SX Trial Ex. 2" or "Salinger WRT at __, Live365 Reb. Ex. 1"). For citation to an exhibit that was attached to a witness's written testimony, the internal exhibit number will follow the "WDT" or "WRT" abbreviation and precede the trial exhibit number (e.g., "McCrady WDT, Ex. 101-DP, SX Trial Ex. 7" or "Fratrik WDT, Ex. 9, Live365 Trial Ex. 30"). "Tr." is the abbreviation for the transcript of oral testimony that took place before the Court. "Tr." abbreviations will follow the relevant date of the testimony and precede a pin cite to the location in the transcript as well as the last name of the witness on the stand (e.g., "4/27/10 Tr. 1211:22-1212:12 (Fratrik)").

25. In the *Webcasting II* proceeding, Docket No. 2005-1 CRB DTRA, the Judges designated SoundExchange as the Collective to collect and distribute statutory webcasting royalties. 37 C.F.R. § 380.4(b).

26. The Judges have also designated SoundExchange as the Collective to collect and distribute royalties for other types of services, including preexisting subscription services and preexisting satellite digital audio radio services. 37 C.F.R. § 382.3(a), § 382.13(b).

27. SoundExchange is controlled by an 18-member Board of Directors comprised of equal numbers of representatives of copyright owners and performers. Copyright owners are represented by board members associated with the major record companies (four), independent record companies (two), the Recording Industry Association of America (two), and the American Association of Independent Music (one). Artists are represented by one representative each from the American Federation of Musicians ("AFM") and the American Federation of Television and Radio Artists ("AFTRA"). There are also seven at-large artist seats, which are currently held by artists' lawyers and managers (four), an individual artist, and individuals who are affiliated with the Future of Music Coalition and the Rhythm & Blues Foundation. Kessler WDT at 2-3, SX Trial Ex. 5.

28. As of September 2009, SoundExchange had approximately 9,700 record label members and 29,000 artist members. SoundExchange also distributes statutory royalties to non-members – copyright owners and artists alike – as if they were also members. In total, as of September 2009, it maintained accounts for approximately 11,500 record labels and 41,000 artists, including members and non-members. Kessler WDT at 3, SX Trial Ex. 5.

29. SoundExchange has distributed royalties based on billions of webcasting performances. As of September 2009, SoundExchange had conducted a total of 33 royalty

distributions and made nearly 150,000 individual payments totaling more than $250 million (not limited to webcasting royalties). Kessler WDT at 4, SX Trial Ex. 5. By April 21, 2010, total distributions to copyright owners and artists had grown to $417 million (not limited to webcasting royalties). 4/21/10 Tr. 516:8 (Kessler). SoundExchange has nearly 2 million sound recordings in its database. Kessler WDT at 18, SX Trial Ex. 5.

**2. The Webcasting Services**

30. The services engaged in statutory webcasting include companies that are large and small, commercial and noncommercial, and that operate under an array of business models. For example, the parties that filed petitions to participate in this proceeding include companies such as MTV Networks, Inc. and Accuradio that operate Internet-only webcasting services; companies such as Live365, Inc. that use statutory webcasting to promote sales of other products or services; companies such as Sirius XM Radio, Inc. that operate subscription-only music services; major radio conglomerates such as Clear Channel that operate hundreds of simulcasting stations; companies such as Yahoo! that offer statutory webcasting as part of larger online services; and noncommercial services, including National Public Radio and noncommercial services affiliated with educational institutions, such as the members of Intercollegiate Broadcasting System ("IBS") and College Broadcasters Inc. ("CBI"). *See* Ordover WRT at 9-10, SX Trial Ex. 45.

31. The number of webcasters paying royalties to SoundExchange is robust – 610 webcasting services paid SoundExchange statutory royalties in 2008. This number under-counts the total number of webcasters that paid royalties in 2008. Some corporate enterprises (*e.g.*, radio station groups) pay and report in a consolidated manner on behalf of all of their affiliates, while affiliates of other enterprises pay and report separately for each station or for distinct subsets of stations (for example, on a regional basis). Taking these differences into account,

SoundExchange actually receives separate reporting, and in some cases separate payment, from over 1,400 different webcasting services, representing thousands of channels and stations. Kessler WDT at 4-5, SX Trial Ex. 5.

### B. History of Prior Webcasting Proceedings

#### 1. The *Webcasting I* Decision

32. The Copyright Arbitration Royalty Panel ("CARP") convened the first rate-setting proceeding for statutory webcasting. In 2002, it issued its report setting rates and terms for the time period 1998 - 2002. *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2 (CARP Feb. 20, 2002). The CARP set a rate for the performance right under Section 114 of $0.0014 per stream for Internet-only webcasters, and $0.0007 per stream for broadcaster simulcasters. For noncommercial services, the CARP accepted the Recording Industry Association of America's offer to license performances at one-third of the rate for commercial webcasters. With respect to Section 112, the CARP set the ephemerals rate as 8.8% of the rate paid for performances.

33. The Librarian of Congress rejected some of the CARP's recommendations, found no rational basis for setting different rates for Internet-only webcasters and broadcaster simulcasters, and set the rate for both at $0.0007 per stream. *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, *Final Rule and Order*, 67 Fed Reg. 45,240, 45,272 (July 8, 2002) ("*Webcasting I*"). Several parties appealed to the D.C. Circuit, which upheld the Librarian's decision. *Beethoven.com LLC v. Librarian of Congress*, 394 F.3d 939 (D.C. Cir. 2005).

#### 2. The *Webcasting II* Decision

34. In 2005, this Court initiated a proceeding to set the statutory webcasting rates and terms for the time period 2006 - 2010. After the submission of written cases, discovery, and

extensive hearings, this Court issued its Final Determination of Rates and Terms in 2007. *Webcasting II*, 72 Fed. Reg. at 24,084.

35. The Judges are required to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B); 17 U.S.C. § 112(e)(4). With respect to the willing buyer/willing seller standard, the Judges found "that in the hypothetical marketplace that would exist in the absence of a statutory license constraint, the willing sellers are the record companies." The Judges endorsed the conclusion from *Webcasting I* that "the willing buyers are the services which may operate under the webcasting license (DMCA-compliant services), the willing sellers are record companies and the product consists of a blanket license for each record company's complete repertoire of sound recordings." *Webcasting II*, 72 Fed. Reg. at 24,091 (quoting *Webcasting I*, 67 Fed. Reg. at 45,244).

36. Both the webcasters and SoundExchange proposed rate structures that included revenue-based elements and usage-based elements. The Judges, however, concluded that a per performance usage fee structure was more appropriate for commercial webcasters, and rejected revenue-based proposals. *Webcasting II*, 72 Fed. Reg. at 24,089.

37. The parties submitted competing benchmarks as the basis for setting rates. The Judges concluded that based on the available evidence, "the most appropriate benchmark agreements are those reviewed by Dr. Pelcovits in the market for interactive webcasting covering the digital performance of sound recordings." *Webcasting II*, 72 Fed. Reg. at 24,092.

38. For commercial webcasters, the Judges established per performances rates as follows: $.0008 for 2006; $.0011 for 2007; $.0014 for 2008; $.0018 for 2009; and $.0019 for 2010. For noncommercial webcasters, the Judges set a per station or per channel rate of $500 for

transmissions not exceeding 159,140 ATH per month, with usage in excess of that ATH cap at the commercial per performance rates. For all webcasters, the Judges set a non-refundable but recoupable minimum fee at $500 per channel or station. *Webcasting II*, 72 Fed. Reg. at 24,096, 24,100.

39. With respect to the royalty for ephemeral copies, the Judges expressed their dissatisfaction with the record evidence presented by the parties, and declined to ascribe any percentage of the royalty as the value of the Section 112 license. *Webcasting II*, 72 Fed. Reg. at 24,101-02.

40. The Judges also established terms for the Section 112 and 114 licenses, including the designation of SoundExchange as the sole Collective to collect and distribute statutory webcasting royalties. *Webcasting II*, 72 Fed. Reg. at 24,102-10.

**a. Appeals to the D.C. Circuit**

41. Several webcasters appealed various aspects of this Court's decision to the United States Court of Appeals for the District of Columbia Circuit. Commercial webcasters challenged the rates and terms on several grounds, including that the Judges erred by not basing rates on a perfectly competitive market, and by basing rates on the Pelcovits interactive benchmark because the interactive market is insufficiently competitive. The D.C. Circuit rejected all of these claims. *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 757-58 (D.C. Cir. 2009).

42. Commercial webcasters also appealed the $500 minimum fee, arguing that it was arbitrary for the Judges not to impose a cap on the number of a service's channels or stations subject to the minimum fee. *Intercollegiate Broad. Sys.*, 574 F.3d at 761-62. The D.C. Circuit agreed, and vacated and remanded the minimum fee for commercial webcasters. *Intercollegiate Broad. Sys.*, 574 F.3d at 762.

43. Noncommercial webcasters challenged several aspects of the Judges' decision, including the Judges' rejection of the NPR agreement as a benchmark, the $500 minimum fee, the adoption of a usage-based fee above the 159,140 ATH cap, and the Judges' decision to defer a determination on record-keeping requirements to a later proceeding. *Intercollegiate Broad. Sys.*, 574 F.3d at 761-62. The D.C. Circuit rejected these claims, except the minimum fee challenge. With respect to the minimum fee, the D.C. Circuit held that "[b]ecause there is no record evidence that $500 represented SoundExchange's administrative cost per channel or station, the Judges' determination in this regard cannot be sustained." *Intercollegiate Broad. Sys.*, 574 F.3d at 767. The D.C. Circuit thus vacated and remanded the minimum fee for noncommercial webcasters.

44. Finally, Royalty Logic challenged the constitutionality of the Copyright Royalty Judges under the Appointments Clause. The D.C. Circuit ruled that Royalty Logic waived this argument by failing to raise it in its opening appellate brief. *Intercollegiate Broad. Sys.*, 574 F.3d at 755-56. Royalty Logic also argued that the designation of SoundExchange as the sole Collective was contrary to Section 114, but the D.C. Circuit affirmed the designation. *Intercollegiate Broad. Sys.*, 574 F.3d at 770-71.

**b. Remand of the Minimum Fee Decisions**

45. On remand, SoundExchange and the Digital Media Association submitted a settlement regarding the statutory minimum fee to be paid by commercial webcasters. The settlement provided that commercial webcasters would pay a $500 annual per station or channel minimum fee, but that they would not be required to pay more than $50,000 a year in the aggregate (for 100 or more channels or stations). Upon publication of the settlement, *see* 74 Fed. Reg. 68,214 (Dec. 23, 2009), the Judges received no objections, except for one comment by IBS.

The Judges then adopted the settlement as a final rule for commercial webcasters for 2006 - 2010. 75 Fed. Reg. 6,097, 6,098 (Feb. 8, 2010).

46. The Judges convened a proceeding to set the minimum fee for noncommercial services on remand. IBS was the only participant on behalf of noncommercial services. SoundExchange participated on behalf of copyright owners and performers. SoundExchange presented evidence estimating that its administrative costs per station or channel exceed $500. *Amendment to Determination Pursuant to Remand Order*, at 4, Docket No. 2005-1 DTRA (June 30, 2010). It also presented evidence that the Webcaster Settlement Act agreement between CBI and SoundExchange includes a minimum fee of $500. *Amendment to Determination Pursuant to Remand Order*, at 4-6.

47. On this evidentiary record, the Judges set a $500 annual per station or channel minimum fee for noncommercial services for 2006 - 2010. *See Amendment to Determination Pursuant to Remand Order*, Docket No. 2005-1 DTRA (June 30, 2010).

### C. The Webcaster Settlement Acts of 2008 and 2009

48. In 2008, Congress passed the Webcaster Settlement Act ("WSA") of 2008, which Congress and the President extended in 2009, to encourage settlements of royalty disputes for statutory webcasting rates. Written Direct Testimony of W. Tucker McCrady at 3, SX Trial Ex. 7 ("McCrady WDT"). The WSA permitted SoundExchange and webcasters to negotiate settlements of ongoing disputes arising out of the royalty rates that were set by the Judges for the time period 2006 - 2010, and permitted SoundExchange to negotiate royalty rates for the time period 2011 - 2015. McCrady WDT at 3, SX Trial Ex. 7.

49. Congress's purpose in enacting the WSA was to facilitate settlements. Congress recognized that the circumstances of some webcasters might require experimental settlements, and that if settlements were automatically deemed precedential in rate-setting proceedings, then

parties might be deterred from entering into them -- a concern borne out by the fact that relatively few meaningful settlements were reached in prior webcasting proceedings. In light of this concern, the statute provides that WSA agreements may only be designated precedential by consent of both parties and that non-precedential WSA agreements "shall be considered a compromise motivated by the unique business, economic and political circumstances of webcasters, copyright owners, and performers rather than as matters that would have been negotiated between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(5)(C). Accordingly, Congress provided that the "rate structure, fees, terms, conditions, or notice and recordkeeping requirements" of non-precedential agreements shall not be "admissible as evidence or otherwise taken into account" in rate-setting proceedings. 17 U.S.C. § 114(f)(5)(C).

50. The WSA was successful in achieving its objective. SoundExchange entered into eight agreements under the WSA. *See* 74 Fed. Reg. 9,293 (March 3, 2009) (three agreements); 74 Fed Reg. 34,796 (July 17, 2009) (one agreement); 74 Fed. Reg. 40,614 (Aug. 12, 2009) (four agreements)

51. The vast majority of statutory webcasting royalties are paid by licensees subject to one of the WSA settlements with SoundExchange. Live365 Trial Ex. 25 at 12, 24 (showing that 94% of webcasting royalties paid to SoundExchange were at WSA rates for 2008, and 95% were at WSA rates for 2009); 4/21/10 Tr. 495:20-497:18 (Kessler) (3-4% of webcasters in 2008 and 2009 paid SoundExchange at CRB rates, and the rest paid at settled rates).

52. Indeed, the royalties paid by the webcasters that have opted into one of the three precedential Webcaster Settlement Act agreements that were admitted as exhibits in this proceeding – the Broadcasters Agreement with the National Association of Broadcasters ("NAB"), the Noncommercial Educational Webcasters Agreement with College Broadcasters,

Inc. ("CBI"), and the Commercial Webcasters Agreement with Sirius XM Radio – represented over 50% of the total webcasting royalties paid to SoundExchange in 2008. Kessler WDT at 5, SX Trial Ex. 5; Amended and Corrected Written Direct Testimony of Michael D. Pelcovits at 14, SX Trial Ex. 2 ("Pelcovits WDT"); Live365 Trial Ex. 25 at 12.

53. By contrast, the commercial webcasters that initially submitted written direct cases in this proceeding -- Live365 and RealNetworks -- account for a small portion of the total webcasting royalties paid to SoundExchange. In 2008, the royalties paid by these two parties' webcasting services represented less than 2.5% of the total webcasting royalties paid to SoundExchange. In 2009, they represented less than 2% of the webcasting royalties paid up to the date that direct cases were filed in September 2009. Kessler WDT at 5, SX Trial Ex. 5.

### D. History of This Proceeding

54. On January 5, 2009, the Judges published in the Federal Register a notice announcing the commencement of a proceeding to determine the reasonable rates and terms for public performances of sound recordings by means of an eligible nonsubscription transmission and transmissions made by a new subscription service, and the making of an ephemeral recording in furtherance of making a permitted public performance of the sound recording under Sections 112 and 114 of the Copyright Act, for the period January 1, 2011 to December 31, 2015. 74 Fed. Reg. 318 (Jan. 5, 2009).

#### 1. The Submission of Petitions to Participate

55. Petitions to participate were due no later than February 4, 2009. 74 Fed. Reg. 318, 319 (Jan. 5, 2009).

56. Thirty timely petitions to participate were filed (some jointly), by the following forty entities: Access2ip; Accuradio, LLC, Digitally Imported, Inc., Got Radio, LLC, ioWorldMedia, Inc., Radio Paradise, Inc., and SomaFM.com LLC (jointly); Amazon.com, Inc.;

Apple Inc.; Bonneville International Corporation; Catholic Radio Association; CBS Radio Inc.; Citadel Broadcasting Corporation, Clarke Broadcasting Corporation, Entercom Communications Corp., Galaxy Communications, LP, and Greater Media, Inc. (jointly); Clear Channel Communications, Inc.; College Broadcasters, Inc.; Commonwealth Broadcasting Corporation; David W. Rahn; Digital Media Association; Intercollegiate Broadcasting System, Inc. and Harvard Radio Broadcasting Co., Inc. (jointly); Live365, Inc.; LoudCity LLC; mSpot, Inc.; MTV Networks, a division of Viacom International Inc.; National Association of Broadcasters; National Religious Broadcasters Music License Committee; National Religious Broadcasters Noncommercial Music License Committee; NCE Radio Coalition; Pandora Media, Inc.; RealNetworks, Inc. (on behalf of itself and its affiliates); Royalty Logic, LLC; Sirius XM Radio Inc.; Slacker, Inc.; SoundExchange, Inc.; Spacial Audio Solutions, LLC; and Yahoo!, Inc.

57. The petitions of Access2ip, Commonwealth Broadcasting Corporation, Digital Media Association, Live365, Inc., LoudCity LLC, Slacker, Inc., and Spacial Audio Solutions were cited by the Judges as noncompliant with § 350.2 of the Judges' procedural regulations. These entities were directed to show cause, by no later than March 2, 2009, as to why their petitions should be accepted. *Order Announcing Negotiation Period and to Show Cause* (Feb. 24, 2009).

58. The petitions of Access2ip, Digital Media Association, Live365, Inc., and Slacker Inc. were subsequently accepted by the Judges. The petition of LoudCity LLC was not accepted, but the late-filed petition of Brandon J. Casci was accepted instead. The petition of Spacial Audio Solutions was not accepted. *Order Regarding Petitions to Participate Subject to Show Cause Order* (March 5, 2009).

59. National Public Radio, Inc., its member stations and all Corporation for Public Broadcasting-qualified radio stations (collectively, "Public Radio") filed a late petition to participate on June 4, 2009, which was accepted by the Judges. *Order Granting Public Radio's Motion for Leave to File Out of Time a Petition to Participate* (June 24, 2009).

**2. Period of Voluntary Negotiations**

60. A voluntary negotiation period began March 2, 2009 and ended May 29, 2009. Written notification of the status of negotiations was due June 1, 2009. *Order Announcing Negotiation Period and to Show Cause* (Feb. 24, 2009).

61. On June 1, 2009, SoundExchange submitted its Notice of Status of Settlement Negotiations. SoundExchange informed the Court that it had reached settlement agreements covering more than 400 licensees and several thousands individual stations, including entities that had filed petitions to participate in the Webcasting III proceeding. *See SoundExchange's Notice of Status of Settlement Negotiations*, at 1 (June 1, 2009). However, a small number of webcasting services had not opted into settlements and chose to litigate rates in this proceeding.

**3. Submission of Settlements to the CRJs**

**a. NAB Agreement**

62. Pursuant to 17 U.S.C. § 801(b)(7), on June 1, 2009 SoundExchange and the NAB jointly submitted to the Judges for publication and adoption as the basis for statutory rates and terms a partial settlement for certain Internet transmissions by commercial broadcasters.

63. The Judges published the settlement with modifications in the Federal Register on April 1, 2010, and invited any comments or objections by April 22, 2010. 75 Fed. Reg. 16377 (April 1, 2010).

64. No comments or objections were filed with respect to this settlement.

### b. Noncommercial Educational Webcasters Agreement

65. On August 13, 2009, SoundExchange and CBI jointly submitted to the Judges for publication and adoption as the basis for statutory rates and terms a partial settlement for certain Internet transmissions by noncommercial educational webcasters.

66. The Judges published the settlement with modifications in the Federal Register on April 1, 2010, and invited any comments or objections by April 22, 2010. 75 Fed. Reg. 16377 (April 1, 2010).

67. Twenty-four noncommercial educational webcasters filed comments in support of this settlement. IBS filed comments opposing this settlement, and SoundExchange filed comments noting two typographical errors in the settlement.

### c. Hearing on the Settlements

68. On May 5, 2010, the Judges held a hearing on the two settlements. SoundExchange appeared and argued in support of adoption of both settlements. CBI appeared and argued in support of adoption of the Noncommercial Education Webcasters Agreement. IBS appeared and opposed the Noncommercial Education Webcasters Agreement.

69. To date, the Judges have neither adopted nor declined to adopt the two settlements.

## 4. The Direct Cases

70. On September 29, 2009, the following six participants filed written direct statements in this proceeding: CBI, IBS, Live365, Inc., RealNetworks, Inc., Royalty Logic, LLC, and SoundExchange, Inc.

71. On April 16, 2010, RealNetworks filed a notice of withdrawal from the proceeding.

72. The direct case hearing was conducted over seven trial days from April 19, 2010 through April 28, 2010.

73. CBI, IBS, Live365, and SoundExchange presented witnesses in the direct case hearing. Royalty Logic did not appear or present evidence at the hearing.

**a. SoundExchange Witnesses**

74. During the direct case hearing, SoundExchange presented testimony from the following six witnesses:

75. Dennis Kooker is the Executive Vice President, Operations, and General Manager, Global Business and U.S. Sales, for Sony Music Entertainment ("Sony"), a position he has held since October 2008. Corrected Written Direct Testimony of Dennis Kooker at 1, SX Trial Ex. 1 ("Kooker WDT"). He is responsible for overseeing all aspects of the day-to-day operations of the Global Digital Business Group, which handles digital distribution and sales initiatives for Sony's label groups worldwide including the United States, and of the U.S. Sales Group, which handles distribution and sales and marketing initiatives for Sony's label groups in the United States. At Sony, Finance, Sales Reporting, Research, U.S. Supply Chain, and distributed labels report to Kooker. He also has general oversight with respect to the artist website group and the direct to consumer sales group. Kooker WDT at 1, SX Trial Ex. 1. Kooker testified before the Court during the direct phase of the trial on Monday, April 19, 2010, Vol. 1 ("4/19/10 Tr. (Kooker)").

76. Dr. Michael Pelcovits, an economist who received his Ph.D. from MIT in 1976, is a Principal of the consulting firm Microeconomic Consulting & Research Associates, Inc. ("MiCRA"), which specializes in the analysis of antitrust and regulatory economics. Since joining MiCRA in 2002, he has provided consulting services and reports for major corporations on a wide range of applied microeconomic issues, including telecommunications and intellectual

property. He has provided testimony before the Federal Communications Commission, many state regulatory commissions, the Office of Telecommunications in the United Kingdom, the European Commission, and the Ministry of Telecommunications of Japan, often in rate-setting proceedings. Pelcovits WDT at 1, SX Trial Ex. 2.

77. He previously testified before this Court on behalf of SoundExchange on three occasions: Docket No. 2005-1 CRB DTRA ("*Webcasting II*"); Docket No. 2006-1 CRB DSTRA ("*SDARS*"); and Docket No. 2005-5 CRB-DTNSRA. On each occasion, the Court accepted him as an expert in applied microeconomics. Pelcovits WDT at 1, SX Trial Ex. 2.

78. Prior to joining MiCRA, Dr. Pelcovits was Vice President and Chief Economist at WorldCom. In this position, and in a similar position at MCI prior to its merger with WorldCom, he was responsible for directing economic analysis of regulatory and antitrust matters before federal, state, foreign, and international government agencies, legislative bodies, and the courts. Prior to his employment at MCI, he was a founding principal of a consulting firm, Cornell, Pelcovits & Brenner. From 1979 to 1981, he was Senior Staff Economist in the Office of Plans and Policy, Federal Communications Commission. Pelcovits WDT at 1, SX Trial Ex. 2.

79. Dr. Pelcovits has lectured widely at universities and published several articles on telecommunications regulation and international economics. He holds a B.A. from the University of Rochester (*summa cum laude*) and a Ph.D. in Economics from MIT, where he was a National Science Foundation fellow. Pelcovits WDT at 2, SX Trial Ex. 2.

80. Dr. Pelcovits testified before the Court during the direct phase of the trial on Monday, April 19, 2010, Vol. 1 ("4/19/10 Tr. (Pelcovits)") and on Tuesday, April 20, 2010, Vol. 2 ("4/20/10 Tr. (Pelcovits)"). The Court accepted Dr. Pelcovits as an expert in applied microeconomic analysis. 4/19/10 Tr. 118:15-119:2 (Pelcovits).

81. Kim Roberts Hedgpeth is the National Director of the American Federation of Television and Radio Artists ("AFTRA"). AFTRA is a national labor organization representing over 70,000 actors, performers, journalists and other professionals and artists employed in the news, entertainment, advertising and sound recording industries, including approximately 12,000 vocalists on sound recordings. Written Direct Testimony of Kim Roberts Hedgpeth at 1-2, SX Trial Ex. 3 ("Roberts Hedgpeth WDT"). One of AFTRA's primary goals is to ensure its members' livelihoods by securing adequate compensation for the use of copyrighted sound recordings. Roberts Hedgpeth has worked for AFTRA for 28 years. She is also a member of the Board of SoundExchange. Roberts Hedgpeth WDT at 1-2, SX Trial Ex. 3. Roberts Hedgpeth testified before the Court during the direct phase of the trial on Tuesday, April 2010, Vol. 2 ("4/20/10 Tr. (Roberts Hedgpeth)").

82. Dr. George Ford is the President of Applied Economic Studies, a private consulting firm specializing in economic and econometric analysis. He is also the Chief Economist of the Phoenix Center for Advanced Legal & Economic Policy Studies, a Washington, D.C. based 501(c)(3) research organization that specializes in the legal and economic analysis of public policy issues involving the communications and technology industries. He is an Adjunct Professor at Samford University, where he teaches economics in the graduate program of the business school. He serves as a member of the Alabama Broadband Taskforce upon appointment by Alabama's Governor. Written Direct Testimony of Dr. George S. Ford at 1, SX Trial Ex. 4 ("Ford WDT").

83. Dr. Ford received a Ph.D. in Economics from Auburn University in 1994. In 1994, he became an economist in the Competition Division of the Federal Communications Commission. After his government tenure, he became an economist at MCI Communications,

where his work focused on telecommunications policy. In April 2000, he became the Chief Economist of Z-Tel Communications in Tampa, Florida, a small competitive telephone company. He has been in his present employment since 2004. Ford WDT at 1, SX Trial Ex. 4.

84. Dr. Ford's areas of specialty in economics include Industrial Economics, Regulation, and Public Policy, with an emphasis on the communications industries, including broadcast radio and television. He has written many papers on telecommunications and media policy, and much of this work has been published in economic and law journals including the *Journal of Law & Economics*, *Empirical Economics*, the *Journal of Business*, the *Journal of Regulatory Economics*, the *Antitrust Bulletin*, *Energy Economics*, the *Yale Journal on Regulation*, the *Federal Communications Law Journal*, and many others. He has testified before numerous public service commissions, state legislative bodies, and committees of the U.S. Congress on communications policy and rate setting. Ford WDT at 2, SX Trial Ex. 4

85. Dr. Ford testified before the Court during the direct phase of the trial on Tuesday, April 20, 2010, Vol. 2 ("4/20/10 Tr. (Ford)"). The Court accepted Dr. Ford as an expert in industrial economics. 4/20/10 Tr. 406:10-:17 (Ford).

86. Barrie Kessler is the Chief Operating Officer of SoundExchange, a position she has held since July 2001. She previously served as SoundExchange's Senior Director of Data Administration, beginning in November 1999. Her responsibilities include overseeing the collection and distribution of royalty payments for the performance of sound recordings through the various types of services eligible for statutory licensing. She supervises SoundExchange staff that receives royalty payments from licensees, determines the amounts owed copyright owners and performers, and distributes the royalties to those individuals and entities. She also oversees SoundExchange's technical involvement with licensees, manages its budget, and

coordinates its systems requirements, development, and testing. Kessler WDT at 1, SX Trial Ex. 5. Kessler testified before the Court during the direct phase of the trial on Tuesday, April 2010, Vol. 2 ("4/20/10 Tr. (Kessler)") and on Wednesday, April 21, 2010, Vol. 3 ("4/21/10 Tr. (Kessler)").

87. W. Tucker McCrady is Associate Counsel, Digital Legal Affairs at Warner Music Group (WMG), a position that he has held since early 2006. At WMG, he is primarily involved in negotiating digital licensing agreements. McCrady has negotiated agreements for the use of WMG sound recordings in a variety of different services, including downloads, audio and video streaming, ringtones and custom radio. In addition to his work at WMG, he also serves on the Board of Directors and the Licensing Committee of SoundExchange. The Licensing Committee is responsible for negotiating and approving settlements for statutory licensing on behalf of SoundExchange. McCrady WDT at 1, SX Trial Ex. 7. McCrady testified before the Court during the direct phase of the trial on Thursday, April 22, 2010, Vol. 4 ("4/22/10 Tr. (McCrady)").

**b. Live365 Witnesses**

88. During the direct phase of the proceeding, Live365 presented testimony from the following three witnesses:

89. Johnie Floater testified before the Court during the direct phase of the trial on Monday, April 26, 2010, Vol. 5 ("4/26/10 Tr. (Floater)").

90. Dr. Mark Fratrik testified before the Court during the direct phase of the trial on Tuesday, April 27, 2010, Vol. 6 ("4/27/10 Tr. (Fratrik)").

91. Dianne Lockhart testified before the Court during the direct phase of the trial on Wednesday, April 28, 2010, Vol. 7 ("4/28/10 Tr. (Lockhart)").

### c. IBS Witnesses

92. During the direct phase of the proceeding, IBS presented testimony from the following three witnesses:

93. John E. Murphy testified before the Court during the direct phase of the trial on Wednesday, April 21, 2010, Vol. 3 ("4/21/10 Tr. (Murphy)").

94. Benjamin Shaiken testified before the Court during the direct phase of the trial on Wednesday, April 21, 2010, Vol. 3 ("4/21/10 Tr. (Shaiken)").

95. Captain Frederick J. Kass, Jr. testified before the Court during the direct phase of the trial on Thursday, April 22, 2010, Vol. 4 ("4/22/10 Tr. (Kass)").

## 5. The Rebuttal Cases

96. On June 7, 2010, the following three participants filed written rebuttal statements: IBS, Live365, and SoundExchange.

97. The rebuttal case hearing was conducted over three trial days from July 28, 2010 through August 2, 2010.

98. SoundExchange and Live365 presented witnesses in the rebuttal trial.

### a. SoundExchange Witnesses

99. During the rebuttal phase of the proceeding, SoundExchange presented testimony from the following two witnesses:

100. Dr. Janusz Ordover is Professor of Economics and former Director of the Masters in Economics Program at New York University. He has worked at New York University since 1973. Dr. Ordover previously served as Deputy Assistant Attorney General for Economics at the Antitrust Division of the United States Department of Justice. His areas of specialization include industrial organization economics, with particular focus on antitrust and regulatory economics. He has testified previously on behalf of SoundExchange in the *SDARS* proceeding, Docket No.

2006-1 CRB DSTRA. Dr. Ordover has also testified or consulted on numerous other matters involving music or other content industries. Written Rebuttal Testimony of Dr. Janusz Ordover at 1-2, SX Trial Ex. 45 ("Ordover WRT").

101. Dr. Ordover testified before the Court during the rebuttal phase of the trial on Monday, August 2, 2010, Rebuttal Phase Vol. 3 ("8/2/10 Tr. (Ordover)"). The Court accepted Dr. Ordover as an expert in industrial organization economics. 8/2/10 Tr. 315:8-:15 (Ordover).

102. Kyle Funn worked at SoundExchange from May 2005 through August 2010, and became Manager, Licensing and Enforcement, in early 2008. His job responsibilities included monitoring licensees' compliance with the regulations related to payment and reports of use, and communicating deficiencies to them. He acted as a liaison between SoundExchange and licensees related to their compliance with statutory and regulatory requirements. In addition, he fielded questions from current and prospective licensees regarding general licensing, reporting and payment issues. Written Rebuttal Testimony of Kyle Funn at 1, SX Trial Ex. 46 ("Funn WRT"). Mr. Funn testified before the Court during the rebuttal phase of the trial on Monday, August 2, 2010, Rebuttal Phase Vol. 3 ("8/2/10 Tr. (Funn)").

**b. Live365 Witnesses**

103. During the rebuttal phase of the proceeding, Live365 presented testimony from the following two witnesses:

104. Dr. Michael A. Salinger testified before the Court during the rebuttal phase of the trial on Wednesday, July 28, 2010, Rebuttal Phase Vol. 1 ("7/28/10 Tr. (Salinger)").

105. Alexander Smallens testified before the Court during the rebuttal phase of the trial on Wednesday, July 28, 2010, Rebuttal Phase Vol. 1 ("7/28/10 Tr. (Smallens)").

### 6. Stipulation Concerning Ephemerals and Minimum Fee for Commercial Services

106. On May 14, 2010, SoundExchange and Live365 filed a stipulation seeking adoption of an agreed-upon minimum fee applicable to commercial webcasters, and a royalty rate under 17 U.S.C. § 112(e) for the making of ephemeral recordings. Specifically, the two parties proposed, based on substantial evidence in the record, an annual, nonrefundable minimum fee of $500 per channel or station, subject to an annual cap of $50,000 for a licensee with 100 or more channels or stations, and a royalty for the making of ephemeral recordings to be included within and constitute 5% of the total royalties paid under §§ 112 and 114. *See Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings* (May 14, 2010).

### 7. Stipulation Concerning Certain Terms

107. Live365 and SoundExchange have recently stipulated to some of the terms proposed by SoundExchange, and SoundExchange and Live365 are submitting those Stipulated Terms to the Court. *See Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding Certain Proposed Terms* (Sept. 10, 2010).

## III. THE WILLING BUYER/WILLING SELLER STANDARD AND THE HYPOTHETICAL MARKET

108. The Copyright Act requires the Judges to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B); 17 U.S.C. § 112(e)(4).

109. Section 114 sets forth "economic, competitive and programming information" that the Judges may consider in setting rates and terms:

> (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
>
> (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.
>
> In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements . . .

17 U.S.C. § 114(f)(2)(B).

110. This Court has held that the willing buyer/willing seller standard encompasses consideration of these factors. *Webcasting II*, 72 Fed. Reg. at 24,092.

111. In *Webcasting II*, this Court adopted a benchmarking approach to rate-setting and held that "we agree with *Webcaster I* that such considerations 'would have already been factored into the negotiated price' in the benchmark." 72 Fed. Reg. at 24,092 (citation omitted). In that circumstance, the Court declined to adjust the benchmark because it found that the § 114(f)(2)(B) factors were "implicitly accounted for in the rates that result from negotiations between the parties in the benchmark marketplace." 72 Fed. Reg. at 24,095.

112. As this Court has explained, the willing buyer/willing seller standard does not require that the rate ultimately set preserve the business of every webcaster:

> It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property

> rights of copyright owners. Furthermore, it would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act.

*Webcasting II*, 72 Fed. Reg. at 24,088 n.8.

113. The statutory directive to set rates and terms that "would have been negotiated" in the marketplace between a willing buyer and a willing seller requires the CRJs to replicate rates and terms that would have been negotiated in a hypothetical marketplace. The market is hypothetical because the actual marketplace for sound recordings sold to webcasters is preempted by the compulsory license that is the subject of this proceeding. *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, at 21, No. 2000-9 CARP DTRA 1&2 (CARP Feb. 20, 2002). The Judges therefore are called upon to establish a rate that would exist in this market if the parties were not subject to a statutory compulsory license.

114. The Judges have held "that in the hypothetical marketplace that would exist in the absence of a statutory license constraint, the willing sellers are the record companies." *Webcasting II*, 72 Fed. Reg. at 24,091. In *Webcasting II*, the Judges endorsed the conclusion from *Webcasting I* that "the willing buyers are the services which may operate under the webcasting license (DMCA-compliant services), the willing sellers are record companies and the product consists of a blanket license for each record company's complete repertoire of sound recordings." *Webcasting II*, 72 Fed. Reg. at 24,091 (quoting *Webcasting I*, 67 Fed. Reg. at 45,244).

115. The hypothetical market need not be characterized by "perfect" competition. *Webcasting II*, 72 Fed. Reg. at 24,091. In fact, the D.C. Circuit rejected such a claim, explaining that "[t]he statute does not require that the market assumed by the Judges achieve metaphysical

perfection in competitiveness." *Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 574 F.3d 748, 757 (D.C. Cir. 2009).

116. The question of competition "is concerned with whether market prices can be unduly influenced by sellers' power or buyers' power in the market." *Webcasting II*, 72 Fed. Reg. at 24091. This Court has explained that an "effectively competitive market is one in which super-competitive prices cannot be extracted by sellers or buyers, because both bring 'comparable resources, sophistication and market power to the negotiating table.'" *Webcasting II*, 72 Fed. Reg. at 24,091 (quoting *Webcasting I*, 67 Fed. Reg. at 45,245). The question of competition is "not confined to an examination of the seller's side of the market alone." *Webcasting II*, 72 Fed. Reg. at 24,091.

## IV. SOUNDEXCHANGE'S RATE PROPOSAL FOR COMMERCIAL WEBCASTERS

117. SoundExchange's rate proposal for commercial webcasters is set forth in the *Second Revised Proposed Rates and Terms of SoundExchange, Inc.* (July 23, 2010). SoundExchange submitted proposed regulations (redlined to show changes from the current regulations) as an attachment to its *Second Revised Proposed Rates and Terms*.

118. For commercial webcast transmissions and related ephemeral recordings by commercial webcasters as defined in 37 C.F.R. § 380.2(d), SoundExchange has proposed the following per performance rates:

| *Year* | *Rate per performance* |
|---|---|
| 2011 | $0.0021 |
| 2012 | $0.0023 |
| 2013 | $0.0025 |
| 2014 | $0.0027 |
| 2015 | $0.0029 |

119. The proposed rates fall well within the range of marketplace rates that Dr. Pelcovits has calculated, and thus meet the willing buyer/willing seller standard of 17 U.S.C. § 114(f)(2)(B). The economic analysis underlying SoundExchange's proposed per performance rates for commercial webcasters is discussed *infra* at Section V.

120. SoundExchange has also proposed a $500 annual, nonrefundable minimum fee for each calendar year or part of a calendar year, for each channel or station, subject to an annual cap of $50,000 for a licensee with 100 or more channels or stations. Under this proposal, upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalty fees payable in the same calendar year. *See Second Revised Proposed Rates and Terms of SoundExchange*, at 2 (July 23, 2010). Live365 and SoundExchange have stipulated to this minimum fee for commercial webcasters, and the evidence supporting the proposed minimum fee is discussed *infra* at Section X.A.2.

121. In addition, pursuant to 17 U.S.C. § 801(b)(7), SoundExchange submitted two settlements to the Judges for publication and adoption as the basis for statutory rates and terms for certain webcasting services: (1) an agreement with the National Association of Broadcasters ("NAB"), and (2) an agreement with College Broadcasters, Inc. ("CBI"). The Judges have published those settlements for comment, but have neither adopted nor declined to adopt them. SoundExchange continues to support adoption of those settlements. If the settlements are adopted, then the webcasting services that meet the eligibility definitions in the settlements should be subject to the rates and terms therein. If the settlements are not adopted, then those webcasting services should be subject to the rates and terms set in this proceeding.

122. SoundExchange has also proposed terms, which are discussed *infra* at Section XII.A.

123. SoundExchange's proposal for an ephemeral rate, which Live365 has stipulated to, is discussed *infra* at Section XIV.

## V. SOUNDEXCHANGE'S RATE PROPOSAL FALLS WITHIN THE RANGE OF REASONABLE RATES CALCULATED BY DR. PELCOVITS.

124. Dr. Pelcovits analyzed two types of evidence from the market to establish a reasonable range of rates for the statutory license. Specifically, Dr. Pelcovits analyzed (1) the license fees in the interactive, on demand audio streaming market and (2) the recent precedential agreements negotiated by SoundExchange with two sets of commercial webcasters under the Webcaster Settlement Acts of 2008 and 2009 (the "WSA"). Pelcovits WDT at 2, SX Trial Ex. 2.

125. In using the interactive services benchmark and the analysis of the precedential WSA Agreements, Dr. Pelcovits sought to estimate the proper per-performance license fee "that would prevail in the hypothetical market as defined by this Court's interpretation of the governing statute." Pelcovits WDT at 6, SX Trial Ex. 2. Dr. Pelcovits applied the willing buyer/willing seller standard to his analysis, wherein the buyers in the hypothetical market "are the statutory webcasting services and this marketplace is one in which no statutory license exists," and the sellers "are record companies, and the products sold consist of a blanket license for the record companies' complete repertoire of sound recordings." Pelcovits WDT at 6, SX Trial Ex. 2.

126. Ultimately, Dr. Pelcovits concluded that SoundExchange's proposed rate for commercial webcasters falls within the range of reasonable rates that would possibly occur in the hypothetical marketplace as demonstrated in the following table:

| *Year* | *WSA Agreement Rates* | *SoundExchange Rate Proposal* | *Interactive, On-Demand Rates (No Substitution Adjustment)* |
|---|---|---|---|
| 2011 | $0.00175 | **$0.0021** | $0.0036 |
| 2012 | $0.00200 | **$0.0023** | $0.0036 |
| 2013 | $0.00215 | **$0.0025** | $0.0036 |
| 2014 | $0.00225 | **$0.0027** | $0.0036 |
| 2015 | $0.00245 | **$0.0029** | $0.0036 |

Pelcovits WDT at 37, SX Trial Ex. 2.

127. As set forth above, even the highest of SoundExchange's proposed rates -- $0.0029 in 2015 -- falls well below the top of the range of reasonable rates determined by Dr. Pelcovits. Rather than propose its highest rate for all five years of the statutory term, SoundExchange has proposed that the rates should increase gradually in $0.0002 increments per year during the course of the statutory period, ending at the highest rate.

128. This gradually stepped increase is supported by the rate structures in the three WSA agreements submitted as evidence in this proceeding. Under the NAB Agreement, rates increase by $0.0001, $0.0002 or $0.0003 each year of the 20011 - 2015 term. McCrady WDT, Ex. 101-DP at § 4.2, SX Trial Ex. 7. Under the Commercial Webcasters Agreement, rates increase by $0.0002 for two of the years and by $0.0001 for two years of the 2011 - 2015 term. McCrady WDT, Ex. 102-DP at § 4.2, SX Trial Ex. 7. Under the CBI Agreement, the royalty rates for usage in excess of the minimum increase by $0.0001, $0.0002 or $0.0003 each year of the 2011 - 2015 term. McCrady WDT, Ex. 103-DP at § 4.2, SX Trial Ex. 7. (The NAB and Commercial Webcasters Agreements also include rate increases of $0.0001 for years before the 2011 - 2015 term.)

### A. Dr. Pelcovits's Interactive Services Benchmark

129. As he did in *Webcasting II*, Dr. Pelcovits has conducted a benchmark analysis by analyzing "the license fees that have been negotiated in the recent past between willing buyers and willing sellers in the market for interactive, on-demand digital audio transmissions." Pelcovits WDT at 2, 29, SX Trial Ex. 2; 4/19/10 Tr. 126:6-126:15 (Pelcovits).

130. Dr. Pelcovits explained that the agreements from the interactive, on-demand market "are important evidence because they are marketplace agreements negotiated, in many cases, between the very same companies that would be actors in the hypothetical market in this case, and involve services that are very similar to statutory webcasting except for the degree of interactivity that is offered to consumers." Pelcovits WDT at 3, SX Trial Ex. 2; 4/19/10 Tr. 126:20-22 (Pelcovits).

131. Dr. Pelcovits testified about additional strengths of analyzing the interactive, on-demand market, including the fact that in this proceeding he "was able to obtain evidence on the nature of the transactions that go on in the market" for interactive webcasting. 4/19/10 Tr. 126:22-127:2 (Pelcovits). He also explained that the interactive, on-demand market reflects "a market which is not directly affected by the statutory or regulatory regime that's setting the rates," in the statutory webcasting market, which further strengthens the usefulness of his analysis. 4/19/10 Tr. 127:2-4 (Pelcovits); Pelcovits WDT at 3, SX Trial Ex. 2 ("[T]he interactive, on-demand service agreements represent marketplace transactions with no regulatory backstop for the parties, and in that sense offer a better benchmark" than the WSA Agreements).

### 1. Dr. Pelcovits Used the Same Interactive Services Benchmark That This Court Used to Set Rates in *Webcasting II*.

132. In prior proceedings, this Court has consistently relied on a benchmark approach to setting rates. *E.g.*, *Webcasting II*, 72 Fed. Reg. at 24,095-96; *SDARS*, 73 Fed. Reg. at 4,093-94.

133. In *Webcasting II*, SoundExchange presented a Pelcovits interactive services benchmark adjusted to account for the value of interactivity. *Webcasting II*, 72 Fed. Reg. at 24,092. This Court concluded that the Pelcovits benchmark was "of the comparable type that the Copyright Act invites us to consider," and the "most appropriate" benchmark presented to it. *Webcasting II*, 72 Fed. Reg. at 24,092. Accordingly, this Court held that the Pelcovits benchmark supported the usage rates proposed by SoundExchange, and used the benchmark as the basis for the rates it set. *Webcasting II*, 72 Fed. Reg. at 24,095-96.

134. In this proceeding, SoundExchange has presented the same Pelcovits interactive benchmark (updated with more recent information) with a similar interactivity adjustment in support of its rate proposal. 4/19/10 Tr. 126:6-15 (Pelcovits); Pelcovits WDT at 22-24, SX Trial Ex. 2.

135. This Court explained its reasons for accepting the Pelcovits benchmark in *Webcasting II*. The CRJs found that the "interactive webcasting market is a benchmark with characteristics reasonably similar to non-interactive webcasting, particularly after Dr. Pelcovits' final adjustment for the difference in interactivity." *Webcasting II*, 72 Fed. Reg. at 24,092. The Court observed that "[b]oth markets have similar buyers and sellers and a similar set of rights to be licensed (a blanket license in sound recordings)." *Webcasting II*, 72 Fed. Reg. at 24,092. The Court further explained the suitability of the Pelcovits benchmark as follows:

> Both markets are input markets and demand for these inputs is driven by or derived from the ultimate consumer markets in which these inputs are

> put to use. In these ultimate consumer markets, music is delivered to consumers in a similar fashion, except that, as the names suggest, in the interactive case the choice of music that is delivered is usually influenced by the ultimate consumer, while in the non-interactive case the consumer usually plays a more passive role. . . . But this difference is accounted for in Dr. Pelcovits' analysis.

*Webcasting II*, 72 Fed. Reg. at 24,092.

136. In *Webcasting II*, the CRJs determined that, based on the evidence in the record, a per-performance usage fee rate structure was the most appropriate structure for commercial webcasters. *Webcasting II*, 72 Fed. Reg. at 24,090. Among other things, such a rate structure avoids the difficulties that may be associated with measuring revenue in a greater-of rate structure that includes a percentage-of-revenue fee. *Webcasting II*, 72 Fed. Reg. at 24,089.

137. Consistent with the Court's determination in *Webcasting II*, Dr. Pelcovits has presented, and SoundExchange has proposed, a per performance usage fee rate structure.

### 2. Overview of the Interactive-Services Benchmark

138. As in *Webcasting II*, Dr. Pelcovits determined that "the interactive, on-demand music services [are] the best benchmark to use for the purpose of setting rates for statutory webcasting services in this proceeding." Pelcovits WDT at 23, SX Trial Ex. 2. Dr. Pelcovits testified that "it is reasonable to predict that the ratio of per-subscriber royalty fees to consumer subscription prices will be essentially the same in both the benchmark and target markets." Pelcovits WDT at 23, SX Trial Ex. 2; 4/20/10 Tr. 277:4-278:21 (Pelcovits) (explaining that the calculation is based in part on the assumption that elasticities of demand will be equivalent in the interactive and statutory webcasting markets, a result that Dr. Pelcovits has observed "in a number of markets with intellectual property, and it is also confirmed if you were to do an analysis or a variety of other analyses"); Live365 Trial Ex. 5 at 30-37 (outlining the economic

support for this theory); 7/28/10 Tr. 41:9-42:1 (Salinger) (accepting the assumption that the ratio will be the same in both markets).

139. In order to use the rates in the benchmark market to develop a rate in the target market, Dr. Pelcovits had to make a number of adjustments "to account for the differences between the benchmark and target markets." Pelcovits WDT at 22, SX Trial Ex. 2; 4/29/10 Tr. 127:5-15 (Pelcovits). Specifically, Dr. Pelcovits had to: (1) adjust the subscription prices in the interactive market to remove the value of interactivity; (2) adjust the benchmark rates to take into account the fact that there are more plays per subscriber in the non-interactive market; and (3) conduct a sensitivity analysis to address the possibility that the interactive market substitutes for the sales of CDs or digital downloads to a greater degree than the statutory market. Pelcovits WDT at 23, SX Trial Ex. 2.

### 3. Background on Marketplace Agreements

140. The starting point for the interactive services benchmark is "the agreements between the interactive webcasters and the record companies." 4/19/10 Tr. 128:1-3 (Pelcovits); Pelcovits WDT at 29, SX Trial Ex. 2. As set forth in Appendix IV of Dr. Pelcovits's written testimony, he reviewed 214 such agreements and amendments in preparing his testimony. Pelcovits WDT, App IV, SX Trial Ex. 2; *see also Post-Hearing Responses to Judges' Questions by Michael D. Pelcovits*, at 2-3 (May 21, 2010).

141. The 214 agreements that Dr. Pelcovits reviewed included numerous agreements from all four of the major record companies -- Universal Music Group ("UMG"), Sony Music Entertainment ("Sony"), Warner Music Group ("WMG"), and EMI. Pelcovits WDT, App IV, SX Trial Ex. 2. The agreements and amendments reviewed by Dr. Pelcovits "spanned the period from approximately 2004 through 2009," but "most of the contracts were in the last three years."

4/19/10 Tr. 129:3-5 (Pelcovits). All of the agreements and amendments that Dr. Pelcovits reviewed were produced to Live365 in discovery in this proceeding.

142. Under the terms of the agreements that Dr. Pelcovits reviewed, interactive webcasting services generally "pay royalties on the basis of the greatest of three measures: a per-play rate; a percentage of gross revenue rate; and a per-subscriber fee." Pelcovits WDT at 29, SX Trial Ex. 2; 4/29/10 Tr. 129:10-130:3 (Pelcovits).

143. To provide context for Dr. Pelcovits's analysis of the marketplace agreements, Tucker McCrady testified at length about "deals for the digital exploitation of WMG's extensive catalog of copyrighted sound recordings." McCrady WDT at 9, SX Trial Ex. 7. According to McCrady, the agreements for online audio streaming within the United States "fall into three broad categories: (1) subscription on-demand streaming, (2) ad-supported streaming, and (3) custom radio." McCrady WDT at 9, SX Trial Ex. 7.

**a. Subscription On-Demand Streaming**

144. Subscription on-demand audio streaming services are "[a]mong the more established and profitable negotiated streaming deals that WMG has executed." McCrady WDT at 12, SX Trial Ex. 7. The identifying feature of this type of service is that it allows a paying subscriber to request the exact song he or she wishes to hear. McCrady WDT at 12, SX Trial Ex. 7. In addition, most of these services allow their subscribers to conditionally download requested songs to their personal computer and sometimes to a portable storage device, such as an iPod. McCrady WDT at 12, SX Trial Ex. 7. These downloads remain available for listening at any time by a subscriber, provided that the subscription remains active. McCrady WDT at 12, SX Trial Ex. 7.

145. McCrady testified about the agreement that WMG has with Napster, LLC ("Napster") for its on-demand audio streaming service, which has both a non-portable and a

portable offering. *See* McCrady WDT, Ex. 104-DR, SX Trial Ex. 7. For both offerings, on a monthly basis WMG receives the greatest of either [ ]. McCrady WDT at 12-13, SX Trial Ex. 7. [ ]. McCrady WDT at 12-13, SX Trial Ex. 7. Although the specific amounts in each of the three payment calculations varies from agreement to agreement, the agreement with Napster contains the general rate structure that WMG has with all subscription on-demand streaming services. McCrady WDT at 13, SX Trial Ex. 7.

146. By design, the per-play fee in the Napster agreement functions as a floor for WMG's revenue from the deal. McCrady WDT at 14, SX Trial Ex. 7. As highlighted by the May 2009 Subscription Earnings Statement provided by Napster to WMG and attached to Mr. McCrady's testimony, in neither the portable nor non-portable tier of service was the per-play fee the "greatest of". McCrady WDT, Ex. 105-DR, SX Trial Ex. 7; McCrady WDT at 13, SX Trial Ex. 7. For the portable service offering, WMG was paid on the basis of the [ ], an amount that was [ ]. McCrady WDT, Ex. 105-DR, SX Trial Ex. 7; McCrady WDT at 13, SX Trial Ex. 7. For the non-portable service offering, WMG was paid on the basis of the [ ], an amount that was [ ]. McCrady WDT, Ex. 105-DR, SX Trial Ex. 7; McCrady WDT at 14, SX Trial Ex. 7.

147. WMG has also recently negotiated deals with two streaming service providers -- Napster and Microsoft -- for services that provide a limited number of monthly permanent

download credits to their subscribers. McCrady WDT at 14, SX Trial Ex. 7. These downloads can be played by a subscriber regardless of whether he or she maintains a subscription and "are being offered essentially as a sales incentive, in an attempt to win over consumers who may continue to be uncomfortable with the idea of 'renting' music that is associated with Napster and other such services, where access to music is dependent on continued membership, and users never possess the music on a permanent basis." McCrady WDT at 14, SX Trial Ex. 7.

148. The bundled-offer agreement with Napster has a three-tier greatest of structure that is essentially the same as the more traditional on-demand subscription agreement that WMG has with Napster. McCrady WDT, Ex. 106-DR, SX Trial Ex. 7. And as with that prior agreement, the per-play fee in the bundled-offer agreement serves as a floor for WMG's revenues. The May 2009 Bundled Offer Royalty Statement provided to WMG by Napster and attached to McCrady's testimony shows that for that month WMG was paid on the basis of the [redacted] for the [redacted] and for the [redacted] the [redacted] McCrady WDT at 14, SX Trial Ex. 7; McCrady WDT, Ex. 107-DR, SX Trial Ex. 7. Although this service offering is new, McCrady explained that WMG is "enthusiastic about the possibility that these types of services represent for revenue growth," and that these bundled-offer agreements "are examples of the opportunities presented by free-market negotiations." McCrady WDT at 14-15, SX Trial Ex. 7.

### b. Ad-Supported On-Demand Streaming

149. Recently, a number of on-demand streaming services have begun offering ad-supported streaming, that allows listeners to request specific songs but does not require a subscription. As McCrady noted, WMG tends "to view the ad-supported audio business model with caution, because it has yet to generate stable revenue streams." McCrady WDT at 15, SX

Trial Ex. 7. McCrady explained that in contrast to traditional terrestrial radio and statutory webcasting, both of which are well-established business models that WMG hopes will continue to grow, whether ad-supported on-demand services "will stand on their own terms or whether they will be able to generate the revenues that are commensurate with the customer experiences has yet to be seen, so that's why I refer to them as experimental." 4/22/10 Tr. 663:7-16 (McCrady)

150. Because of this cautious approach, the licensing agreements that WMG entered into with imeem and MySpace -- two social networking sites that at one point in time offered ad-supported on-demand streaming -- represent "WMG's licensing approach at its most experimental, as we seek to develop an alternate business model that is very much in demand (as evidenced by the services' popularity), but which is not yet mature." McCrady WDT at 15, SX Trial Ex. 7.

151. With ad-supported on-demand services like MySpace Music, WMG works with the service provider in an effort to drive consumers to purchase more digital downloads. Even more importantly, the agreements that WMG has negotiated with these types of services are "[ ]." McCrady WDT at 15, SX Trial Ex. 7.

**c. Custom Radio**

152. The final category of audio streaming services with which WMG has negotiated direct agreements are so-called custom radio services, which "are not on-demand, but are, to a degree, customized to the listener's preferences." McCrady WDT at 16, SX Trial Ex. 7. Traditionally, the direct agreements with custom radio services "included a per-play rate expressed as a percentage of the statutory webcasting rate." McCrady WDT at 16, SX Trial Ex.

7. For example, in WMG's agreement with Slacker, discussed in McCrady's testimony, the per-play rate for the Basic Radio Service, which features advertising and limited numbers of skips, is [ ] and the per-play rate for the Premium Radio Service, which is ad-free and permits unlimited forward skipping, is [ ] McCrady WDT at 17, SX Trial Ex. 7; Live365 Trial Ex. 18 at 11.

153. There has been some uncertainty about whether custom radio services were covered by the statutory license. In *Arista Records, et al. v. Launch Media, Inc.*, 578 F.3d 148, 164 (2d Cir. 2009), the Second Circuit determined that Launch, a custom radio service, qualified as non-interactive. WMG "has always believed that custom radio services, with their varying degrees and types of customization, ought to pay more than the terms in the agreements tend to indicate because the user experience of some of these services is so good that they probably substitute for on-demand services that tend to pay us more." McCrady WDT at 16, SX Trial Ex. 7. But because many custom radio services believed that they were covered by the statutory license, even prior to the *Launch Media* decision, "the existence of the statutory licensing option has depressed the market rates for the use of copyrighted music in customized audio streaming deals." McCrady WDT at 16, SX Trial Ex. 7.

154. As noted by McCrady, as a result of the *Launch Media* decision, "we are likely to see a proliferation of customized webcasting services in the coming years that will be able to offer listeners a highly personalized entertainment experience, while paying only the statutory royalties the CRJs have established for more traditional, non-interactive, non-customized webcasting." McCrady WDT at 16, SX Trial Ex. 7; *see also* Pelcovits WDT at 13-14, SX Trial

Ex. 2. Because of this likely increase in customized webcasting, "the importance of setting a reasonable statutory rate, designed to reflect the likely migration to customized webcasting services, is of paramount importance to WMG." McCrady WDT at 18, SX Trial Ex. 7.

**d. Factors Considered in Licensing**

155. In all of WMG's digital audio deals, there are a number of consistently important components that are the focus of WMG's negotiating strategy. Chief among WMG's concerns is that all of its negotiated marketplace agreements "feature a payment structure based on the greatest of three different amounts (or in some cases, the greater of two different amounts)." McCrady WDT at 9-10, SX Trial Ex. 7.

156. According to McCrady, there is not a single agreement for the use of WMG's sound recordings in an audio streaming service operating within the United States that features a payment structure that requires payments solely on the basis of a per-play rate. McCrady WDT at 10, SX Trial Ex. 7; 4/22/10 Tr. 658:1-5 (McCrady). In WMG's marketplace streaming agreements, the company "view[s] the per-play minimum payment as the absolute floor for [its] revenue, a minimum protection for the value of the recordings [it] provide[s]." McCrady WDT at 10, SX Trial Ex. 7.

157. To establish an upside for the possible revenue from a streaming agreement, WMG generally requires audio streaming services to pay the greatest of: "[ ]" McCrady WDT at 10, SX Trial Ex. 7. The proportionate share is calculated as a percentage of the total streams on a service that are streams of WMG content. McCrady WDT at 10, SX Trial Ex. 7. As explained by McCrady, WMG's use of a greatest-of structure is:

> particularly important for business models that haven't fully matured or that we hope to see a lot more from in that it enables us to set a per-play floor, a basic rate that is much lower than we would have liked, but that is seen as sort of a minimum protection for the value of the music that we provide. And then it, on the other hand, offers a revenue share that allows us to -- it allows us to share in the upside as the service exceeds and it allows the service to experiment with retail prices and charges to the consumer and rates to advertising partners and so on to see where the best fit is.

4/22/10 Tr. 658:9-20 (McCrady).

158. SoundExchange previously proposed a greatest-of structure for the statutory license, but that structure was rejected by the Court in *Webcasting II* and SoundExchange does not presently propose such a structure.

159. In addition to the greatest-of rate structure, WMG also negotiates a number of other important features in the marketplace agreements that cannot be negotiated in the statutory license. For example, the typical WMG audio streaming agreement includes a non-refundable advance payment, which "essentially serve[s] as [a] minimum revenue guarantee[]," and "which can be significantly higher than the minimum payment requirements under the statutory rate and the WSA settlements." McCrady WDT at 10, SX Trial Ex. 7; 4/22/10 Tr. 659:5-6 (McCrady). In the agreement that WMG has with Napster for Napster's subscription on-demand audio streaming service, Napster was required to pay a [redacted] for the first year of the agreement and an additional [redacted] for each renewal term. McCrady WDT at 13, SX Trial Ex. 7.

160. WMG's marketplace agreements also feature strict security requirements, limitations on approved devices, audio quality specifications, and occasional limitations on the catalog of recordings that are made available. McCrady WDT at 10-11, SX Trial Ex. 7. As McCrady explained, "[a]ll of these deal components are designed to ensure that each digital

audio streaming service functions as a distinct product, offering a distinct method of monetization, and limit the substitution risk for other revenue sources (such as permanent digital downloads)." McCrady WDT at 11, SX Trial Ex. 7; 4/22/10 Tr. 660:16-661:16 (McCrady).

161. WMG's marketplace agreements are also generally of short duration relative to the five-year term for the statutory license rates. By agreeing to short-term deals, especially for new services, "WMG is able to commit to a particular deal structure in the short term, knowing that it will be able to re-assess the structure's long-term financial viability when technology and consumer preferences inevitably change." McCrady WDT at 11, SX Trial Ex. 7. In contrast, the five-year rate period for the statutory license "means that there is no opportunity to correct for undervaluation until the next rate-setting proceeding." McCrady WDT at 11, SX Trial Ex. 7.

#### 4. Calculation of the Interactive, On-Demand Benchmark Rate

162. As discussed *supra* at Section V.A.1, in *Webcasting II*, the CRJs determined that a per-performance rate was the most appropriate rate structure for statutory webcasting. *Webcasting II*, 72 Fed. Reg. at 24,090. For that reason, Dr. Pelcovits proposes only a range of per-performance rates and has not analyzed any other potential rate structures. Pelcovits WDT at 6, SX Trial Ex. 2; 4/29/10 Tr. 130:4-13 (Pelcovits).

163. An element of using a benchmark approach is that because "it is not the same market as the market where the court is setting the rate, it's necessary to make an adjustment in order to apply the benchmark to the statutory market." 4/19/10 Tr. 127:10-15 (Pelcovits); Pelcovits WDT at 3, SX Trial Ex. 2. As Dr. Pelcovits explained, in deriving a recommended statutory rate from the benchmark interactive rate, "[m]ost importantly, an adjustment must be made to account for the value that consumer place on the greater interactivity offered by the on-demand services compared to statutory services." Pelcovits WDT at 3, SX Trial Ex. 2; *Webcasting II*, 72 Fed. Reg. at 24,092 ("In order to make the benchmark interactive market more

comparable to the non-interactive market, Dr. Pelcovits adjusts the benchmark by the added value associated with the interactivity characteristic.").

164. Dr. Pelcovits also made adjustments on the basis of differences in usage intensity by subscribers of interactive and non-interactive services, Pelcovits WDT at 31, SX Trial Ex. 2, and differences in the substitutional effect of the two types of services on CD and permanent download sales. Pelcovits WDT at 35-36, SX Trial Ex. 2.

**a. The Per-Play Calculation and Adjustment**

165. In *Webcasting II*, Dr. Pelcovits used the per-subscriber fee set forth in the on-demand marketplace agreement as the starting point. Pelcovits WDT at 30, SX Trial Ex. 2; Live365 Trial Ex. 5 at 28-31. He then proceeded to calculate a recommended three-part royalty rate for the statutory license modeled after the greatest-of three-part structure found in the interactive agreements. Pelcovits WDT at 30, SX Trial Ex. 2; Live365 Trial Ex. 5 at 41-46.

166. In this proceeding, however, Dr. Pelcovits "adopted the approach that this Court found most appropriate in Web II, and . . . present[ed] only a per-play rate." Pelcovits WDT at 30, SX Trial Ex. 2. Because he only calculated a per-play royalty rate, Dr. Pelcovits determined the "effective per-play rate paid under the current contracts as the starting point for my calculation, rather than the per-subscriber rate." Pelcovits WDT at 30, SX Trial Ex. 2.

167. Dr. Pelcovits obtained from the record companies "either the raw monthly or quarterly statements that they receive for the interactive services with which they have agreements, or a spreadsheet showing the monthly revenue and unique plays reported by all such services." Pelcovits WDT at 30, SX Trial Ex. 2; 4/29/10 Tr. 128:3-7 (Pelcovits) ("I obtained actual data on essentially the transactions, how much the webcaster has paid the record companies over about approximately the last year and a half for these licenses."). The data that Dr. Pelcovits analyzed represents revenue "collected under the 'greatest of' formula that each

record company has negotiated with each service." Pelcovits WDT at 30, SX Trial Ex. 2. The data reviewed by Dr. Pelcovits also showed that the percentage of plays on the interactive services attributable to the four major labels was approximately 85%. 4/20/10 Tr. 299:12-19 (Pelcovits).

168. To derive the effective per-play rate in the interactive market, Dr. Pelcovits "divided the total revenue collected by the record companies from these services by the total number of unique plays of recorded music owned (or distributed) by the four major record companies reported by the interactive webcasting service[s]." Pelcovits WDT at 30, SX Trial Ex. 2; 4/19/10 Tr. 130:14-131:15 (Pelcovits). Dr. Pelcovits considered the data from numerous interactive webcasting services, including some that offer both a portable and non-portable service. Pelcovits WDT at 30, SX Trial Ex. 2. In total, the data reflected millions of dollars in revenues and "hundreds of millions or more" performances. 4/20/10 Tr. 346:12-347:9 (Pelcovits).

169. Using this data, Dr. Pelcovits calculated an effective per-play rate of 2.194¢. Pelcovits WDT at 30, SX Trial Ex. 2.

170. Among the adjustments necessary to apply the benchmark rate to the statutory webcasting market is the per-play adjustment factor, which will account for differences in the number of plays by subscribers of interactive, on-demand services and subscribers of non-interactive, statutory services. Pelcovits WDT at 31, SX Trial Ex. 2; 4/19/10 Tr. 139:22-141:4 (Pelcovits) ("[T]he number of plays on average by subscribers to the statutory service is different than in the benchmark market. And since I have derived my interactivity adjustment factor based on looking at this on a per subscriber basis, it's necessary for me to adjust for this

difference in plays on average in the two markets."); Live365 Trial Ex. 5 at 45 (conducting a similar adjustment in *Webcasting II*).

171. In calculating the monthly plays per subscriber for interactive services, Dr. Pelcovits used the same data set that he used to calculate the effective per-play rate, with the exception of one service which he excluded because it "did not report consistent total usage to all of the record companies." Pelcovits WDT at 31, SX Trial Ex. 2; 4/19/10 Tr. 141:6-15 (Pelcovits); 4/20/10 Tr. 307:1-10 (Pelcovits).

172. Using this data, Dr. Pelcovits calculated that the average number of monthly plays per subscriber for on-demand, interactive subscription services is 287.37. Pelcovits WDT at 31, SX Trial Ex. 2.

173. Dr. Pelcovits acknowledged that there is some difficulty in calculating the average number of monthly plays per subscriber for non-interactive services, primarily because "these services do not report the number of subscribers in public documents or in data provided to the record companies or SoundExchange." Pelcovits WDT at 31, SX Trial Ex. 2. In light of these difficulties, Dr. Pelcovits relied on data provided to the record companies for the subscription custom radio service Slacker Premium. Pelcovits WDT at 32, SX Trial Ex. 2. Although Slacker Premium does allow a degree of customization, most of the music transmitted through the service is pushed to the consumer, rather than being truly on-demand. Pelcovits WDT at 32, SX Trial Ex. 2. Therefore, Dr. Pelcovits concluded that "the data on plays-per-subscriber for this service is a good proxy for plays-per-subscriber for statutory subscription services -- especially those with a positive price." Pelcovits WDT at 32, SX Trial Ex. 2; 4/19/10 Tr. 141:16-142:12 (Pelcovits) (discussing use of Slacker Radio data as proxy).

174. Using the Slacker Premium data, Dr. Pelcovits calculated that the average monthly plays per subscriber for a statutory service is 563.36. Pelcovits WDT at 32, SX Trial Ex. 2. Dividing the plays per subscriber for interactive services by the plays per subscriber for statutory services results in a per-play adjustment of 0.5101. Pelcovits WDT at 33, SX Trial Ex. 2.

175. Based on data produced by Live365 during discovery, Dr. Pelcovits confirmed that the plays per subscriber number that he calculated for Slacker Premium represents a reasonable estimate of the plays per subscriber for the statutory webcasting market. Pelcovits WDT at 32 n.27, SX Trial Ex. 2. Because of inconsistencies regarding the actual intensity of listening by Live365's subscribers between testimony from Live365 witnesses and data produced during discovery, Dr. Pelcovits was not able to rely on Live365's data on plays per subscriber. Pelcovits WDT at 32 n.27, SX Trial Ex. 2. But Dr. Pelcovits did explain that "using the average of Slacker's data and Mr. Floater's assertion of 40 hours [of listening] per subscriber would lead to a slightly lower recommended non-interactive rate of $0.0035, and using the average of the Slacker data and the Live365 data [derived from Live365's documents] would lead to a rate slightly higher than the rate I have recommended." Pelcovits WDT at 32 n.27, SX Trial Ex. 2; 4/19/10 Tr. 142:12-21 (Pelcovits) (noting that the data from Live365, although "a little bit harder to interpret," "actually works out to numbers that are very similar to the Slacker numbers").

**b. The Interactivity Adjustment**

176. Once he had calculated the effective per-play rate in the interactive market and the per-play adjustment factor, Dr. Pelcovits further adjusted the per-play rate to account for the value of interactivity to consumers. Pelcovits WDT at 31, SX Trial Ex. 2; 4/19/10 Tr. 131:16-132:11 (Pelcovits) (explaining the use of an interactivity adjustment in *Webcasting II* and in the current proceeding). The starting point of this calculation is a comparison of subscription rates

for interactive and non-interactive audio streaming services. Pelcovits WDT at 24, SX Trial Ex. 2; Live365 Trial Ex. 5 at 31-32.

177. The theory behind comparing consumer subscription prices and then calculating an interactivity adjustment is based on the concept of derived demand, or as Dr. Pelcovits testified "the webcasters demand or have a need for the music performance because that's what their customers demand." 4/19/10 Tr. 132:12-133:1 (Pelcovits); Pelcovits WDT at 23, SX Trial Ex. 2 ("I believe it is reasonable to predict that the ratio of per-subscriber royalty fees to consumer subscription prices will be essentially the same in both the benchmark and target markets."); Live365 Trial Ex. 5 at 31-37 (explaining the economic theory behind the assumption that the ratio of per-subscriber royalty fees to subscription prices will be the same in both markets); 7/28/10 Tr. 41:9-42:1 (Salinger) (accepting the assumption that the ratio will be the same in both markets).

178. Dr. Pelcovits used the "interactivity factor to see how that would change the consumers' willingness to pay and then, based on a formula of an expectation that the ratio of the fee to the price in the two markets should be the same, I'm able to develop the recommended fee for the statutory royalty." 4/19/10 Tr. 133:2-17 (Pelcovits).

179. As he did in *Webcasting II*, Dr. Pelcovits calculated the so-called interactivity adjustment -- the calculation of the value consumers place on interactivity -- in two different ways. 4/19/10 Tr. 133:18-134:13 (Pelcovits); Live365 Trial Ex. 5 at 37-40. First, Dr. Pelcovits compared the retail subscription prices for interactive and non-interactive streaming services. Pelcovits WDT at 24, SX Trial Ex. 2; Live365 Trial Ex. 5 at 39-40.

180. Dr. Pelcovits and his research team collected information about forty-one audio streaming services that were available in the market at the time he prepared his testimony.

Pelcovits WDT at 24, SX Trial Ex. 2; 4/19/10 Tr. 134:14-135:4 (Pelcovits). Eighteen of the forty-one services that Dr. Pelcovits identified were paid subscription services. Pelcovits WDT at 24, SX Trial Ex. 2.

181. As Dr. Pelcovits testified, "[b]ecause it is more straightforward to infer differences in consumer willingness-to-pay (and by extension how much the webcaster would be willing to pay for the license) from observed prices for subscription services, I will focus my discussion on the results derived from these eighteen services." Pelcovits WDT at 24, SX Trial Ex. 2. Appendix III of Dr. Pelcovits's written testimony contains an econometric analysis of all 41 of the services and the results of that analysis "confirm the validity of the conclusions from the subscription services." Pelcovits WDT, App. III, SX Trial Ex. 2.

182. Of the 18 subscription services, 11 offer fully interactive, on-demand audio streaming, and 7 are arguably statutory non-interactive webcasters. Pelcovits WDT at 24-25, SX Trial Ex. 2. The average subscription price for the non-interactive services is $4.13. Pelcovits WDT at 25, SX Trial Ex. 2.

183. Dr. Pelcovits calculated the average subscription price of the interactive, on-demand services in two different ways. Pelcovits WDT at 25, SX Trial Ex. 2. The first approach simply took the average of the subscription prices for the 11 services and resulted in an average of $13.70. Pelcovits WDT at 25, SX Trial Ex. 2. In the second approach, Dr. Pelcovits adjusted two of the subscription prices downward, because those services offer a fixed monthly number of permanent downloads along with access to the on-demand, interactive audio streaming service. Pelcovits WDT at 25, SX Trial Ex. 2; 4/19/10 Tr. 135:5-136:16 (Pelcovits) (explaining the use of data from the record company to determine the appropriate downward adjustment for bundled

downloads). This calculation resulted in an average subscription price, adjusted for the bundled downloads, of $13.30. Pelcovits WDT at 25, SX Trial Ex. 2.

184. Dr. Pelcovits then calculated the interactivity adjustment factor based on the difference in means. The results of this calculation are an interactivity adjustment factor of 0.301 using the unadjusted subscription prices for the interactive services and of 0.311 using the subscription prices for the interactive services adjusted for the bundled downloads offered by two services. Pelcovits WDT at 26, SX Trial Ex. 2; 4/19/10 Tr. 136:16-137:6 (Pelcovits).

185. In addition to calculating the interactivity adjustment through comparison of average subscription prices, Dr. Pelcovits offered an additional interactivity adjustment derived from hedonic regression analysis. Pelcovits WDT at 26, SX Trial Ex. 2; Live365 Trial Ex. 5 at 38-39. This hedonic regression is used "to isolate the value of interactivity to consumers of online music services" by "measure[ing] the value of difference characteristics of a heterogeneous product," which in this case is subscription audio streaming services. Pelcovits WDT at 26, SX Trial Ex. 2; 4/19/10 Tr. 137:7-17 (Pelcovits).

186. In the regression that Dr. Pelcovits relied on, he analyzed a number of variables across the 18 subscription streaming services that he had identified and using the subscription price adjusted for the value of the bundled downloads. Pelcovits WDT at 26-27, SX Trial Ex. 2. Among the variables that Dr. Pelcovits included in the regression were the presence of interactivity, the availability of a mobile application for the service, and the ability to conditionally download tracks to a portable device (expressed as "Tethered Downloads" in the regression table). Pelcovits WDT at 27, SX Trial Ex. 2. Both the interactivity variable and the portable downloads variable were used by Dr. Pelcovits in his similar analysis in *Webcasting II.*

*Post-Hearing Responses to Judges' Questions by Michael D. Pelcovits*, at 2 (May 21, 2010); *see also* Live365 Trial Ex. 5 at 39.

187. Dr. Pelcovits's regression analysis resulted in an $8.52 interactivity coefficient, which Dr. Pelcovits testified is "highly significant." Pelcovits WDT at 27-28, SX Trial Ex. 2. As Dr. Pelcovits explained, this result "means that interactivity . . . is worth $8.52 per month to the typical subscriber." Pelcovits WDT at 28, SX Trial Ex. 2; 4/19/10 Tr. 137:17-138:7 (Pelcovits) (explaining that the results of the regression "yielded an estimate of the value of interactivity to the consumer").

188. Dr. Pelcovits proceeded to calculate an interactivity adjustment factor using the results of the regression analysis. This interactivity adjustment factor is calculated as "the ratio of the average price of the interactive services net of the interactivity coefficient to [the] average price of interactive services without this adjustment." Pelcovits WDT at 28, SX Trial Ex. 2; 4/19/10 Tr. 138:8-139:1 (Pelcovits). Using that formula, Dr. Pelcovits calculated a third potential interactivity adjustment of 0.359. Pelcovits WDT at 28, SX Trial Ex. 2; 4/19/10 Tr. 139:2-5 (Pelcovits).

189. Based on the above techniques, Dr. Pelcovits derived "a range of interactivity adjustment factors that I will use to present a range of reasonable license fees for statutory services." Pelcovits WDT at 28, SX Trial Ex. 2. That range is shown in the following table:

| Source | Interactivity Adjustment |
|---|---|
| Comparison of Mean Subscription Rates -- Unadjusted Subscription Prices | 0.301 |
| Comparison of Mean Subscription Rates -- Adjusted Subscription Prices | 0.311 |
| Regression of Subscription Prices | 0.359 |

Pelcovits WDT at 29, SX Trial Ex. 2.

190. Once Dr. Pelcovits had calculated the effective per-play rate in the interactive, on-demand market, the per-play adjustment and the interactivity adjustment he multiplied the per-play rate by both adjustments to derive the following range of recommended statutory license fees:

| Source of Interactivity Adjustment | Recommended Statutory Rate |
|---|---|
| Comparison of Mean Subscription Rates -- Unadjusted Subscription Prices | $0.0034 |
| Comparison of Mean Subscription Rates -- Adjusted Subscription Prices | $0.0035 |
| Regression of Subscription Prices | $0.0040 |

Pelcovits WDT at 33, SX Trial Ex. 2; 4/19/10 Tr. 142:22-145:14 (Pelcovits) (explaining the step-by-step calculations used to derive the recommended statutory per-play royalty fee). The simple

average of these three rates is $0.0036 per play. Pelcovits WDT at 33, SX Trial Ex. 2; 4/19/10 Tr. 145:15-18 (Pelcovits).

### c. The Substitution Analysis

191. The Copyright Act requires the CRJs to consider "whether use of the service may substitute for or may promote the sales of phonorecords," in setting the statutory rate. 17 U.S.C. § 114(f)(2)(B)(i); 17 U.S.C. § 112(e)(4)(A). In *Webcasting II*, Dr. Pelcovits conducted "a sensitivity analysis to show the effect on my recommendation if interactive services did substitute for CD sales to a greater degree than statutory services." Pelcovits WDT at 34, SX Trial Ex. 2; Live365 Trial Ex. 5 at 46-54. In his testimony in this proceeding, Dr. Pelcovits repeated that analysis. Pelcovits WDT at 34, SX Trial Ex. 2; 4/19/10 Tr. 145:19-146:22 (Pelcovits).

192. Dr. Pelcovits conducted his sensitivity analysis by assuming that subscribing to an interactive, on-demand music service "will cause the consumer to purchase two fewer CDs per year than if the consumer had subscribed to a non-interactive service instead." Pelcovits WDT at 34-35, SX Trial Ex. 2. He also assumed that the profit margin on a CD was $5.60 and that therefore "the differential effect of a subscription to on-line services on the profit earned from the average subscriber would be equivalent to 93¢ per month." Pelcovits WDT at 35, SX Trial Ex. 2; 4/19/10 Tr. 147:1-148:1 (Pelcovits) (explaining that he conducted the sensitivity analysis in the same manner and using the same numbers and assumptions in both *Webcasting II* and the current proceeding); Live365 Trial Ex. 5 at 46-54 (sensitivity analysis in Pelcovits's *Webcasting II* testimony).

193. Dr. Pelcovits testified that the loss in CD sales can be thought of "as an increase in the marginal costs of the copyright holder of providing (or licensing) music to on-line services." Pelcovits WDT at 35, SX Trial Ex. 2. He assumed that one-half of the increased

marginal cost will be passed on to the subscribers and he converted that into a per-play adjustment of 0.162¢. Pelcovits WDT at 35, SX Trial Ex. 2. The result of this calculation is an adjusted interactive per-play fee of $0.02031. Pelcovits WDT at 35, SX Trial Ex. 2.

194. Dr. Pelcovits then adjusted his recommended rate by rerunning his calculations using this updated interactive per-play fee:

| Source of Interactivity Adjustment | Recommended Statutory Rate Adjusted for Substitution |
|---|---|
| **Comparison of Mean Subscription Rates -- Unadjusted Subscription Prices** | $0.0031 |
| **Comparison of Mean Subscription Rates -- Adjusted Subscription Prices** | $0.0032 |
| **Regression of Subscription Prices** | $0.0037 |

Pelcovits WDT at 35-36, SX Trial Ex. 2; 4/19/10 Tr. 148:2-11 (Pelcovits). The simple average of these three rates is $0.0033 per play. Pelcovits WDT at 36, SX Trial Ex. 2; 4/19/10 Tr. 148:12-14 (Pelcovits).

### 5. Dr. Salinger's Criticisms of Dr. Pelcovits's Benchmark Analysis Are Unsupported.

195. In its rebuttal case, Live365 presented the testimony of Dr. Michael Salinger in order to "review and comment on the report by Dr. Michael D. Pelcovits." Salinger WRT at 3, Live365 Reb. Ex. 1. Dr. Salinger highlighted a number of purported "major flaws" in Dr. Pelcovits's analysis. Salinger WRT at 5-8, Live365 Reb. Ex. 1. None of Dr. Salinger's criticisms, however, actually rebut the recommended rates derived by Dr. Pelcovits.

### a. Alleged Methodological Flaws and Selection Bias

196. Dr. Salinger criticizes Dr. Pelcovits's use of the interactive, on-demand market as a benchmark for the non-interactive statutory webcasting market for a number of reasons, despite also testifying that he had accepted Dr. Pelcovits's use of the interactive market as an appropriate benchmark. 7/28/10 Tr. 97:5-12 (Salinger).

197. First, Dr. Salinger refers to benchmark analysis as a "shortcut," and claims that Dr. Pelcovits's conclusion that the ratio of per-subscriber royalty fees to consumer subscription prices will be essentially the same in both the on-demand, interactive and non-interactive markets is "at best . . . an approximation to be used because it is convenient, not because it is correct." Salinger WRT at 12-13, Live365 Reb. Ex. 1. Yet Dr. Salinger does not actually ever say why the assumption is incorrect, nor does he address Dr. Pelcovits's detailed explanation of the derived demand for music in both markets that supports his underlying assumption. *See* Live365 Trial Ex. 5 at 31-37. Dr. Salinger also testified that he does not think a modeling approach is superior to a benchmark analysis and that in an unrelated rate-setting proceeding he actually adopted a benchmark approach. 7/28/10 Tr. 87:20-88:13 (Salinger).

198. Dr. Salinger ignores the fact that this Court concluded in *Webcasting II* that the interactive streaming market is "of the comparable type that the Copyright Act invites us to consider." *Webcasting II*, 72 Fed. Reg. at 24,092. Dr. Salinger's criticisms of Dr. Pelcovits's use of the interactive services benchmark as convenient, but not necessarily correct, would apply equally to this Court's determination of the rates in *Webcasting II*.

199. Dr. Salinger's main criticism of Dr. Pelcovits's benchmark analysis is that Dr. Pelcovits focused on subscription services, despite the fact that the statutory webcasting market is predominantly an ad-supported market. Salinger WRT at 13-15, Live365 Reb. Ex. 1. This criticism, however, is based in part of Dr. Salinger's reliance on inaccurate data regarding the

breakdown of performances on statutory webcasting services between subscribers and non-subscribers provided to him by Live365's counsel. 7/28/10 Tr. 102:6-108:5 (Salinger) (explaining that he was not trying to be "accurate to the last decimal point" with his calculations related to subscription performances and that other documents that were available to him would have led to a significantly greater percentage of subscription performances).

200. Furthermore, to the extent that Dr. Salinger claimed that Dr. Pelcovits completely ignored ad-supported services, the overwhelming majority of the webcasting services covered under the NAB Agreement are ad-supported rather than subscription-based. 4/20/10 Tr. 354:6-9 (Pelcovits). And as explained *infra* at Section V.B.1, Dr. Pelcovits analyzed that agreement in depth and he and Dr. Ordover both concluded that the rates in that agreement, which are for predominantly ad-supported services, are useful evidence of the appropriate rate under the willing buyer/willing seller standard. Pelcovits WDT at 14-22, SX Trial Ex. 2; Ordover WRT at 14-28, SX Trial Ex. 45.

201. Dr. Salinger's implicit assumption that the webcasting market can be neatly divided into subscription services and ad-supported services is also unsupported by the evidence in this proceeding. In fact, numerous witnesses have testified about the diversity of business models within the webcasting market, many of which derive revenue in ways that are not reflected in Dr. Salinger's binary construct of subscription versus ad-supported models. 4/27/10 Tr. 1230:2-19 (Fratrik) (testifying about webcasting companies that make money through the sale of downloads or that use webcasting as a component of a portal that drives users to other revenue-generating components); Ordover WRT at 10-11, SX Trial Ex. 45; 7/28/10 Tr. 92:9-19 (Salinger) (explaining the need to consider how much webcasting promotes another line of business when attempting a modeling approach).

202. Moreover, Dr. Salinger's suggestion that a "purely subscription-based non-interactive service" might not even exist is incorrect in light of the fact that Sirius XM operates only on a subscription basis. 7/28/10 Tr. 109:17-19 (Salinger). Dr. Salinger, however, excluded Sirius XM from his calculations of webcasting performances by subscribers. 7/28/10 Tr. 109:7-110:1 (Salinger).

203. Dr. Salinger claimed to provide a "more realistic assessment of the industry," by calculating the revenue per play for Pandora and Live365. Salinger WRT at 14, Live365 Reb. Ex. 1; Salinger WRT, Ex. 4 and 5, Live365 Reb. Ex. 1. But as Dr. Salinger acknowledged during the rebuttal hearing, the revenue per play that Live365 earns is substantially higher than the revenue earned by Pandora. 7/28/10 Tr. 110:17-111:13 (Salinger) (explaining that the numbers for Pandora and Live365 are very different); Salinger WRT, Ex. 4 and 5, Live365 Reb. Ex. 1. In fact, Live365's revenue per play as calculated by Dr. Salinger is around $0.0048. 7/28/10 Tr. 111:11-13 (Salinger). And that calculation actually understates Live365's revenue per play, because it excludes all revenue earned by Live365 through its provision of broadcasting services to webcasters, a flaw that is even more prominent in Dr. Fratrik's economic analysis discussed *infra* at Section VII.D. 7/28/10 Tr. 112:14-113:1 (Salinger).

204. Setting aside the fact that the data Dr. Salinger relies on does not actually support his conclusions, Dr. Pelcovits has consistently testified that even if ad-supported services are less profitable in the long run, there is no need to set a royalty rate to accommodate those services. 4/20/10 Tr. 336:3-338:22 (Pelcovits); Live365 Trial Ex. 5 at 54-55. Specifically, in this proceeding, Dr. Pelcovits explained that in deciding whether to analyze subscription or ad-supported services:

> I would start with the point that the copyright holder, the seller of the product, is not interested in supporting all possible business

> models that used its product. That's not its goal. Its goal is to maximize profits. And if some uses of that product -- let's say it's ad-supported -- are not going to be profitable in the market when going head to head against a subscription-type service and the copyright holder can make more money that way, then the copyright owner won't be interested in continuing or perpetuating a weaker business model.
>
> The reason I focus on the subscription model in my analysis -- I did then and I do now -- is that allows a direct observation of willingness to pay by the ultimate consumer, the subscriber to the service, for a service that includes this -- performances of copyrighted music. It's a much more direct measure, and it is not as likely to fluctuate depending on what's happening in a very different market, in the case of advertising, where that maximum is subject to a lot of fluctuations over time and, as we've seen, has been hard to predict.
>
> ***
>
> I did look at advertiser-supported services in one of my regressions that's in the appendix. I think it's very hard to work with that data and, even to the extent I did, it didn't give very different results.

4/20/10 Tr. 337:1-338:13 (Pelcovits). And as this Court has previously noted, "in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant." *Webcasting II*, 72 Fed. Reg. 24,088. In fact, Dr. Salinger himself testified that "it might be a plausible strategy for the sellers in this market to set rates at a level that subscription services could afford and not worry about whether free services could afford" those rates. 7/28/10 Tr. 96:5-9 (Salinger).

205. According to Dr. Salinger, Dr. Pelcovits also erred in failing to analyze data from the independent record labels in computing his effective per-play rate in the interactive marketplace. Salinger WRT at 15-16, Live365 Reb. Ex. 1. Based on a few statements found on the internet, Dr. Salinger claimed that "[c]ontent from independent labels represents a substantial percentage of music streamed on non-interactive services." Salinger WRT at 15, Live365 Reb. Ex. 1.

206. But the conclusions that Dr. Salinger reached, that the independent labels "*may have* less bargaining power than the major labels and *may* be more interested in promotion to increase their market share," and that inclusion of independent label data, "*might have* produced a significantly lower estimate of a reasonable rate," are nothing more than speculation, unsupported by any evidence. Salinger WRT at 16, Live365 Reb. Ex. 1 (emphasis added); 7/28/10 Tr. 56:11-60:17 (Salinger) (explaining that speculation on effect of inclusion of independent label data was not based on any factual knowledge); 7/28/10 Tr. 118:112-121:10 (Salinger) (testifying that other than the fact that at one point in time some independent labels offered music on a royalty-free basis, he had no opinion on whether the independents would charge more or less than the major labels).

207. In fact, evidence from Live365's other witnesses undercuts Dr. Salinger's conclusions. *See* 4/26/10 Tr. 1026:10-1027:6 (Floater) (referring to a small number of royalty-free agreements with record labels, all of which were executed in either 2004 or 2005); Lockhart WDT at 3, Live365 Exhibit 33; 4/28/10 Tr. 1338:1-22 (Lockhart) (explaining failed efforts to obtain a royalty-free license from an independent record label).

208. Dr. Salinger also criticized Dr. Pelcovits for only using six services in calculating an effective per-play rate in the interactive market. Salinger WRT at 17 n.20, Live365 Reb. Ex. 1. He goes so far as to state that Dr. Pelcovits may have "cherry-picked" observations "to obtain a desired solution." Salinger WRT at 17 n.20, Live365 Reb. Ex. 1. Dr. Salinger offers no support for this inflammatory claim. And Dr. Salinger could not identify any interactive services that Dr. Pelcovits should have, but did not, include in his calculations. 7/28/10 Tr. 121:14-122:12 (Salinger) (testifying that he had no personal knowledge of additional interactive services that Dr. Pelcovits should have included). Moreover, as Dr. Pelcovits testified, the data he used to

calculate the effective per-play rate included millions of dollars in revenues and "hundreds of millions or more" performances. 4/20/10 Tr. 346:12-22 (Pelcovits).

209. Finally, Dr. Salinger criticized Dr. Pelcovits for failing to account for a downward trend in the per-performance rate in the interactive streaming market. Salinger WRT at 16-17, Live365 Reb. Ex. 1; 7/28/10 Tr. 127:13-128:2 (Salinger). But as Dr. Salinger acknowledged, the way to address this concern would be to multiply the recommended rate by .01917/.02194 (or .8737). 7/28/10 Tr. 128:12-129:2 (Salinger).

210. Although Dr. Salinger did not actually perform this calculation, the following table reports the results of adjusting the rate derived by Dr. Pelcovits from the interactive market (Column 1) by .8737 (Column 2). The table also reports the result of making the same adjustment to SoundExchange's proposed rate in this proceeding (Columns 3 and 4). This second calculation, although not specifically suggested by Dr. Salinger, results in a rate structure that is nearly identical to the rates contained in the precedential WSA Agreements discussed *infra* at Section V.B:

| *Pelcovits Interactive Rate* | *Salinger Adjusted Rate* | *SoundExchange Proposed Rate* | *Salinger Adjusted Rate* |
|---|---|---|---|
| $0.0036 | $0.0031 | $0.0021 | $0.0018 |
| $0.0036 | $0.0031 | $0.0023 | $0.0020 |
| $0.0036 | $0.0031 | $0.0025 | $0.0022 |
| $0.0036 | $0.0031 | $0.0027 | $0.0024 |
| $0.0036 | $0.0031 | $0.0029 | $0.0025 |

211. These variations corroborate Dr. Pelcovits's testimony that, with respect to his analysis of the per-play rate in the interactive market, there was "not a lot of variation from month to month or across the major services." 4/20/10 Tr. 347:2-10 (Pelcovits); 4/20/10 Tr. 367:6-368:5 (Pelcovits) ("The data tended to be very highly grouped, close to the 2.194 cents.").

### b. Alleged Flaws with Dr. Pelcovits's Regression

212. Although Dr. Salinger criticized Dr. Pelcovits's use of regression analysis at length, he ultimately concluded that in using the interactive benchmark, the average of the subscription prices was the preferable approach. Salinger WRT at 17-21, Live365 Reb. Ex. 1; 7/28/10 Tr. 123:9-22. And, in fact, Dr. Pelcovits did use the average of the subscription prices for two of the three ways in which he calculated the recommended rate. Pelcovits WDT at 24-26, SX Trial Ex. 2; 7/28/10 Tr. 123:20-22 (Salinger).

213. Dr. Pelcovits also elaborated on his use of the regression, explaining that "the goal of a regression in a case like this is not to try to defy what the direct observation of the averages is telling you," and that the results from the regression and the comparison of means were "generally in the same range." 4/20/10 Tr. 343:19-344:22 (Pelcovits). Furthermore, Dr. Pelcovits conducted numerous other regressions, which gave him confidence in the results of the regression that he did report in his testimony. 4/20/10 Tr. 345:1-8 (Pelcovits); Live365 Trial Ex. 15.

214. Dr. Salinger also criticized Dr. Pelcovits for his use of fixed effects variables in his regression analysis. Salinger WRT at 20-21, Live365 Reb. Ex. 1. In fact, Dr. Salinger wrote that it appeared that the fixed effects variables were "manipulate[ed] to obtain a desired result." Salinger WRT at 21, Live365 Reb. Ex. 1. On cross-examination, Dr. Salinger stated that he did not actually believe Dr. Pelcovits had manipulated the data, in direct contradiction to his harsh written assessment. 7/28/10 Tr. 125:17-127:11 (Salinger).

215. And as Dr. Pelcovits testified, he used the fixed variables for particular services because "they appear to have characteristics which are not well explained by the other variables." 4/20/10 Tr. 301:11-302:20 (Pelcovits). Dr. Pelcovits also ran regressions without the fixed effects variables, and those results were produced to Live365. 4/20/10 Tr. 372:9-373:17

(Pelcovits); Live365 Trial Ex. 15 at 27-28. Contrary to the suggestion that the use of a fixed effects variable is the equivalent of excluding the observation from the regression, Dr. Pelcovits explained that "that observation is still in the regression, and the regression will estimate coefficients based on all of the data used in the regression. Fixed effect is changing the intercept of the curve, in a sense, for that observation, but it doesn't change any of the ways the other coefficients work with respect to that variable." 4/20/10 Tr. 303:13-304:3 (Pelcovits).

### B. The NAB and Commercial Webcasters Agreements Are Probative Evidence of the Hypothetical Market Rate.

216. In addition to his analysis of the interactive benchmark, Dr. Pelcovits determined that the agreements that SoundExchange negotiated with the National Association of Broadcasters (the "NAB Agreement") and Sirius XM Satellite Radio (the "Commercial Webcasters Agreement") pursuant to the Webcaster Settlement Acts of 2008 and 2009 ("WSA"):

> are important evidence because they are very recent, voluntary agreements covering precisely the statutory webcasting services at issue here, negotiated on both sides between entities that have an important stake in establishing reasonable rates, and Section 114(f)(2)(B) permits the Court to "consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements."

Pelcovits WDT at 2-3, 14, SX Trial Ex. 2. As Dr. Pelcovits testified, these two precedential WSA agreements "cover webcasters that paid more than 50 percent of the webcasting royalties received by SoundExchange in 2008." Pelcovits WDT at 14, SX Trial Ex. 2; 4/19/10 Tr. 149:13-150:14 (Pelcovits).

217. Dr. Pelcovits reviewed the WSA agreements and determined that they "are useful to understand the bargaining range over which buyers and sellers would negotiate in the hypothetical market for statutory webcasting." Pelcovits WDT at 15, SX Trial Ex. 2; 4/19/10 Tr. 150:18-151:1 (Pelcovits) (explaining that the strength of using the WSA agreement is that they

"cover the exact performance rights that the court is considering in this case," and therefore they "tell us something about the buyers' and sellers' willingness to essentially have an exchange in the market at this price").

218. A further relevant aspect of the NAB Agreement in particular is that it represents an agreement with a group of webcasters that are almost entirely dependent on advertising rather than subscription revenue. 4/20/10 Tr. 283:20-22 (Pelcovits). This feature mitigates any potential concerns raised by Dr. Salinger's criticisms of Dr. Pelcovits's use of the interactive services benchmark and the alleged disparity between the percentage of listening by subscribers in the two markets. *See supra* at Section V.A; Salinger WRT at 13-15, Live365 Reb. Ex. 1.

219. Dr. Ordover reached a similar conclusion that "economic theory supports the use of the negotiated rates in the NAB Agreement as probative evidence of rates that would occur under the willing buyer/willing seller statutory standard." Ordover WRT at 18, SX Trial Ex. 45; 8/2/10 Tr. 344:21-345:4 ("My overarching conclusion is that the NAB rates do provide a valuable data point for the judges' consideration in determining what the willing buyer/willing seller rate would be for webcasting."). Analysis of the WSA agreements, which involved direct negotiations with entities that would be buyers in the hypothetical market, renders meaningless Dr. Salinger's criticism that somehow Dr. Pelcovits's range of recommended rates ignores the willing buyer component of the statutory standard. Salinger WRT at 5 and 12, Live365 Reb. Ex. 1 ("Dr. Pelcovits did not directly address the question of what a willing buyer would pay.").

### 1. NAB Agreement

220. In February of 2009, SoundExchange entered into a WSA Agreement with the National Association of Broadcasters (the "NAB"). McCrady WDT, Ex. 101-DP, SX Trial Ex. 7. This agreement between SoundExchange and the NAB (the "NAB Agreement") covers the

statutory webcasting activities of commercial terrestrial broadcasters. McCrady WDT, Ex. 101-DP, SX Trial Ex. 7; McCrady WDT at 4, SX Trial Ex. 7.

221. As McCrady explained, statutory webcasting by commercial terrestrial broadcasters "overwhelmingly consist[s] of internet simulcasts of over-the-air radio broadcast transmissions, although [it] also may include internet-only programming." McCrady WDT at 4, SX Trial Ex. 7.

222. The NAB Agreement was made available to any broadcaster, as the term is defined in the Agreement. McCrady WDT, Ex. 101-DP at §§ 1.2(a), 2.1, SX Trial Ex. 7. Those broadcasters who were already webcasting at the time that the NAB Agreement was executed were required to opt-in within 30 days of the Agreement's publication in the Federal Register or by March 31, 2009, whichever date was later. McCrady WDT, Ex. 101-DP at § 2.2, SX Trial Ex. 7. And those broadcasters who were not yet engaged in webcasting at that time may opt-in at any time within 30 days of their first transmission. McCrady WDT, Ex. 101-DP at § 2.2, SX Trial Ex. 7.

223. As of September 2009, "404 entities have opted into the NAB Agreement on behalf of several thousand individual stations." Kessler WDT at 21, SX Trial Ex. 5. Of those broadcasters, just under 100 reported their first performances to SoundExchange after the execution of the NAB Agreement. Ordover WRT at 18, SX Trial Ex. 45. In other words, since the execution of the NAB agreement, approximately 100 broadcasters, covering over 300 individual stations, have begun webcasting. Ordover WRT at 18, SX Trial Ex. 45.

224. Moreover, as Dr. Pelcovits testified, CBS Radio has elected to have all of its webcasting entities covered by the rates and terms of the NAB Agreement, including Last.fm, a custom radio webcasting service, and AOL Radio and Yahoo! Music -- none of which are

simulcasters. 4/19/10 Tr. 195:18-196:8 (Pelcovits); 4/20/10 Tr. 324:2-17 (Pelcovits) (explaining that the NAB Agreement rates are not above a profit-maximizing rate because of CBS Radio's election of those rates for all of its services).

225. The rate structure for broadcasters that opt into the NAB Agreement is as follows:

| *Year* | *Rate per performance* |
|---|---|
| 2006 | $0.0008 |
| 2007 | $0.0011 |
| 2008 | $0.0014 |
| 2009 | $0.0015 |
| 2010 | $0.0016 |
| 2011 | $0.0017 |
| 2012 | $0.0020 |
| 2013 | $0.0022 |
| 2014 | $0.0023 |
| 2015 | $0.0025 |

McCrady WDT, Ex. 101-DP at § 4.2, SX Trial Ex. 7. These rates apply to any statutory webcasting performances transmitted by a broadcaster, whether it is part of a simulcast -- a contemporaneous retransmission of a terrestrial broadcast -- or web-only programming. 4/22/10 Tr. 644:13-19 (McCrady).

226. According to McCrady, "WMG believes that these rates are below what the webcasting rate would be in the open market, but nevertheless sees this agreement with the broadcasters as a positive development." McCrady WDT at 4, SX Trial Ex. 7.

227. The NAB Agreement contains a minimum fee of $500 per channel or station, with a cap of $50,000 on the minimum fees owed by any single broadcaster. McCrady WDT, Ex. 101-DP at § 4.1, SX Trial Ex. 7; 4/22/10 Tr. 645:5-14 (McCrady).

228. Broadcasters that elect to be covered by the NAB Agreement are also required to comply with the Agreement's reporting requirements, which are generally more comprehensive

than those in the current reporting regulations. McCrady WDT at 5, SX Trial Ex. 7. Most broadcasters that are covered by the NAB Agreement are required to provide reports of use to SoundExchange "on a census reporting basis (i.e., reports of use shall include every sound recording performed in the relevant month and the number of performances thereof)." McCrady WDT, Ex. 101-DP at § 5.2, SX Trial Ex. 7; 4/22/10 Tr. 645:20-646:4 (McCrady). Small broadcasters (which are also defined by the Agreement) have the option to pay an additional fee and avoid submitting reports of use for a limited period of time and will thereafter be required to submit full census reporting. McCrady WDT, Ex. 101-DP at § 5.1, SX Trial Ex. 7; 4/22/10 Tr. 706:22-707:6 (McCrady).

229. The NAB Agreement also contains a limited Most Favored Nations clause, which applies only if SoundExchange negotiates more favorable rates and terms with other broadcasters. McCrady WDT, Ex. 101-DP at § 4.3, SX Trial Ex. 7.

**2. Commercial Webcasters Agreement**

230. In July of 2009, SoundExchange executed a WSA agreement that is applicable to commercial webcasters (the "Commercial Webcasters Agreement"). McCrady WDT, Ex. 102-DP at §§ 1.2 and 2.1, SX Trial Ex. 7; *see also* 4/22/10 Tr. 633:16-19 (McCrady) (explaining that the agreement "is what we refer to as the SIRIUS/XM deal because it was negotiated with SIRIUS/XM, although, of course, it's available to any large commercial webcaster who wants to opt into it"). Sirius XM, the satellite radio service, executed the Commercial Webcasters Agreement. McCrady WDT at 7, SX Trial Ex. 7.

231. Those commercial webcasters that were already webcasting at the time that the Commercial Webcasters Agreement was executed were required to opt-in within 15 days of the Agreement's publication in the Federal Register. McCrady WDT, Ex. 102-DP at § 2.2, SX Trial Ex. 7. And those commercial webcasters that were not yet engaged in webcasting at that time

may opt-in at any time within 30 days of their first transmission. McCrady WDT, Ex. 102-DP at § 2.2, SX Trial Ex. 7.

232. As of September 2009, several commercial webcasters have opted into the Commercial Webcasters Agreement. Live365 Trial Ex. 25 at 18.

233. The rate structure for commercial webcasters that opt into the Commercial Webcasters Agreement is as follows:

| *Year* | *Rate per performance* |
|---|---|
| 2009 | $0.0016 |
| 2010 | $0.0017 |
| 2011 | $0.0018 |
| 2012 | $0.0020 |
| 2013 | $0.0021 |
| 2014 | $0.0022 |
| 2015 | $0.0024 |

McCrady WDT, Ex. 102-DP at § 4.2, SX Trial Ex. 7; 4/22/10 Tr. 655:2-5 (McCrady).

234. The Commercial Webcasters Agreement contains a minimum fee of $500 per channel or station, with a cap of $50,000 on the minimum fees owed by any single broadcaster. McCrady WDT, Ex. 102-DP at § 4.1, SX Trial Ex. 7; 4/22/10 Tr. 655:6-12 (McCrady).

235. Commercial webcasters that opt into the Commercial Webcasters Agreement must comply fully with the reporting obligations of other webcasters as established in the governing regulations. McCrady WDT, Ex. 102-DP at § 4.5, SX Trial Ex. 7; 4/22/10 Tr. 655:13-656:5 (McCrady) ("The Commercial Webcaster settlement does not change any requirements to -- of any webcaster that opts into the deal."). Sirius XM had already agreed to provide SoundExchange with census reporting and the parties executed a side letter at the time of the Commercial Webcasters Agreement indicating that nothing in the Agreement would change that census reporting. 4/22/10 Tr. 656:6-13 (McCrady)

### 3. There Is No Need to Adjust the WSA Rates.

236. Dr. Fratrik testified that there were a number of reasons that the Court should not consider the rates in the NAB Agreement without making unspecified downward adjustments. Fratrik WDT at 40-41, Live365 Trial Ex. 30. According to Dr. Fratrik, the NAB Agreement rates are artificially high as a result of (1) SoundExchange's exercise of market power, (2) differences between the cost structures of terrestrial broadcasters and internet-only webcasters, (3) the NAB's desire to avoid litigation costs, and (4) the grant of the limited waiver of the performance complement. Fratrik WDT at 40-41, Live365 Trial Ex. 30. Dr. Salinger also testified that the rates must be adjusted because the NAB and Sirius XM agreed to higher rates in order to raise their rivals' costs and that SoundExchange would be able to negotiate a higher rate than the individual record companies could negotiated individually. Salinger WRT at 22-27, Live365 Reb. Ex. 1.

237. Dr. Pelcovits noted that when analyzing the WSA agreements, "consideration must be given to the fact that these agreements were negotiated in the shadow of a regulatory environment that prohibited the sellers from refusing to grant a license, and allowed both buyers and sellers to seek a rate from this Court in the event that a rate could not be achieved through negotiation." Pelcovits WDT at 3 and 15, SX Trial Ex. 2.

238. But both Dr. Pelcovits and Dr. Ordover explained at length why the rates in the NAB Agreement and the Commercial Webcasters Agreement are probative evidence of the rates that would be negotiated under the willing buyer/willing seller standard. Pelcovits WDT at 14-22, SX Trial Ex. 2; Ordover WRT at 14-28, SX Trial Ex. 45. Most importantly, the testimony from Drs. Pelcovits and Ordover establish that the rates in those agreements may be considered in this proceeding without any adjustments. Dr. Salinger, Live365's rebuttal expert, endorsed the conclusions reached by Drs. Pelcovits and Ordover.

### a. The WSA Agreements Represent the Low End of the Range of Market Outcomes.

239. According to McCrady, WMG believes that the NAB Agreement "rates are below what the webcasting rate would be in the open market, but nevertheless sees this agreement with the broadcasters as a positive development." McCrady WDT at 4, SX Trial Ex. 7. This belief is supported by Dr. Pelcovits's analysis of the agreements. Pelcovits WDT at 16, SX Trial Ex. 2 ("Under the particular circumstances presented here, I conclude that the WSA agreements likely represent the low end of the range of market outcomes.").

240. To begin with, Dr. Pelcovits noted that "any negotiation over rates to be in effect in 2011-2015 will be affected by the parties' expectations as to the rates this Court would set if no settlement were reached (and also after netting out the cost of litigating the case before this Court)." Pelcovits WDT at 15, SX Trial Ex. 2. Specifically, the buyers will not agree to rates higher than what they would expect the Court to set, and the seller, SoundExchange, will not agree to rates lower than what it expects the Court to set. Pelcovits WDT at 15-16, SX Trial Ex. 2; 4/19/10 Tr. 156:3-17 (Pelcovits) (the parties negotiations are colored by how they expect "the court will interpret the willing buyer/willing seller standard, not their own estimation because, ultimately, it's the court that makes that determination").

241. As Dr. Pelcovits explained, "[t]he buyer's negotiating position will be affected by whether it feels it can construct a financially viable business model using the rates in the settlement." Pelcovits WDT at 16, SX Trial Ex. 2; 4/19/10 Tr. 153:6-20 (Pelcovits). The rates that the NAB and Sirius XM agreed to in the WSA agreements must therefore represent rates at which those entities believe they can operate a financially viable webcasting service. Pelcovits WDT at 16, SX Trial Ex. 2. Otherwise, the buyers "either would seek better rates from this Court, or simply not engage in statutory webcasting at all." Pelcovits WDT at 16, SX Trial Ex.

2. Even Live365's own expert testified that "when you're negotiating in that context where if there's a failure to negotiate a deal there will be a court that sets the rate, as the buyer, if you anticipate that the Court is going to set a rate that reasonably approximates a market rate, you're unlikely to agree to a rate higher than that." 7/28/10 Tr. 130:4-16 (Salinger).

242. In other words, the buyer's negotiating position is influenced by the fact that under the statutory scheme the buyer "always has the option of not offering a statutory service." Pelcovits WDT at 16, SX Trial Ex. 2; 4/19/10 Tr. 153:21-154:2 (Pelcovits). In contrast, because of the compulsory nature of the statutory license, the sellers *must* sell, which influences the sellers' negotiating position. Pelcovits WDT at 16, SX Trial Ex. 2; 4/19/10 Tr. 154:3-4 (Pelcovits). In a market free from the statutory license, "a record company would have the very real alternative of not licensing the music to non-interactive webcasters, and would not grant the license if withholding the license would increase sales or licensing of music to other channels (such as CDs, digital downloads, or fully interactive music services)." Pelcovits WDT at 16, SX Trial Ex. 2; 4/19/10 Tr. 152:10-153:5 (Pelcovits).

243. This imbalance in motivations leads to the following conclusion:

> [T]he buyers operating under a statutory scheme are not likely to negotiate a rate above the free market rate even if they believe that the Court might set the rate too high, because they have the option of not buying at all. But the sellers might sell at a rate below the free market rate if they believe that the Court might set the rate too low, because they have no ability to decline a license. Therefore, the outcome of settlements -- in the current regime where a statutory license is the alternative to the settlement -- is likely to be more favorable to the webcasting industry than what would prevail in a free-market setting.

Pelcovits WDT at 16-17, SX Trial Ex. 2; 4/19/10 Tr. 151:20-152:8 (Pelcovits).

244. Dr. Pelcovits points to marketplace agreements negotiated by the record companies with custom radio services as further evidence that the rates in the WSA agreements

are at the low end of the range of market rates. Pelcovits WDT at 17, SX Trial Ex. 2. Custom radio services allow the listener a degree of control over the types of music that are played and therefore offer a greater degree of personalization. Pelcovits WDT at 17-18, SX Trial Ex. 2; McCrady WDT at 16, SX Trial Ex. 7. Partially as a result of past disagreements about whether custom radio services qualify for the statutory license, the record companies have negotiated direct licenses with a number of the services in the past. Pelcovits WDT at 17, SX Trial Ex. 2.

245. The marketplace agreements for custom radio services contained per-performance rates expressed as a percentage of the prevailing statutory webcasting rate, ranging from 115% of the statutory rate to 150% of the statutory rate, depending on the record company and the service. Pelcovits WDT at 18, SX Trial Ex. 2. These agreements also frequently contain a percentage of revenue fee as part of a greater-of structure. Pelcovits WDT at 18, SX Trial Ex. 2.

246. Dr. Pelcovits has testified in the past that the custom radio rates have likely been artificially deflated by the statutory rate. Pelcovits WDT at 18, SX Trial Ex. 2. But in light of the *Launch Media* decision, which suggests that many custom radio services do in fact qualify as statutory webcasters, Dr. Pelcovits testified in this proceeding that the voluntary agreements, with per-performance rates of 115% to 150% of the statutory rate, "represent compelling evidence that on a forward-looking basis the current statutory rate may be too low." Pelcovits WDT at 18, SX Trial Ex. 2.

247. In fact, the rates in those custom radio agreements are higher than the rates negotiated in the WSA Agreements. Pelcovits WDT at 18-19, SX Trial Ex. 2 (explaining that 115% of the 2010 statutory rate is higher than the rates in the NAB and Commercial Webcasters Agreements until 2013 and 2014 respectively, and 150% of the 2010 statutory rate is higher than either of the WSA agreements ever reach).

248. As Dr. Pelcovits concluded:

> If greater and more valuable functionality is permitted for statutory webcasters than previously was thought to be the case, the statutory rate should reflect that fact. The custom radio rates may be artificially low due to the gravitational pull of the statutory rates, but they nevertheless stand as evidence that webcasters willingly agree to pay more than the current statutory rates for the right to use music in a customized digital music service.

Pelcovits WDT at 18, SX Trial Ex. 2. Yet neither the broadcasters in the NAB nor Sirius XM offer webcasting services that are customized. Pelcovits WDT at 19, SX Trial Ex. 2. "Thus the rates they negotiated may be lower than the rates that would be negotiated by webcasters offering customized services, which may now be deemed to be statutory." Pelcovits WDT at 20, SX Trial Ex. 2.

**b. Market Power**

249. Unlike the statutory willing buyer/willing seller standard, which contemplates the individual record companies as the willing sellers, the NAB Agreement was negotiated by SoundExchange on behalf of all sound recording copyright owners and recording artists. Ordover WRT at 6, SX Trial Ex. 45. Dr. Ordover explained that because the rates in the NAB Agreement "were negotiated collectively by the record companies under the auspices of SoundExchange," the rates might "reflect, to some extent, the additional bargaining power held by SoundExchange relative to the bargaining power held by the individual record companies." Ordover WRT at 22, SX Trial Ex. 45.

250. Dr. Pelcovits testified that such concerns are misplaced, however, in part because the seller is compelled to license the sound recordings, regardless of who the seller is -- either SoundExchange or the individual record companies. Pelcovits WDT at 17, SX Trial Ex. 2; 4/19/10 Tr. 154:3-4 (Pelcovits). Moreover, Dr. Pelcovits explained that because each record company has a unique catalog of sound recordings that are valued, and possibly even necessary,

for a competitive webcasting service, the individual record companies all enjoy a degree of market power. Pelcovits WDT at 17, SX Trial Ex. 2. The buyers, on the other hand, are essentially price takers in the market. Pelcovits WDT at 17, SX Trial Ex. 2.

251. But that dynamic exists regardless of whether it is SoundExchange or the record companies individually negotiating the license and "does not suggest that SoundExchange was able to extract a rate above the level that would prevail if each record company negotiated separately." Pelcovits WDT at 17, SX Trial Ex. 2. As Dr. Pelcovits concluded, if SoundExchange had attempted to extract an above-market rate "the buyers presumably would have rejected a settlement with SoundExchange and resorted to a rate-setting proceeding in this Court." Pelcovits WDT at 17, SX Trial Ex. 2.

252. Dr. Ordover also explained that there are conditions in which the rate negotiated by SoundExchange as a collective will be lower than those that would be negotiated by each of the individual record companies. Ordover WRT at 22, SX Trial Ex. 45.

**i. SoundExchange Does Not Function as a Cartel.**

253. There has been no evidence presented in this proceeding that SoundExchange acted as a cartel. Both Dr. Pelcovits and Dr. Ordover highlighted the fact that SoundExchange is only permitted to negotiate the royalty rates on a non-exclusive basis. 4/19/10 Tr. 159:5-160:10 (Pelcovits) (explaining that as long as the record companies can negotiate separate agreements with the NAB or Sirius XM, "they would have the potential to undercut the price, and that would reduce the possibility of that cartel having a price-increasing effect on the market"); Ordover WRT at 22, SX Trial Ex. 45. In other words, "SoundExchange does not replace the record companies but rather operates as an additional seller through which the record companies have the opportunity, but not the obligation, to bargain collectively." Ordover WRT at 22-23, SX Trial Ex. 45. SoundExchange operates as an additional seller and any concerns about

SoundExchange's bargaining power are therefore mitigated. Ordover WRT at 21-22, SX Trial Ex. 45.

254. Dr. Pelcovits also pointed to the marketplace agreements with custom radio services as probative evidence on "the issue of whether the collective bargaining under the WSA enabled the copyright owners to exercise cartel-like power and therefore set a higher price than in the absence of the statutory regime." Pelcovits WDT at 19, SX Trial Ex. 2. Specifically, Dr. Pelcovits testified that because "the record companies negotiated the custom radio deals individually and independently, and the resulting rates were above the WSA agreement rates, this would indicate that cartel-like discipline was not essential to achieving the WSA agreement rates." Pelcovits WDT at 19, SX Trial Ex. 2. If SoundExchange actually had more bargaining power than the record companies individually have, "one would not expect the rates negotiated by SoundExchange to be significantly lower than the individually negotiated rates for customer radio services that are close substitutes to the statutory services (and may now be statutory services under the *Launch* decision)." Pelcovits WDT at 19, SX Trial Ex. 2.

255. Moreover, as Dr. Ordover noted, the NAB, which negotiated on behalf of a group of broadcasters, probably enjoyed a degree of bargaining power on the buyers' side during its negotiations with SoundExchange. Ordover WRT at 23, SX Trial Ex. 45; 7/28/10 Tr. 129:13-130:3 (Salinger). At the time of the WSA Agreement negotiations, broadcasters had accounted for over 50% of the royalty payments to SoundExchange in the immediately preceding calendar year. Ordover WRT at 23, SX Trial Ex. 45; Live365 Trial Ex. 25. Dr. Ordover testified that "[s]uch added market power on the buyer side tends to mitigate, if not fully offset, additional leverage that SoundExchange might bring to the negotiations." Ordover WRT at 23, SX Trial Ex. 45; *Webcasting II*, 72 Fed. Reg. at 24,091 (explaining that "[t]he question of competition is

not confined to an examination of the seller's side of the market alone. Rather, it is concerned with whether market prices can be unduly influenced by sellers' power or buyers' power in the market.").

256. The fact that the NAB or any webcasters negotiating with SoundExchange could choose to be subject to the rates set by the Court rather than agree to a settlement limits any potential ability for SoundExchange to function as a cartel and extract above-market royalty rates. Ordover WRT at 23, SX Trial Ex. 45. Dr. Ordover explained that "[a]t some point, buyers such as the NAB members would simply elect to seek rates established by the Judges -- which would be free of any potential cartel effects -- rather than voluntarily agree to pay above-market rates." Ordover WRT at 23, SX Trial Ex. 45; Salinger WRT at 27, Live365 Reb. Ex. 1 (explaining that the buyers can resort to the Court if the collective seeks to charge more than each individual member could charge).

#### ii. SoundExchange As a Single Seller Negotiated Lower Rates Than the Individual Record Companies Would Have.

257. Dr. Ordover explained that the NAB Agreement represents a circumstance when SoundExchange, acting as a single seller on behalf of the record labels, will "agree to lower royalty rates compared to the average that would emerge in a market in which individual record companies function as sellers." Ordover WRT at 23, SX Trial Ex. 45. Specifically, when "the catalogs of all four major [record companies] are needed, then economic theory predicts that a rate negotiated with SoundExchange can actually be *lower* than the average rate that would be reached through individual negotiations." Ordover WRT at 24, SX Trial Ex. 45.

258. In the context of the NAB Agreement, Dr. Ordover noted that the NAB was negotiating on behalf of terrestrial broadcasters and that those broadcasters do not pay a sound recording royalty for their over-the-air transmissions. Ordover WRT at 24, SX Trial Ex. 45.

Because the broadcasters do not pay royalties for their core business -- terrestrial broadcasting -- Dr. Ordover testified that there is an expectation that "these entities [will] include in their terrestrial programming sound recordings from the catalogs of all four major record companies and at least some independent record companies." Ordover WRT at 24-25, SX Trial Ex. 45.

259. Ultimately, Dr. Ordover concluded that because the broadcasters have already programmed their terrestrial broadcasts using recordings for all of the major record companies

> the failure to obtain licenses from all of the majors in connection with their webcasting services would, by definition, eliminate the ability to simulcast. Because they cannot re-broadcast their terrestrial signal over the Internet without access to the catalogs of the four majors, economic theory would predict that the rates voluntarily negotiated between SoundExchange and the NAB are actually lower than the rates that would obtain through negotiations between a single NAB member and one of the four major labels, *i.e.*, through arms-length bargaining between a willing buyer and a willing seller.

Ordover WRT at 25, SX Trial Ex. 45; *see also* Ordover WRT at 6, SX Trial Ex. 45 (explaining that "where the NAB companies needed to acquire rights from all four major record companies, economic theory indicates that SoundExchange might well have offered a lower royalty than the aggregate rate that [the] NAB could have obtained had it negotiated separately with each of the four major record companies"). The same conclusion applies to Sirius XM and its satellite radio transmissions. Ordover WRT at 25, SX Trial Ex. 45.

260. Dr. Ordover explained in depth how this theory operates. Ordover WRT at 26-27, App. Two, SX Trial Ex. 45. When a webcaster requires the catalogs of all four of the major record companies and the record companies negotiate licenses separately rather than collectively, those negotiations "give rise to a well-known pricing issue commonly referred to by economists as *Cournot-complements*." Ordover WRT at 26, SX Trial Ex. 45; 8/2/10 Tr. 354:9-355:21 (Ordover) (explaining the theory of complements and the "idea that a purchaser may require a set

of licenses in order to have a valuable product"); 4/19/10 Tr. 157:3-158:9 (Pelcovits) (explaining that the catalogs of the record companies are not substitute products). By negotiating individually, a higher rate charged by one record company will increase the marginal costs incurred by each webcaster. Ordover WRT at 26, SX Trial Ex. 45. Webcasters will be able to pass along at least some of those higher royalty rates to their customers which will result ultimately in "decreased demand for the webcaster's service by downstream consumers, and hence for music." Ordover WRT at 26, SX Trial Ex. 45.

261. When demand for webcasting decreases, the revenues of all record companies will be negatively affected, not just the record company that negotiated the higher royalty rate. Ordover WRT at 26, SX Trial Ex. 45. But the individual record company "only takes into account the adverse effect of lower demand on its own revenues, ignoring the effect that its decision imposes on the revenues of the other record companies." Ordover WRT at 26, SX Trial Ex. 45. Because the individual record company does not take into account the effect its higher rate will have on the other companies, the "constraint faced by an individual firm when it contemplates an increase to its royalty rate" is weakened. Ordover WRT at 26, SX Trial Ex. 45.

262. In the negotiations between SoundExchange and the NAB, however, because SoundExchange effectively controls all of the necessary sound recordings -- the catalogs of the four major record companies -- it "will set a royalty rate that fully accounts for the effect of that rate on the downstream supplier's output, *i.e.*, the firm will internalize the full effect that a higher royalty has on market demand." Ordover WRT at 27, SX Trial Ex. 45. The internalization "tightens the constraint faced by the firm when it considers raising its royalty, which results in lower rates compared to individually-negotiated rates." Ordover WRT at 27, SX Trial Ex. 45; 4/19/10 Tr. 165:10-168:14 (Pelcovits) ("[T]he economics says that when you can negotiate

collectively for complements, you actually end up with a lower price that if you let each firm negotiate separately.").

263. In Appendix Two, Dr. Ordover presents a numerical example of how this theory plays out. Ordover WRT at 27, App. Two, SX Trial Ex. 45. The Appendix also demonstrates what Dr. Ordover refers to as the "well-known result that the more independent licensors there are, the lower is the royalty rate applied to the whole repertoire as a result of collective negotiations *vis-à-vis* the rates that would emerge through individual negotiations." Ordover WRT at 27 and App. Two, SX Trial Ex. 45.

264. Ultimately, any concerns about SoundExchange exercising potential market power to extract an above-market royalty rate are misplaced with respect to the NAB Agreement because the NAB webcasters require access to the catalogs of all four major record companies. Ordover WRT at 27, SX Trial Ex. 45. In fact, despite writing that "a collective of competing record companies would seek a higher rate than would the individual companies," Salinger WRT at 27, Live365 Reb. Ex. 1, Dr. Salinger endorsed the applicability of *Cournot-complements* theory. 7/28/10 Tr. 129:4-13 (Salinger) (agreeing that "if the buyers in the market view the record companies as complements rather than substitutes, then the effect of having SoundExchange negotiate on behalf of all of the record companies would be actually a lower rate on average than what the record companies would negotiate themselves").

**iii. The Theory of Raising Rivals' Costs Is Inapplicable.**

265. As Dr. Salinger acknowledged "when you're negotiating in that context where if there's a failure to negotiate a deal there will be a court that sets the rate, as the buyer, if you anticipate that the Court is going to set a rate that reasonably approximates a market rate, you're unlikely to agree to a rate higher than that." 7/28/10 Tr. 130:4-130:16 (Salinger). But Dr. Salinger claimed that a buyer might be motivated to agree to a higher rate if it had reason to

engage in a practice known as raising rivals' costs. Salinger WRT at 23-25, Live365 Reb. Ex. 1; 7/28/10 Tr. 130:4-17 (Salinger). Dr. Salinger's own testimony, however, proves the inapplicability of the raising rivals' costs theory in the context of the NAB Agreement.

266. The theory of raising rivals' costs posits that "[a] company can benefit from an increase in the price of an input if its rivals use the input more intensively than it does." Salinger WRT at 24, Live365 Reb. Ex. 1. Dr. Salinger claimed that "[t]he substantial cost that royalties represent for non-interactive services raises the inherent possibility that terrestrial broadcasters and Sirius XM have engaged in raising rivals' cost strategy to disadvantage their Internet radio competitors." Salinger WRT at 25, Live365 Reb. Ex. 1.

267. According to Dr. Salinger, the NAB and Sirius XM "wanted to raise the rates of the webcasters in order to protect the broadcasters' terrestrial radio market." 7/28/10 Tr. 130:18-131:2 (Salinger). Stated differently, "the Internet radio [business] is a strategic threat to their terrestrial business." 7/28/10 Tr. 74:6-76:17 (Salinger). In fact, Dr. Salinger rejected the possibility that the rivals the NAB would be most concerned about are other terrestrial broadcasters that offer webcasting. 7/28/10 Tr. 76:18-78:17 (Salinger).

268. Under Dr. Salinger's application of raising rivals' costs, if the strategy was successful, "the NAB companies . . . would preserve their terrestrial markets from encroachment by webcasters and increase their webcasting market [share]." 7/28/10 Tr. 131:17-22 (Salinger).

269. As Dr. Salinger acknowledged, in order for the strategy to work, SoundExchange must have agreed to go along with it. 7/28/10 Tr. 132:1-10 (Salinger). Moreover, the NAB companies and Sirius XM would have had to believe that the Court would not set a lower rate than those in the WSA Agreements. 7/28/10 Tr. 134:7-11 (Salinger). But SoundExchange and the record companies do not receive any royalties for performances on terrestrial broadcasts, thus

the effect of SoundExchange agreeing to the NAB's strategy and protecting the terrestrial market would be detrimental to SoundExchange's overall collection of royalties. 7/28/10 Tr. 134:1-5 (Salinger).

270. Furthermore, there is nothing in either the NAB Agreement or the Commercial Webcasters Agreement that prohibits SoundExchange from agreeing to lower rates with other webcasters. In contrast, broadcasters that elect the rates and terms of the NAB Agreement and commercial webcasters that elect the rates and terms of the Commercial Webcasters Agreement, are bound to the rates and terms in the respective agreement for the entire rate term, "in lieu of other rates and terms from time to time applicable" for the statutory license. McCrady WDT, Ex. 101-DP at § 2.1, SX Trial Ex. 7; McCrady WDT, Ex. 102-DP at § 2.1, SX Trial Ex. 7. And the only most-favored nation clause in either agreement is one that applies if SoundExchange reaches a different agreement with a broadcaster. McCrady WDT, Ex. 101-DP at § 4.3, SX Trial Ex. 7.

### c. The Cost Structures of Broadcasters and Webcasters

271. According to Dr. Fratrik, the rates agreed to in the NAB Agreement should be adjusted downward if they are to be applied to commercial webcasters. This argument is based on the assertion that "there are vastly different economics associated with terrestrial commercial radio broadcasters affecting the amount that a willing buyer would be willing to pay." Fratrik WDT at 41, Live365 Trial Ex. 30.

272. But Dr. Fratrik presented no empirical evidence to support this claim and he and other Live365 witnesses acknowledged that there are numerous costs that broadcasters incur that webcasters do not incur. Some of these costs, such as on-air talent, are ongoing costs, 4/27/10 Tr. 1273:22-1276:10 (Fratrik), while others are higher upfront costs, such as procuring an FCC

license. 4/27/10 Tr. 1169:1-1170:15 (Fratrik); 7/28/10 Tr. 232:13-15 (Smallens); 7/28/10 Tr. 261:9-18 (Smallens).

273. In addition, although Dr. Fratrik sought to undermine the NAB Agreement's rates because of purported differences in cost structures between broadcasters and inter-only webcasters, he also used terrestrial radio's revenue and operating margin as a foundation for his modeling approach. Specifically, and as addressed in more detail *infra* at Section VII.B, Dr. Fratrik testified that terrestrial radio is a "comparable" industry to webcasting and should serve as the benchmark for a reasonable operating profit for a typical webcaster. Fratrik WDT at 21-22, Live365 Trial Ex. 30; 4/27/10 Tr. 1178:14-1179:2 (Fratrik).

274. Live365 cannot have it both ways: it cannot reject Dr. Pelcovits's use of the NAB agreement as a benchmark due to the "vastly different economics associated with terrestrial radio" and then use the economics of terrestrial radio to propose an appropriate operating margin for webcasters. Fratrik WDT at 41, Live365 Trial Ex. 30. As observed by Judge Wisniewski, it is "difficult to have one comparison be appropriate in one place but not in another when you're, in both cases, trying to compare with commercial webcasters." 4/27/10 Tr. 1180:8-11 (Fratrik).

275. Moreover, Dr. Ordover explained that even if Dr. Fratrik was correct in asserting that the different economics of broadcasters leads to a higher willingness to pay, "it does not matter because SoundExchange cannot directly control the magnitude of listener consumption at each of the services, *i.e.*, SoundExchange cannot take measures to limit listening at services that pay a low rate." Ordover WRT at 4, SX Trial Ex. 45.

276. Implicitly, Dr. Fratrik's argument rests on the theory that SoundExchange can and should price discriminate between different types of webcasters. 4/27/10 1248:22-1249:7 (Fratrik) ("If you charge different rates and you cannot price discriminate, in a sense, you would

have problems and that wouldn't work for the seller."). Dr. Ordover, however, makes clear that because SoundExchange cannot control how much music is consumed on any give webcasting service, "a relatively low rate offered to one webcaster, insofar as that rate makes the webcaster a more effective competitor in the marketplace, can shift demand away from webcasters who are paying higher rates, quite likely leading to a reduction in total royalty payments collected by SoundExchange from statutory webcasters." Ordover WRT at 4, SX Trial Ex. 45; 4/20/10 Tr. 339:1-340:9 (Pelcovits) (explaining that it is not in the interest of the copyright owner "to subsidize or price specially for certain business that use the product, if that doesn't maximize his own profits"). In other words, SoundExchange is likely to be "unwilling to offer lower rates to a higher-cost licensee unless it has the ability to price discriminate *at the level of the ultimate consumer*." Ordover WRT at 15, SX Trial Ex. 45; 4/27/10 1249:8-13 (Fratrik) (acknowledging that in order to price discriminate the seller must "be able to segment out customers, effectively").

277. Dr. Ordover testified that issues of demand creation and demand cannibalization must be balanced in analyzing whether SoundExchange would agree to lower rates for high-cost webcasters. 8/2/10 Tr. 345:9-18 (Ordover). Specifically, Dr. Ordover explained that:

> [I]f offering a lower rate to these high cost -- let's call them high cost suppliers, or suppliers who have maybe less desirable product, simply transfers a huge chunk of sales from the more -- the lower cost group to those with higher costs, then this is not a net gain. It's likely to be a net loss to the seller of the input. Here, the licensing rights to the music.
>
> On the other hand, if the . . . high cost suppliers fill an important niche and stimulate demand as opposed to cannibalizing it, then there may be some incentive to sustain cannibalization losses to some extent while stimulating overall supply.
>
> So much depends on the degree of stimulation and the degree of cannibalization. Those are standard economic ideas that are

> reflected in such concepts as cross-elasticity of demand and elasticity of demand.

8/2/10 Tr. 345:19-346:16 (Ordover); 8/2/10 Tr. 402:11-403:2 (Ordover) ("Because from the standpoint of the SoundExchange clients or members, what matters . . . is the overall effect of these rates on the revenues that flow to SoundExchange and then are redistributed to the proper economic agents. So from the standpoint of SoundExchange and its members, it's the aggregate flows of revenue that matter. And, therefore, the cannibalization and stimulation considerations enter at that place."). Dr. Ordover further explained that in considering how a royalty rate could either stimulate or cannibalize demand, there is both a price dimension and a quality dimension to a given webcasting service that could be impacted by a change in the royalty rate. 8/2/10 Tr. 348:6-351:5 (Ordover).

278. In the absence of effective controls on listeners, the concern with a lower rate, of course, is that if it "has the effect of shifting listener demand towards the services paying the lower rate, the result may be that the revenues collected by SoundExchange will decrease." Ordover WRT at 15, SX Trial Ex. 45. Dr. Ordover goes on to note that there is reason to believe that a lower rate for a higher-cost webcaster would result in shifting demand to such a service. There is no dispute that terrestrial broadcasters that webcast -- simulcasters -- compete for advertising and listenership with internet-only webcasters. Ordover WRT at 15, SX Trial Ex. 45; 4/27/10 1249:14-17 (Fratrik). Therefore, "[l]ower rates offered to certain webcasters may allow them to compete more successfully for listeners," by allowing these webcasters to lower subscription prices or find other ways to enhance their service offerings. Ordover WRT at 15-16, SX Trial Ex. 45.

279. Even if higher-cost webcasters did not change their service offering after receiving a lower royalty rate from SoundExchange, "with the benefit of a lower rate, such

webcasters may simply remain in the market as a competitive alternative when they might otherwise withdraw from the market." Ordover WRT at 16, SX Trial Ex. 45. In either situation, shifting listener demand to the webcasters that pay a lower rate would lead to a decline in SoundExchange's revenues, which in turn would decrease the amount of revenues to record companies and performing artists and result in a decline in the production of new music. Ordover WRT at 16, SX Trial Ex. 45; Pelcovits WDT at 21, SX Trial Ex. 2 ("The likely result of granting lower rates would be to enable the new market entrants that pay lower royalty rates to take market share away from the NAB webcasters and Sirius XM, which pay high royalty rates, thus reducing the aggregate royalties paid by webcasting services."). For all of these reasons, "SoundExchange would be unwilling to agree to a rate structure for commercial webcasters below the structure in its agreement with the NAB." Ordover WRT at 16, SX Trial Ex. 45.

280. In *Webcasting II*, the terrestrial radio broadcasters sought "to differentiate their simulcasting operations from the operations of other commercial webcasters and, thereby, obtain a different, lower royalty rate." 72 Fed. Reg. 24,095. But this Court rejected that request, noting that there was no evidence to suggest "that these simulcasters operate in a submarket separate from and non-competitive with other commercial webcasters." *Webcasting II*, 72 Fed. Reg. 24,095. In fact, there was "substantial evidence . . . in the record indicating that commercial webcasters such as those represented by DiMA in this proceeding and simulcasters such as those represented by Radio Broadcasters in this proceeding regard each other as competitors in the marketplace." *Webcasting II*, 72 Fed. Reg. 24,095. The evidence in this proceeding similarly indicates that commercial webcasters, like Live365, and terrestrial broadcasters directly compete and neither group deserves a lower rate compared to the other. Ordover WRT at 10-11, 15, SX

Trial Ex. 45; 4/27/10 1249:14-17 (Fratrik); 4/26/10 Tr. 1028:3-17 (Floater); SX Trial Ex. 13 at 129:23-130:1 (noting that terrestrial radio is "[i]n fact, very formidable competition").

281. This Court has also previously rejected the notion that any particular webcaster is guaranteed the ability to operate profitably. *Webcasting II*, 72 Fed. Reg. at 24,088 n.8. And economic theory supports that conclusion. Ordover WRT at 14, SX Trial Ex. 45. As Dr. Ordover explained, "[i]f a webcaster is unable to earn an at least normal risk-adjusted rate of return at appropriately determined market-based rates for digital performance rights, then economic efficiency mandates not a lower rate but rather a realignment of the webcaster's business model or its exit from the marketplace." Ordover WRT at 14, SX Trial Ex. 45; 8/2/10 Tr. 382:17-383:2 (Ordover) (explaining that economic theory "does not mean that every webcaster, however desirable or undesirable his product is, or efficient or inefficient his business or her business model is, will survive under whatever rate Your Honors decide to set. We do know that there are webcasters out there who are able and willing to pay the rate and surviving in the industry"); 7/28/10 Tr. 95:1-96:12 (Salinger) (explaining that a market rate "could exclude some companies that would like to be in the business but can't make it").

**d. Avoidance of Litigation Costs**

282. According to Dr. Fratrik, the NAB (and implicitly Sirius XM) had an incentive to agree to higher rates in the WSA deals than they otherwise would have in an effort to avoid incurring litigation costs. Fratrik WDT at 43, Live365 Trial Ex. 30. But Dr. Fratrik's criticism is unfounded. Because "both SoundExchange and the NAB likely have a high degree of confidence that the Judges will establish rates that are consistent with the willing buyer/willing seller construct," Dr. Ordover explained that "neither party likely would be willing to incur litigation costs in the event of a disagreement insofar as the predicted outcome would be a

schedule of rates to which both sides likely would have been willing to agree in any event." Ordover WRT at 16, SX Trial Ex. 45.

283. In any event, both the NAB and SoundExchange had an incentive to avoid the costs of litigation. Ordover WRT at 5 and 16-17, SX Trial Ex. 45; 8/2/10 Tr. 351:8-21 (Ordover) (explaining that the threat of litigation "works on both sides"). Dr. Fratrik claimed that only the NAB had an incentive to avoid litigation costs, because SoundExchange can recover its litigation costs through royalty collections. Fratrik WDT at 43, Live365 Trial Ex. 30. But Dr. Fratrik's claim is unsupported. As Dr. Ordover explained, both SoundExchange and webcasters have revenue sources from which to fund litigation costs, and "[f]or both sides, the payment of litigation costs is a first-order loss in income or profits." Ordover WRT at 17, SX Trial Ex. 45; 8/2/10 Tr. 351:21-352:3 (Ordover) ("I do not agree with Dr. Fratrik that the fact that each side has to finance litigation differently somehow creates an imbalance of incentives as between the NAB members and the SoundExchange members.").

284. Finally, the NAB's choice as posited by Dr. Fratrik -- either settle or incur litigation costs -- ignores another option: the NAB could simply choose not to participate in the proceeding. Ordover WRT at 17, SX Trial Ex. 45. In other words, the NAB could avoid litigation costs by electing not to participate or not offering a statutory service at all. Ordover WRT at 17, SX Trial Ex. 45; Pelcovits WDT at 16, SX Trial Ex. 2 ("The buyer in the existing statutory scheme always has the option of not offering a statutory service."). Any webcaster that chose not to settle and also chose not to participate in the proceeding would simply be subject to the rates established by the Court. Ordover WRT at 17, SX Trial Ex. 45. Thus, as noted by Dr. Ordover, "[i]t does not follow that the NAB would agree to a higher-than-market rate in order to

avoid litigation, when it was not compelled to litigate in any event." Ordover WRT at 17, SX Trial Ex. 45.

### e. Performance Complement Waivers

285. Finally, Dr. Fratrik argued that the NAB Agreement rates must be adjusted downward because the NAB obtained limited waivers of the performance complement from the major record labels. According to Dr. Fratrik, the performance complement waiver has unique value to the NAB simulcasters and therefore the rates in the NAB Agreement reflect a higher willingness to pay relative to internet-only commercial webcasters. Fratrik WDT at 43-44, Live365 Trial Ex. 30. But the testimony of Drs. Pelcovits and Ordover and Mr. McCrady establish that the waivers had value to both the NAB and the record companies, and that the existence of the waivers does not mean that the NAB Agreement rates should be adjusted downward. Pelcovits WDT at 20 n.21, SX Trial Ex. 2; Ordover WRT at 5, 18, SX Trial Ex. 45; McCrady WDT at 5-6, SX Trial Ex. 7.

286. Through direct, individual negotiations with the four major record labels, the NAB reached agreements for a limited waiver of the sound recording performance complement, which is codified in 17 U.S.C. § 114(j)(13). McCrady WDT at 5, SX Trial Ex. 7; Live365 Trial Ex. 8, 9, 10 and 11. Only the four major record companies negotiated these waivers and each waiver is applicable to only that company's sound recordings. 4/19/10 Tr. 227:5-9 (Pelcovits). The sound recording performance complement places limits on the number and frequency of sound recordings that may be played on the internet in a given time period by a given artist or from a given album. 17 U.S.C. § 114(j)(13); *see also* McCrady WDT at 5, SX Trial Ex. 7.

287. Terrestrial broadcasters have often claimed that the performance complement serves as an obstacle to simulcasting their over-the-air transmissions because the specific rules are "incompatible with their traditional broadcasting practices." McCrady WDT at 5, SX Trial

Ex. 7; 4/22/10 Tr. 674:2-10 (McCrady) (explaining that the negotiators for the NAB represented to McCrady that the performance complement was an obstacle for some terrestrial broadcasters to begin simulcasting); 4/19/10 Tr. 230:1-12 (Pelcovits) (noting that he was told that "smaller broadcasters in particular would have a difficult time conforming with the performance complement waivers").

288. McCrady explained WMG's motivation for granting the limited waiver to the NAB. The foundation of the performance complement "is that when it comes to programming designed specifically for the Web, you have just a completely different set of parameters that you have to live in when you're doing your programming." 4/22/10 Tr. 648:15-19 (McCrady). According to McCrady, "for Web-only programming the performance complement is probably the single most important thing that makes sure that webcasting looks as much as possible like traditional terrestrial broadcasting." 4/22/10 Tr. 649:22-650:3 (McCrady).

289. To reflect the important distinction between internet-only programming and traditional terrestrial broadcasting, WMG's waiver "[redacted]" McCrady WDT at 5, SX Trial Ex. 7; 4/22/10 Tr. 653:13-18 (McCrady). In other words, a broadcaster that "[redacted]" McCrady WDT at 6, SX Trial Ex. 7.

290. WMG was therefore "happy to offer the waiver," because of the belief that the waiver would "[redacted]" McCrady WDT at 6, SX Trial Ex. 7. Moreover, current terrestrial commercial radio programming practices essentially already "reflect principles that are similar in some respects to the performance complement." McCrady WDT at 6, SX Trial Ex. 7.

In practice, terrestrial radio stations do not typically devote large blocks of programming to a single artist or a single album. Such stations tend to program broadly within a specific genre or format in order to capture listeners within a confined geographic area rather than narrowly to capture listeners from an unlimited geographic area with very specific tastes. McCrady WDT at 6, SX Trial Ex. 7; 4/22/10 Tr. 648:20-649:7 (McCrady). In contrast, for web-only transmissions, "the space for possible products is, effectively, infinite and success can come from appealing to an extremely narrow market segment that might be diffuse, spread out over the entire country, for example." 4/22/10 Tr. 649:9-13 (McCrady).

291. WMG recognized these particular characteristics of terrestrial radio programming and determined that the waiver of the performance complement could be a net benefit for the company. As McCrady explained, however, WMG "included provisions in its complement waiver [ ]." McCrady WDT at 6, SX Trial Ex. 7; 4/22/10 Tr. 653:20-654:16 (McCrady); 4/20/10 Tr. 352:1-22 (Pelcovits) (explaining the purpose of the performance complement and the motivations for a limited waiver). These restrictions preserve the underlying purpose of the performance complement, which McCrady testified remains "absolutely essential to the compulsory license -- and I believe that the record industry could not live without it." 4/22/10 Tr. 648:12-14 (McCrady).

292. Ultimately, to the extent granting the waiver would encourage the small and medium sized broadcasters that reportedly lack the resources to strictly comply with the performance complement to begin webcasting, WMG "[

[redacted]

[redacted]]" McCrady WDT at 5, SX Trial Ex. 7; 4/22/10 Tr. 650:10-20 (McCrady); 4/22/10 Tr. 677:1-4 (McCrady) ("I do know that subject to the calculated business risk that we took, I believe and hope that it had real value to us, and by us here I'm referring specifically to Warner Music and our artists obviously.").

293. Ultimately, the performance complement waivers clearly provide value to the record companies and not just to the NAB, contrary to Dr. Fratrik's assertions. Ordover WRT at 18, SX Trial Ex. 45; McCrady WDT at 5, SX Trial Ex. 5. In fact, since the execution of the NAB Agreement and the performance complement waivers, the decision to grant the waiver appears to be paying off. Close to 100 broadcasters, accounting for over 300 individual radio stations, that had not previously reported webcasting performances to SoundExchange have opted into the NAB Agreement in the last two years and have begun reporting performances and making payments. Ordover WRT at 18, SX Trial Ex. 45; 8/2/10 Tr. 353:1-13 (discussing the simulcasters that are now paying SoundExchange and stating that "there is a benefit because these people now are paying the fees which they otherwise might not"); 4/19/10 Tr. 230:21-231:19 (Pelcovits) (testifying that granting the waivers enlarged the statutory webcasting market).

294. Furthermore, as both Dr. Pelcovits and Dr. Ordover noted, the record labels did not negotiate a performance complement waiver with Sirius XM as part of the Commercial Webcasters Agreement. Pelcovits WDT at 20 n.21, SX Trial Ex. 2; Ordover WRT at 18, SX Trial Ex. 45. Despite the fact that Sirius XM did not obtain a waiver, the rates in the Commercial Webcasters Agreement are nearly identical to those in the NAB Agreement. Pelcovits WDT at 20 n.21, SX Trial Ex. 2; Ordover WRT at 18, SX Trial Ex. 45; 8/2/10 Tr.

352:19-22 (Ordover); McCrady WDT, Ex. 101-DP at § 4.2, SX Trial Ex. 7; McCrady WDT, Ex. 102-DP at § 4.2, SX Trial Ex. 7. Thus, as Dr. Ordover testified, any potential market value of the waiver "is quite small." Ordover WRT at 18, SX Trial Ex. 45; Pelcovits WDT at 20 n.21, SX Trial Ex. 2.

### f. Discounts in the Early Years

295. Dr. Pelcovits considered whether the rates for 2011-2015 in the NAB Agreement and the Commercial Webcasters Agreement needed to be adjusted because of discounts from the current statutory rates for 2009 and 2010 in both agreements. Pelcovits WDT at 20, SX Trial Ex. 2. As part of the long term of the settlements, the rates in both of these WSA agreements for 2009 and 2010 are below the rates set by this Court in *Webcasting II* for those years. Pelcovits WDT at 20, SX Trial Ex. 2. Dr. Pelcovits concluded that no adjustment is necessary. Pelcovits WDT at 22, SX Trial Ex. 2; 4/19/10 Tr. 160:16-161:2 (Pelcovits).

296. Dr. Pelcovits explained that "[i]t is extremely unlikely that a willing seller who expected to have to negotiate future contracts with the same customer base would enter agreements that placed those who settled early at a competitive disadvantage compared to those who held out and settled later." Pelcovits WDT at 21, SX Trial Ex. 2. In other words, adjusting the rates in the later years to reflect the discounts in the early years "would send a strong signal to customers that it is a mistake to settle early." Pelcovits WDT at 21, SX Trial Ex. 2. Such a signal would run counter to SoundExchange's interests because it would create a reputation that settling early will put the settling party in a competitive disadvantage with parties that settle later. Pelcovits WDT at 21, SX Trial Ex. 2; 4/19/10 Tr. 161:4-162:10 (Pelcovits).

297. In the case of the NAB and Commercial Webcasters Agreements, where the settling parties accounted for over 50% of webcasting royalties paid to SoundExchange in 2008, the sellers "are unlikely to risk their reputation as a trustworthy partner in future negotiations

with those who settled for the WSA rates by agreeing to lower rates for the minority of webcasters who have not yet settled." Pelcovits WDT at 21, SX Trial Ex. 2; Live365 Trial Ex. 25 at 12.

298. Dr. Pelcovits also noted that there may be other factors that led to the lower rates in 2009 and 2010 in the WSA Agreements that would not apply to non-settling parties. Specifically, he testified that "SoundExchange may have viewed the ability to obtain agreements with webcasters that represent more than 50% of its webcasting royalty receipts in 2008 as warranting a discount akin to a signing bonus." Pelcovits WDT at 22, SX Trial Ex. 2; Live365 Trial Ex. 25 at 12.

## VI. LIVE365'S RATE PROPOSAL

299. Live365 has proposed a rate of $.0009 per performance for commercial webcasters. *See Rate Proposal for Live365, Inc.*, at 1 (Sept. 29, 2009).

300. Live365 has proposed a minimum fee of $500 per station or channel, subject to a per licensee cap of $50,000 per year. Live365 and SoundExchange have stipulated to the minimum fee for commercial webcasters, as discussed *infra* at Section X.A.1.

301. Live365 has also stipulated to the royalty rate for ephemeral copies, as discussed *infra* at Section XIV.A.

302. Live365 has proposed a 20% discount for so-called "qualified webcast aggregation services" that operate a network of at least 100 independently-operated aggregated webcasters, and satisfy other requirements. *See* Rate Proposal for Live365, Inc., at 2 (Sept. 29, 2009). The proposed aggregator discount is discussed *infra* at Section XII.B.1.

303. Live365 has proposed no other rates or terms.

## VII. DR. FRATRIK'S ANALYSIS DOES NOT SUPPORT LIVE365'S RATE PROPOSAL.

304. Live365's rate proposal is derived entirely from the economic analysis of its witness, Dr. Mark Fratrik.

305. Although this Court relied on benchmark analyses in *Webcasting II* and *SDARS*, Dr. Fratrik rejected the use of a benchmark analysis. 4/27/10 Tr. 1124:1-14 (Fratrik). Instead, Dr. Fratrik used a modeling approach to determine a proposed royalty rate. 4/27/10 Tr. 1104:1-21 (Fratrik).

306. Dr. Pelcovits detailed the problems with using a cost-modeling approach like Dr. Fratrik's: "you have to make a lot of judgments in terms of what is the -- in this case hypothetical willing buyer and who you use as a model to represent the hypothetical buyer," and such an approach is "subject to a lot of judgment calls in terms of how you model." 4/19/10 Tr. 125:20-126:6 (Pelcovits).

307. And Live365's rebuttal expert, Dr. Salinger testified at length about the complexity of using a modeling approach. Specifically, Dr. Salinger explained that in order to undertake a modeling approach designed to determine rates in this proceeding one would need, among other things, "cost and revenue data for at least a representative sample of webcasters." 7/28/10 Tr. 88:14-89:5 (Salinger). Dr. Salinger also testified that there might not be sufficient data to conduct create a satisfactory model, that there is not one webcasting business model that he would identify as typical with respect to costs, that he would "want to understand the relationship" between different elements of a webcaster's business, that a model would need to consider the "cross elasticities of demand within . . . the webcasting business," and that the degree to which webcasting promotes or substitutes for the sellers' other revenue streams would

be a relevant consideration. 7/28/10 Tr. 88:14-89:22, 92:1-97:4 (Salinger). None of these considerations is reflected in Dr. Fratrik's modeling in this proceeding.

308. Dr. Fratrik's model focuses on the willing buyer and ignores the willing seller component of the willing buyer/willing seller standard. His model does not consider copyright owners' (sellers') costs, revenues, and investments. 4/27/10 Tr. 1131:12-14, 1132:2-12, 1133:11-15 (Fratrik); Fratrik WDT at 10, Live365 Trial Ex. 30. Nor does his model include "any data on the actual additional marginal costs that the record companies incur from providing their services to the webcasting services." 4/27/10 Tr. 1132:20-1133:1 (Fratrik).

309. Dr. Fratrik did not speak with anyone from a record label, nor did he review any record label's financial records in the preparation of his testimony. 4/27/10 Tr. 1133:3-10 (Fratrik).

310. While Dr. Fratrik initially asserted that record companies "have no additional costs in connection with the webcast," Fratrik WDT at 37-38, Live365 Trial Ex. 30, he conceded at trial that there are indeed opportunity costs for the record companies associated with selling copyrighted sound recordings to webcasters like Live365, but that he simply chose not to account for those costs in his model. 4/27/10 Tr. 1135:9-1136:9 (Fratrik).

### A. The Evidence Does Not Support Dr. Fratrik's Assumption That Live365 Is a Typical Webcaster.

311. Dr. Fratrik based his entire analysis upon the unsupported and faulty assumption that Live365 is a typical webcaster with respect to its operating costs. Fratrik WDT at 16, Live365 Trial Ex. 30. This assumption is unfounded.

#### 1. Dr. Fratrik Did Not Verify That Live365 Is Typical.

312. Dr. Fratrik readily admitted that he did not verify whether Live365's costs are indeed typical among webcasters. 4/27/10 Tr. 1224:9-11 (Fratrik); Ordover WRT at 7, SX Trial

Ex. 45 ("Dr. Fratrik offers no analysis in support of this assertion" that Live365 is a typical webcaster in terms of its operating costs and subscriber revenues).

313. Dr. Fratrik based his assumption solely on the fact that Live365 has been a webcaster for over ten years, has achieved certain economies of scale, and has engaged in cost-cutting measures. Fratrik WDT at 16, Live365 Trial Ex. 30; 4/27/10 Tr. 1105:4-11 (Fratrik). But "Live365's longevity does not imply its 'typicality' as a webcaster." Ordover WRT at 8, SX Trial Ex. 45.

314. Not only did Dr. Fratrik fail to support his use of Live365's costs as being typical with corroborative data, but he also failed to provide any explanation for why other webcasting business models should be excluded from his analysis. 4/27/10 Tr. 1224:11-1225:9 (Fratrik).

315. Because Dr. Fratrik's model relies on Live365's cost data and is based on the assumption that its costs are typical, these flaws alone are enough to undermine Dr. Fratrik's entire economic model. However, they are hardly the only fundamental shortcomings in Dr. Fratrik's analysis.

**2. Live365's Business Model Is Not Typical.**

316. Far from being typical, Live365's business model and its integration of internet radio and broadcasting services is "unusual if not unique" in the industry.[2] Ordover WRT at 3, SX Trial Ex. 45; 8/2/10 Tr. 372:12-372:16 (Ordover) ("Live's business model is quite different

[2] Live365 asserts that it incurs costs and receives revenue from two separate lines of business: internet radio and broadcast services. Fratrik WDT at 17, Live365 Trial Ex. 30. These Findings of Fact will use the same terms and definitions regarding Live365's separate lines of business as are used in Dr. Fratrik's model. Specifically, the internet radio business will refer to the costs and revenue attributable to those webcasters whose royalty obligations are paid by Live365. 4/27/10 Tr. 1197:11-22 (Fratrik). The broadcast services business will refer to costs and revenue attributable to Live365's provision of bandwidth and other technical services necessary to stream copyrighted content over the internet. Fratrik WDT at 17, Live365 Trial Ex. 30. *See infra* at Section VII.D.

from that of several or many other webcasters creates serious doubt in my mind about their typicality.").

317. Indeed, Live365's own witness, Dr. Salinger, referred to Live365 as "a unique business model." 7/28/10 Tr. 114:5-11 (Salinger). Live365 aggregates thousands of webcasters. SX Trial Ex. 13 at 27:11-17. There is no evidence that any other service that pays SoundExchange operates a service that aggregates thousands of independent webcasters.

318. Unlike most webcasters, Live365 does not have any programming costs because all of its webcasters do their own programming. 4/27/10 Tr. 1274:11-21 (Fratrik). "Instead of providing its own programming, Live365 operates as an aggregator of thousands of individual webcasters that individually program their own channels." Ordover WRT at 8, SX Trial Ex. 45. This independent programming, from webcasters that are actually paying Live365, represents a cost savings for Live365 compared to other webcasters.

319. Another way in which Live365 is not typical is that the so-called broadcasting services that Live365 provides to operators of individual Internet radio stations generate additional revenue to Live365. Ordover WRT at 8, SX Trial Ex. 45.

320. Moreover, Live365 itself does not incur the costs of royalties. Live365's webcasting packages offer webcasters the option either to pay royalties on their own or to choose a "Royalty Included" broadcaster package whereby Live365 charges a separate price to be responsible for paying the webcaster's royalty fees. SX Trial Ex. 14 at 1.

321. If and when rates increase, Live365 can pass on that increase to its webcasters. For example, Live365 simultaneously increased the price of the broadcast packages that it offers to webcasters when the rates were increased in *Webcasting II*. SX Trial Ex. 13 at 150:1-8.

Because Live365 simply passes on the royalty costs to its webcasters, it is not directly affected by higher royalty rates.

322. Ultimately, as Dr. Ordover explained, "[t]here is no reason to think that Live365's operating costs and subscription revenues, as well as the percentage breakdown in Live365's revenues between advertising and subscription, can serve as reasonable proxies for webcasters more generally." Ordover WRT at 3, SX Trial Ex. 45

### 3. There Are Many Different Webcasting Models.

323. The record evidence makes clear that there are a variety of different webcasting services and business models. 4/27/10 Tr. 1231:17-20 (Fratrik); SX Trial Ex. 13 at 127; Ordover WRT at 3, SX Trial Ex. 45. Live365's own witness, Dr. Salinger, testified that there is "not one business model that [he] would say is typical." 7/28/10 Tr. 93:16-94:15 (Salinger). Live365's CEO, N. Mark Lam, explained that there is great diversity in the webcasting industry: "the last five years or so, you see new players coming in that basically wouldn't have existed five years before . . . And different--different players offering different features, and some of them are crossovers and some of them are things that nobody have ever though about five years ago and so on and so forth." SX Trial Ex. 13 at 127:6-14.

324. Dr. Ordover observed that "[t]he webcasting industry is highly diverse, especially with respect to the business models employed by webcasters." Ordover WRT at 3, SX Trial Ex. 45. Dr. Ordover testified about numerous different business models including simulcasters, portals like AOL and Yahoo! that use webcasting to drive traffic to other revenue-producing websites, custom radio services, services like Rhapsody or Live365 that use statutory webcasting to stimulate sales of another product or service, internet-only webcasters, and subscription services like Sirius XM. Ordover WRT at 9-10, SX Trial Ex. 45; 8/2/10 Tr. 333:8-22 (Ordover)

(commenting on the "variety of webcasters" that are in the market and the differences between the business models).

325. This diversity of business models renders Dr. Fratrik's determination that Live365 is somehow typical both "unsupported and untenable." Ordover WRT at 3, SX Trial Ex. 45. As Dr. Ordover observed, "[t]he substantial degree of heterogeneity across the existing webcasting business models makes any attempt to characterize Live365 as a typical webcaster fatally flawed." Ordover WRT at 11, SX Trial Ex. 45.

326. Dr. Fratrik acknowledged that the value of music to these various business models might differ from the value of music to a webcaster like Live365. 4/27/10 Tr. 1239:15-18 (Fratrik); 4/27/10 Tr. 1238:4-20 (Fratrik) (same for custom radio services). Dr. Fratrik also acknowledged that his model does not take into account any revenue a webcaster might earn from something other than advertising on or subscriptions to a webcasting service. 4/27/10 Tr. 1230:6-1231:3 (Fratrik).

### B. Dr. Fratrik's Assumption of a 20% Operating Margin for Webcasters Is Unfounded.

327. A key assumption in Dr. Fratrik's analysis was that a typical webcaster would require a royalty rate that enabled it to earn at least a 20% operating margin. 4/27/10 Tr. 1164:4-11 (Fratrik); Fratrik WDT at 21, Live365 Trial Ex. 30. In other words, a typical webcaster would not pay for a copyrighted work at a rate that did not allow for it to earn a 20% operating margin. 4/27/10 Tr. 1164:17-18 (Fratrik).

328. Dr. Fratrik's 20% figure is not based upon any analysis of the webcasting industry. Dr. Fratrik conceded that he had no "evidence that actual webcasters" would require a 20% operating margin, and that he was not aware of any webcaster currently earning a 20% margin. 4/27/10 Tr. 1166:16-1167:4 (Fratrik).

329. In fact, when choosing the 20% figure, Dr. Fratrik did not even look at the returns earned by any other digital business. 4/27/10 Tr. 1173:6 (Fratrik). The evidence shows that a variety of other digital Internet businesses earn operating margins lower than 5%. 4/27/10 Tr. 1173:17-1174:17 (Fratrik). Nor did Dr. Fratrik look at record companies, which also have operating margins of about 5% or less. 4/27/10 Tr. 1175:13-1176:8 (Fratrik).

330. Instead, Dr. Fratrik arrived at the 20% figure by looking to the operating margins of eight publicly-held radio companies, and reasoned that they provided a useful benchmark because terrestrial radio is a comparable industry. Fratrik WDT at 21-22, Live365 Trial Ex. 30.

331. This choice is flawed. 8/2/10 Tr. 332:3-12 (Ordover) (explaining that he found "[t]he 20 percent variable cost margin that Live is supposed to earn, to be unsupported by evidence, and whatever evidence Dr. Fratrik adduces, *i.e.*, by relying on some calculations from the terrestrial sector, I do not think are adequate to support his claim of the right margin").

332. Dr. Fratrik admitted that the terrestrial radio industry requires much higher capital costs than webcasting, and that the barriers to entry are higher for terrestrial radio than for webcasting. 4/27/10 Tr. 1168:14-1169:5, 1170:20-1172:22 (Fratrik); Ordover WRT at 3, SX Trial Ex. 45 ("Dr. Fratrik's selection of a minimum expected margin of 20% is based on margins earned by terrestrial radio broadcasters, who operate in a market with higher fixed capital and other costs and therefore do not provide a useful benchmark from which to determine a reasonable operating margin.").

333. Dr. Fratrik also admitted that industries with high barriers to entry earn higher margins than industries with low barriers to entry. 4/27/10 Tr. 1170:16-20 (Fratrik).

334. Dr. Fratrik's reliance on the margins for publicly-held terrestrial broadcasters is therefore misplaced. 8/2/10 Tr. 340:9-18 (Ordover) (explaining that Dr. Fratrik "relies on the

margins that he obtained from the terrestrial broadcasting industry, which is in many respects quite different from the webcasting industry, and thereby does not necessarily offer the right benchmark for calculating the appropriate variable cost margin").

335. Dr. Ordover expanded on why it is that a firm in an industry with low barriers to entry and low capital costs -- such as webcasting -- will earn lower operating margins than a firm in an industry with high barriers to entry and high capital costs -- such as terrestrial broadcasting. There is a difference in operating margins between the two types of industries "because the long-run economic viability of a firm requires recoupment of all of its costs, including fixed costs." Ordover WRT at 13, SX Trial Ex. 45. Dr. Ordover further explained that

> when there are high fixed costs and low variable costs, the firm must earn higher operating margins in order to recover its fixed expenditures. Alternatively, when the fixed costs associated with the firm's operations are relatively modest, *i.e.*, entry barriers are low, recoupment of fixed costs requires less contribution from the firm's operating margins. In either case, competition is expected to drive margins down toward the point where the firm earns a normal, risk-adjusted rate of return on its invested capital.

Ordover WRT at 13, SX Trial Ex. 45.

336. The arbitrariness of Dr. Fratrik's selection of a 20% operating margin is highlighted by the fact that -- even under Dr. Fratrik's recommended royalty rate of $0.0009 -- Live365 would not have achieved a 20% operating margin in fiscal years 2008 or 2009. Ordover WRT at 13, SX Trial Ex. 45 ("Indeed, SoundExchange would be required to pay Live365 in order to generate Dr. Fratrik's proposed benchmark margin."); 8/2/10 Tr. 376:19-377:15 (Ordover) (explaining that using two of the three sources of advertising revenue considered by Dr. Fratrik "SoundExchange would be required to pay Live money for playing music in order for Live to obtain the 20 percent variable cost margin which he says is a target rate").

337. As Dr. Ordover testified "[w]hat this means is that under a literal application of Dr. Fratrik's methodology, Live365 should either exit the webcasting business or continue to webcast only if it is paid by the record labels to play their music." Ordover WRT at 12, SX Trial Ex. 45; *see also* Ordover WRT at 11, SX Trial Ex. 45 (Fratrik's "recommended rate does not accomplish this objective because Live365 itself would not earn a 20% margin for its webcasting business under Dr. Fratrik's proposed rate").

338. And although Dr. Fratrik insisted that a willing buyer would "require a rate that gives them a 20 percent operating margin," 4/27/10 Tr. 1164:4-11 (Fratrik), he would not state whether he would actually advise Live365 to exit the industry if it could not earn a 20% operating margin. 4/27/10 Tr. 1167:5-22 (Fratrik).

339. Finally, Dr. Fratrik took inconsistent positions about the comparability of terrestrial radio and webcasting. Notwithstanding his reliance on terrestrial radio's operating margins as the proxy for the margins that webcasters would require, Dr. Fratrik himself asserted that "there are vastly different economics associated with terrestrial commercial radio broadcasters affecting the amount that a willing buyer would be willing to pay." Fratrik WDT at 41, Live365 Trial Ex. 30. Dr. Fratrik made this statement in critique of Dr. Pelcovits's use of the NAB agreement as a benchmark. As Judge Wisniewski observed, however, it is "difficult to have one comparison be appropriate in one place but not in another when you're, in both cases, trying to compare with commercial webcasters." 4/27/10 Tr. 1180:8-11 (Fratrik).

### C. Dr. Fratrik's Use of Subscription and Advertising Revenue Data Is Unsound.

340. In his modeling, Dr. Fratrik used Live365's percentage of subscriber ATH and applied it to subscription revenue per ATH to create his weighted value of total revenue per ATH. He used industry reports to fill in the advertising revenue per ATH. Fratrik WDT at 25, Live365 Trial Ex. 30.

341. There are two main problems with this convoluted analysis. First, it significantly undervalues total revenue per ATH, because Live365's percentage of subscription revenue is much higher than its percentage of subscriber listening hours. Fratrik WDT at 19 and 25, Live365 Trial Ex. 30 (In FY 2008, subscription revenue made up 60% of total U.S. internet radio revenue, whereas subscribers only accounted for 23.5% of total U.S. listening hours.). Second, it masks Dr. Fratrik's belief that Live365 is an atypical webcaster with respect to its advertising revenue, which begs the question of what makes it typical for cost purposes.

342. Rather than using Live365's advertising revenue data, Dr. Fratrik's recommended rate of $0.0009 was derived using industry-wide advertising revenue reported by ZenithOptimedia. Fratrik WDT at 28 Table 5, Live365 Trial Ex. 30. As Dr. Ordover pointed out, Dr. Fratrik's use of the ZenithOptimedia data highlights the methodological and theoretical flaws in Dr. Fratrik's entire approach. 8/2/10 Tr. 370:20-371:11 (Ordover) (explaining that Dr. Fratrik's consideration of three different sources of advertising revenue is "in some way driven by the need to come up with a calculation . . . that he thinks is economically meaningful").

343. Moreover, this Court has previously criticized expert witnesses for relying on data for which the expert had not examined the underlying methodology. *Webcasting II*, 72 Fed. Reg. at 24,093 (criticizing expert for relying "on Accustream data as a sort for certain cost data without examining the methodology used by Accustream in compiling the data"). Dr. Fratrik has used the ZenithOptimedia data (and the Accustream data) in a similarly less than rigorous fashion.

344. The ZenithOptimedia advertising revenue data that Dr. Fratrik used results in advertising revenue per ATH that is nearly double the figure that Live365 has actually achieved in the market. Fratrik WDT at 29 Table 6, Live365 Trial Ex. 30. As a result of this difference,

the $0.0009 royalty that Dr. Fratrik recommends is higher than the rate at which Live365 would obtain the 20% operating margin that Dr. Fratrik claims is essential for a willing buyer, and would have led to a negative operating margin for Live365's webcasting business in fiscal year 2008. Ordover WRT at 11, SX Trial Ex. 45; Fratrik WDT at 21 Table 2, Live365 Trial Ex. 30.

345. Even setting aside the impact of using the ZenithOptimedia data on Live365's operating margin, Dr. Fratrik's decision to use the higher figure demonstrates that Live365 should not be considered a typical webcaster. Under Dr. Fratrik's model, Live365 is assumed to be typical with respect to operating costs and the ratio of subscription listening to free listening. Implicitly, Dr. Fratrik claims that the ZenithOptimedia data provides the advertising revenue per ATH of a typical webcaster. But as Dr. Ordover explained, "[i]f the [ZenithOptimedia] figure is representative of a typical webcaster, the fact that it is nearly two times the analogous value obtained from Live365's financial data precludes Dr. Fratrik from utilizing Live365 as a representative webcaster. If, on the other hand, the figure is not representative of a typical webcaster, then it should not serve as the basis for Dr. Fratrik's recommended rate." Ordover WRT at 12, SX Trial Ex. 45. In other words, Dr. Fratrik has offered no compelling explanation for how Live365 can be considered typical with respect to some, but not all, relevant cost and revenue data, and the evidence that Dr. Fratrik has chosen (the ZenithOptimedia advertising estimates) is so wildly divergent from Live365's own performance, that it undercuts any claim that Live365 should be considered typical for any purpose.

346. It is also worth noting that Live365's other economic expert chose not to use the ZenithOptimedia advertising data in his analysis, and chose instead to use the data from the AccuStream report. Salinger WRT at 10, Live365 Reb. Ex. 1. Dr. Salinger made that choice despite knowing that Dr. Fratrik used the ZenithOptimedia report. 7/28/10 Tr. 98:11-100:12

(Salinger). But Dr. Salinger testified that he chose the AccuStream report because what ZenithOptimedia reports "for Internet . . . radio advertising revenues is for more that just music. It's all Internet radio. So, for example, it would include ESPN radio is my understanding." 7/28/10 Tr. 100:13-20 (Salinger).

347. Finally, the ZenithOptimedia Report relied upon by Dr. Fratrik predicts a 45% growth in internet radio advertising expenditures from the 2008 figure used in Dr. Fratrik's rate proposal to its 2011 forecast. Fratrik WDT Ex. 8 at 187, Live365 Trial Ex. 30. Dr. Fratrik has not predicted a corresponding increase in webcasting costs. Therefore, using his model, the value per performance should increase between 2008 and 2011 for Live365 and all other webcasters. *See* 4/27/10 Tr. 1246:12-1248:1 (Fratrik). Dr. Fratrik, however, proposes a constant rate of $.0009.

### D. Dr. Fratrik's Separation of Live365's Broadcasting and Webcasting Businesses Is Unjustified.

348. In conducting his economic analysis, Dr. Fratrik attempted to separate what he claimed are two different parts of Live365's business -- its webcasting or internet radio business and its broadcasting services business. According to Dr. Ordover, this is the most important problem with Dr. Fratrik's approach. 8/2/10 Tr. 331:14-332:2 (Ordover) (explaining that Fratrik "treats the synergistic or the unitary webcaster, like Live365, as being composed of two separate parts, the webcasting part and the broadcast services part. And I believe that this approach is incorrect with sound economics").

349. The evidence showed that the line Dr. Fratrik attempted to draw between Live365's internet radio business and broadcast services business is indiscernible. The overlapping sources of revenue between the two businesses casts as much doubt on Dr. Fratrik's

distinctions as does his arbitrary separation of costs. Examples of the blurred line between the two businesses are numerous.

350. As a starting point, there is no dispute that a Live365 listener cannot tell the difference between a station that is simply using Live365's broadcast services versus a station that contributes to Live365's internet radio business. 4/27/10 Tr. 1192:2-9 (Fratrik). Both types of stations appear on Live365's directory. 4/27/10 Tr. 1190:15-1191:20 (Fratrik). Instead, the distinction is entirely internal to Live365. 4/27/10 Tr. 1192:2-9 (Fratrik); *Live365's Clarification Regarding Terminology & the Operations of Live365*, at 2 (June 7, 2010) ("Live365's internal nomenclature is to call all webcasters 'broadcasters.'").

351. Under Live365's definitions, broadcast services revenue comes from payments by webcasters for the webcasting technology platform, software tools, bandwidth, and technical know-how. Fratrik WDT at 17, Live365 Trial Ex. 30. *All* of Live365's webcasters use its broadcast services. SX Trial Ex. 13 at 30:24-31:2.

352. Internet radio revenue, on the other hand, comes only from advertisers and subscription listeners -- webcasters' payments to Live365 for the various broadcast packages falls under broadcast services revenue. Fratrik WDT at 17, Live365 Trial Ex. 30. But, inherent in the design of Live365's website is the ability of subscribers to listen to both webcasters who only use Live365's broadcast services and also webcasters who contribute to Live365's internet radio business. 4/27/10 Tr. 1190:15-1191:20 (Fratrik). Thus, a major part of Live365's appeal to both webcasters and listeners -- the sheer size and breadth of its station listings -- attracts subscription revenue regardless of whether those subscribers are listening to stations that Live365 only associates with its broadcast services business. 4/27/10 Tr. 1202:4-1204:1 (Fratrik).

353. In Dr. Fratrik's model, a webcaster is only considered part of Live365's internet radio business, such that advertising revenue and subscription revenue attributable to that webcaster is included in Dr. Fratrik's revenue calculations, if it purchases a royalty included broadcast package. 4/27/10 Tr. 1197:11-22 (Fratrik). But, further blurring the line, broadcasters (*i.e.*, those webcasters that do not select a royalty included package) get paid a commission if a new Live365 subscription is signed up through their channel. 4/26/10 Tr. 896:22-897:6 (Floater). In other words, broadcasters contribute to Live365's subscription revenue and get paid for doing so, even though Dr. Fratrik does not consider them part of Live365's internet radio business.

354. Additionally, broadcast package pricing is directly correlated to advertising revenue: "In the consumer packages, those broadcasters allow me to sell the advertising in their packages, which helps cover that fixed cost of broadcasting and, therefore, those packages can be priced less than if I can't generate some of the revenue by selling their advertising." 4/26/10 Tr. 938:17-22 (Floater). Thus, advertising revenue, which is "internet radio" revenue in Dr. Fratrik's model, affects the price charged to webcasters for broadcast services, which is "broadcast services" revenue.

355. The broadcast services-internet radio distinction is equally dubious on the cost side of Dr. Fratrik's model. The most straightforward problem with Dr. Fratrik's separation of costs is that he unjustifiably allocates 100% of the IT Operations, Customer Service, and "Other" costs to Live365's webcasting business with no explanation of why these cost categories are not also applicable to Live365's broadcasting business. Fratrik WDT at 19, Live365 Trial Ex. 30. On cross-examination, Dr. Fratrik admitted that there are likely IT, customer service, and "other"

costs attributable to the broadcast services business; however, he chose to allocate 100% of those costs to internet radio without explanation. 4/27/10 Tr. 1215:17-1218:3 (Fratrik).

356. Moreover, as already noted, Dr. Fratrik only included webcasters who have Live365 pay their royalty fees in his definition of Live365's internet radio business. 4/27/10 Tr. 1197:12-18 (Fratrik). However, the broadcasting fees that webcasters who are a part of Live365's internet radio business pay to Live365 are only allocated as revenue to Live365's broadcast services business, even though the bandwidth costs of those stations are allocated to the internet radio business. 4/27/10 Tr. 1209:2-19; Fratrik WDT at 19 Table 1. Put simply, Dr. Fratrik has allocated 100% of the revenue from purchasing a broadcast package to broadcast services revenue, while simultaneously attributing 42.8% of Live365's bandwidth costs from broadcasting to the internet radio business. 4/27/10 Tr. 1209:2-19 (Fratrik).

357. Notwithstanding this overlap, Dr. Fratrik attempts to carve out the broadcast-services component of Live365's business model in developing his cost modeling approach to recommending a royalty rate. Ordover WRT at 9, SX Trial Ex. 45 (explaining that although Live365 is paid by webcasters an amount designed to cover their royalty liabilities, "Dr. Fratrik excludes all revenue related to broadcasting services, but at the same time allocates all of the costs associated with, among other things, bandwidth, to the webcasting service"); 4/27/10 Tr. 1190:3-1191:13, 1210:17-1218:3, 1275:3-:5 (Fratrik).

358. Dr. Ordover explained that "[s]uch an exercise is necessarily arbitrary and unreasonable in my view because it disregards the wholly integrated (*i.e.*, synergistic) nature of Live365's business." Ordover WRT at 8-9, SX Trial Ex. 45.

359. Specifically, Dr. Ordover highlighted the fact that Live365's webcasting service -- the transmission of audio streams -- promotes its broadcasting services -- the services that

Live365 sells to those individual webcasters. Thus, "the royalty rate that Live365 would be willing to pay necessarily is influenced by the revenue it generates through its broadcasting services." Ordover WRT at 9, SX Trial Ex. 45. In other words, "even if one assumes (contrary to sound economics) that Live365's financial performance has some relevance for purposes of determining a reasonable rate (or range of rates) in this proceeding, an assessment of the company's financial performance should not arbitrarily attempt to carve out the webcasting segment of the overall business." Ordover WRT at 9, SX Trial Ex. 45.

360. Even Live365's own expert witness, Dr. Salinger, agreed that "a webcaster who uses webcasting in order to promote sales in a related line of business would consider the revenues they get from that related line of business in deciding what royalties they would pay." 7/28/10 Tr. 92:1-19 (Salinger). Dr. Salinger testified further that "where the webcasting business was part of a broader business model," he would "want to understand the relationship with the other part of the business." 7/28/10 Tr. 92:14-19 (Salinger). Moreover, Dr. Salinger suggested that Live365 is not in fact typical by explaining that "if I believe[d] that Live were typical of the industry and didn't have this unique business model" then he would take into account that "the webcasting side of the business helps promote sales in their related line of business" of broadcasting services." 7/28/10 Tr. 118:2-11 (Salinger).

### E. Live365 Has Been Profitable at the *Webcasting II* Rates.

361. The evidence shows that Live365 has been profitable at the statutory royalty rates set in *Webcasting II*. Live365 has maintained a positive overall operating profit margin at the *Webcasting II* rates for the last four fiscal years, including FY 2009 in which its operating profit was over $1 million dollars. Fratrik WDT, Ex. 10, Live365 Trial Ex. 30; 4/26/10 Tr. 990:20-22 (Floater); SX Trial Ex. 23 and 24.

362. For fiscal years 2006-2009, Live365 earned operating margins of 5%, 6%, 14%, and 11% respectively. Fratrik WDT, Ex. 10, Live365 Trial Ex. 30.

363. As of October 2009, [redacted]. SX Trial Ex. 30 at Bates Number LIVE 013020; 4/26/10 Tr. 1009:21-1010:8 (Floater).

364. Indeed, Dr. Fratrik's testimony established that Live365 would have been profitable even if the 2008 royalty rate had been higher. According to the FY 2008 data in Table 5 of Dr. Fratrik's Written Direct Testimony, Live365 could have earned a 5% operating profit margin even if the statutory rate had been $.0018, which is double the rate proposed by Dr. Fratrik and higher than the actual 2008 statutory rate of $.0014. Fratrik WDT at 28, Live365 Trial Ex. 30.

365. For FY 2008, Dr. Fratrik's value per performance calculations, which are based on only Live365's so-called "internet radio" costs and revenue, showed a positive value per performance with up to a 15% operating profit margin. Fratrik WDT at 21 Table 2, Live365 Trial Ex. 30 (showing a value per performance of $0.0004 with a 5% operating margin and $0.0002 with a 10% operating margin). Dr. Fratrik's calculations highlight the fact that Live365 was able to earn an operating margin of nearly 15% under the *Webcasting II* rates, even when its so-called "broadcast services" profits are excluded. Fratrik WDT at 19 Table 1, Live365 Trial Ex. 30. In fact, if Dr. Fratrik's had chosen an operating margin for the typical webcaster that was less than 15%, his model would indicate that the 2008 *Webcasting II* rate was actually set too low.

366. In short, Live365 has thrived financially under the Webcasting II royalty rates. As of January 31, 2010, Live365 had [redacted] in cash on its balance sheet. SX Trial Ex. 25 at 1.

367. From FY 2002 through FY 2009, Live365's advertising revenue grew by roughly 622%. Fratrik WDT, Ex. 10, Live365 Trial Ex. 30; *see also* SX Trial Ex. 24 (data from FY 2002 through first nine months of FY 2009). Its revenue increased every year from FY 2002 through FY 2008 and has grown roughly 7,700% from FY 2002 to FY 2009. Fratrik WDT, Ex. 10, Live365 Trial Ex. 30; SX Trial Ex. 24 (data from FY 2002 through first nine months of FY 2009); 4/26/10 Tr. 1018:21-1019:2 (Floater) (testifying that Live365's internet radio subscription revenues "increased year over year in each of fiscal years '05, '06, '07 and '08").

**F. Live365 Would Be Profitable Under SoundExchange's Rate Proposal.**

368. The calculations performed by Dr. Salinger in his rebuttal testimony demonstrate that Live365 could well afford the rates proposed by SoundExchange. Salinger WRT, Ex. 4, Live365 Reb. Ex. 1; 7/28/10 Tr. 111:2-112:3 (Salinger). Specifically Dr. Salinger claimed to provide a "more realistic assessment of the industry," by calculating the revenue per play for Pandora and Live365. Salinger WRT at 14, Live365 Reb. Ex. 1; Salinger WRT, Ex. 4 and 5, Live365 Reb. Ex. 1.

369. But as Dr. Salinger acknowledged during the rebuttal hearing, the revenue per play that Live365 earns is substantially higher than the revenue earned by Pandora. 7/28/10 Tr. 110:17-111:13 (Salinger) (explaining that the numbers for Pandora and Live365 are very different); Salinger WRT, Ex. 4 and 5, Live365 Reb. Ex. 1. In fact, Live365's revenue per play as calculated by Dr. Salinger is around $0.0048, an amount well above SoundExchange's proposed rate. 7/28/10 Tr. 111:11-13 (Salinger). And those calculations actually understate Live365's revenue per play, because they exclude all revenue earned by Live365 through its provision of broadcasting services to webcasters, a flaw that is even more prominent in Dr. Fratrik's economic analysis. 7/28/10 Tr. 112:14-113:1 (Salinger).

370. In addition, the following table calculates the profit margins Live365 would have earned for fiscal year 2009 under SoundExchange's proposed rates, using Live365's financial data. The table combines all of Live365's revenue (from both its so-called broadcast services and internet radio lines of business) and adjusts Live365's DSRP payments to reflect SoundExchange's proposed rates.

371. Notably, this table assumes no growth whatsoever in any of Live365's revenue streams. The table also does not make any adjustments to account for Live365's history of increasing the amount it charges to webcasters when royalty rates increase. *See* SX Trial Ex. 13 at 150:1-8 (explaining that Live365 increased the fees that it charged to webcasters in response to the *Webcasting II* rate determination). Accordingly, this table presents a conservative estimate of Live365's profitability under SoundExchange's rate proposal, especially in the later years.

**Adjusted Live365 Operating Income Statement FY 2009**

| *Proposed Rate* | *$.0021* | *$.0023* | *$.0025* | *$.0027* | *$.0029* |
|---|---|---|---|---|---|
| **TOTAL REVENUE** | **$9,346,579** | **$9,346,579** | **$9,346,579** | **$9,346,579** | **$9,346,579** |
| Direct Cost of Sales - ***Adjusted DSRP*** | ***$2,466,455*** | ***$2,701,355*** | ***$2,936,256*** | ***$3,171,156*** | ***$3,406,056*** |
| - ASCAP, BMI, SESAC, Thomson | $319,000 | $319,000 | $319,000 | $319,000 | $319,000 |
| - Bandwidth | $371,673 | $371,673 | $371,673 | $371,673 | $371,673 |
| - Ad Rep | $545,688 | $545,688 | $545,688 | $545,688 | $545,688 |
| - IT and CS | $407,426 | $407,426 | $407,426 | $407,426 | $407,426 |
| - Others | $716,966 | $716,966 | $716,966 | $716,966 | $716,966 |
| **Total Cost of Sales** | $4,827,208 | $5,062,108 | $5,297,009 | $5,531,909 | $5,766,809 |
| Total Operating Expenses | $3,803,579 | $3,803,579 | $3,803,579 | $3,803,579 | $3,803,579 |
| TOTAL COSTS AND EXPENSES | $8,630,787 | $8,865,687 | $9,100,588 | $9,335,488 | $9,570,388 |
| **OPERATING PROFIT (EBITDA)** | **$715,792** | **$480,892** | **$245,991** | **$11,091** | **($223,809)** |

* All figures were derived from Fratrik WDT, Ex. 10, Live365 Trial Ex. 30.

** DSRP has been calculated by dividing the amount of DSRP that Live365 actually paid for fiscal year 2009 by the calendar year 2009 per play rate of $.0018 to create a total number of copyrighted plays for fiscal year 2009. This total number of plays was then multiplied with SoundExchange's proposed rates in order to create the DSRP amount that Live365 would have paid using SoundExchange's rates.

372. As evidenced by the figures above, Live365 would almost certainly remain profitable at the rates SoundExchange has proposed until the last year of the upcoming term without any adjustments for revenue changes, broadcast fee increases, or inflation.

### G. Additional Flaws in Dr. Fratrik's Methodology

373. In addition to the fundamental shortcomings of Dr. Fratrik's model discussed above, there are other problems with his methodology that skew his proposed rate lower.

374. For example, Dr. Fratrik uses Live365's proportion of subscriber ATH, 23.5%, and weights the corresponding 76.5% against the publicly available advertising revenue data to create a total revenue per ATH of $.0571 (AccuStream) and $.0872 (ZenithOptimedia). Fratrik WDT at 25, Live365 Trial Ex. 30. This is nothing more than a sleight of hand: Dr. Fratrik uses the ratio of subscriber to non-subscriber *listening hours* as a proxy for the ratio of subscriber *revenue* to advertising revenue. But subscriber revenue accounts for nearly 60% of Live365's total internet radio revenues. Fratrik WDT, Ex. 10, Live365 Trial Ex. 30.

375. A much more straightforward calculation would use Live365's proportion of subscription revenue (60%) to advertising revenue (40%). Using this apples to apples comparison, the actual total revenue per ATH would be $.1017 (AccuStream) and $.1174 (ZenithOptimedia).

376. The following two tables display the values per performance that would result if Dr. Fratrik had used the more accurate ratio of subscription-to-advertising revenue. To accurately reflect the effect on Dr. Fratrik's calculations, both tables exclude Live365's so-called broadcast services revenues in the same manner used by Dr. Fratrik.

**Corrected Fratrik Table 4 (AccuStream)**

| **Revenue per ATH** | $.1017 | $.1017 |
|---|---|---|
| **Costs & Expenses Per ATH** | $.0572 | $.0572 |
| **Operating Margin** | 5% | 20% |
| **Reasonable Profit per ATH** | $.0051 | $.0203 |
| **Total Cost per ATH** | $.0623 | $.0775 |
| **Value of Copyrighted Material per ATH** | $.0394 | $.0242 |
| **Value per Performance** | **$.0028** | **$.0017** |

**Corrected Fratrik Table 5 (ZenithOptimedia)**

| | | |
|---|---|---|
| **Revenue per ATH** | $.1174 | $.1174 |
| **Costs & Expenses Per ATH** | $.0572 | $.0572 |
| **Operating Margin** | 5% | 20% |
| **Reasonable Profit per ATH** | $.0059 | $.0235 |
| **Total Cost per ATH** | $.0631 | $.0807 |
| **Value of Copyrighted Material per ATH** | $.0543 | $.0367 |
| **Value per Performance** | **$.0039** | **$.0026** |

377. As these tables demonstrate, correcting Dr. Fratrik's methodology in this way would result in a proposed rate of *$.0017* using the AccuStream figures and *$.0026* using the ZenithOptimedia figures (at the 20% operating margin proposed by Dr. Fratrik). Thus, Dr. Fratrik's ratio choice significantly undervalues total revenue per ATH and leads him to his proposed rate of $.0009. Fratrik WDT at 29 Table 6, Live365 Trial Ex. 30.

## VIII. THE WEBCASTING MARKET CONTINUES TO GROW.

### A. There Are a Large Number of Services Offering Statutory Webcasting and New Market Entrants Are Succeeding.

378. There are a large number of statutory webcasting services that are paying SoundExchange. In 2008, 610 webcasting services paid SoundExchange statutory royalties. Kessler WDT at 4, SX Trial Ex. 5. Because some entities pay and report separately for affiliates, stations or subsets of stations, SoundExchange actually receives separate reporting, and in some cases separate payments, from over 1,400 webcasting services, which account for thousands of channels and stations. Kessler WDT at 4-5, SX Trial Ex. 5.

379. Market entry is relatively easy because "[t]he technology necessary to become a webcaster is widely available and the most valuable input (*i.e.*, recorded music) is available at a very low sunk cost in the form of the statutory license." Pelcovits WDT at 10, SX Trial Ex. 2.

New market entrants are able to "rapidly capture listeners, and it is easy for listeners to sample new services on the Internet. Pelcovits WDT at 10, SX Trial Ex. 2; *see also* Pelcovits WDT at 11, SX Trial Ex. 2 ("The market is aided by the low costs of entry.").

380. Dr. Fratrik acknowledged that webcasting "has relatively low barriers to entry." 4/27/10 Tr. 1168:14-22 (Fratrik).

381. By way of example, Dr. Pelcovits highlighted two webcasting services that have entered the market relatively recently and grown significantly. First, Last.fm began webcasting in 2003, and by April of 2009 it had become the eighth largest statutory webcaster based on royalties paid to SoundExchange. Pelcovits WDT at 10, SX Trial Ex. 2. Last.fm was purchased in May of 2007 by CBS Radio for $280 million. Pelcovits WDT at 10, SX Trial Ex. 2.

382. Slacker Radio is the second relatively new webcaster discussed by Dr. Pelcovits. Slacker began webcasting in March of 2007 and in the first four months of 2009, it was the 13th largest statutory webcaster based on royalties paid to SoundExchange. Pelcovits WDT at 10, SX Trial Ex. 2. As Dr. Pelcovits testified, "Slacker has rapidly adapted its service to work with new devices as well as its own dedicated web radio," including a Slacker mobile application for Blackberry smartphones. Pelcovits WDT at 10-11, SX Trial Ex. 2.

383. Evidence of market entry is not limited to Last.fm and Slacker. Indeed, Live365's expert witness on the webcasting industry (Smallens) is currently advising a client about entering the statutory webcasting market. Smallens testified that his client, Vibe Media, is considering whether to "launch a statutory" Internet-only webcasting service. 7/28/10 Tr. 239:3-240:5 (Smallens).

384. Notwithstanding Live365's claims about the purported troubles facing statutory webcasting, Smallens is advising his client to enter the statutory webcasting market. The

unavoidable facts are that Smallens has not discouraged Vibe Media from entering the statutory webcasting business, and has not told Vibe that it could not make money or be profitable in the statutory webcasting business. 7/2/8/10 Tr. 240:12-241:14 (Smallens).

385. To the contrary, in the business plan that Smallens presented to Vibe Media in April 2010, he told Vibe Media that there is a large audience for online radio, that the audience is desirable, and that the mobile radio audience is growing by double-digit percentages monthly. 7/28/10 Tr. 243:11-244:8 (Smallens).

386. Nor can Live365 credibly claim that statutory webcasting royalties are preventing services from entering the statutory webcasting market. In advising Vibe Media, Smallens's analysis "factored in" the statutory webcasting royalties, which did not cause him to tell Vibe Media not to engage in statutory webcasting. 7/28/10 Tr. 242:2-13 (Smallens).

387. Live365 tried to use the testimony of Smallens to show that statutory royalty rates have forced webcasters out of business. Smallens WRT at 14, Live365 Reb. Ex. 2. But Live365 failed to do so. Smallens claimed that the "ad-supported music space is withering under the weight of royalty payments to the record labels." Smallens WRT at 14, Live365 Reb. Ex. 2. In support of that claim, however, Smallens cited *interactive* webcasting services, *i.e.*, services that largely are *not* subject to the statutory license. Smallens WRT at 14, Live365 Reb. Ex. 2. (citing SpiralFrog, Ruckus Network, imeem and Lala Media); 7/28/10 251:15-16 (Smallens) (conceding that the four cited services "were ad-supported interactive on-demand services primarily"). Indeed, Smallens ultimately conceded at trial that the statutory royalty rates were "[n]ot specifically" what caused these services to "wither." 7/28/10 Tr. 253:1-3 (Smallens).

388. To further support his dubious claim that statutory royalty rates are hurting webcasters, Smallens cited a news article that reported that Last.fm turned off its free streaming

service. Smallens WRT at 15, Live365 Reb. Ex. 2. But that claim is misleading. Nothing suggests that Last.fm's reported conduct has anything to do with the royalty rates at issue in this proceeding. Indeed, as Smallens admitted at trial, the article actually said that Last.fm shut down its "on-demand" streaming -- not its non-interactive streaming -- and that it did so only in non-major territories outside of the United States. 7/28/10 Tr. 254:13-255:8 (Smallens).

**B. The Advertising Market Continues to Grow.**

389. Contrary to the bleak picture Live365 has attempted to paint, the record evidence shows that advertising revenue has grown substantially over the past few years and will continue to grow in the future. Indeed, Live365's witnesses conceded that Internet radio advertising revenues are growing industry-wide.

390. From October 2001 through FY 2008, Live365's advertising revenue grew by roughly 700%. SX Trial Ex. 24.

391. The evidence suggests that this growth will continue across the webcasting industry. Live365 witness Smallens testified that advertising revenues for statutory webcasting will increase in 2010 and continue increasing through 2015. 7/28/10 Tr. 266:10-267:9 (Smallens). He predicted that advertising revenue for statutory webcasting will be between $600 million and $700 million by 2015. 7/28/10 Tr. 267:10-17 (Smallens).

392. Smallens also testified that advertising budgets for online marketing "absolutely" have been increasing, *see* 7/28/10 Tr. 199:20-22 (Smallens), and that advertising inventory sell-out rates will continue to rise for statutory webcasting. 7/28/10 Tr. 264:7-20 (Smallens).

393. The reports relied upon by Dr. Fratrik in his analysis similarly forecast significant growth in the internet radio advertising market.

394. The ZenithOptimedia report that Dr. Fratrik relied on predicts a 45% growth in internet radio advertising expenditures from the 2008 figure used in Dr. Fratrik's rate proposal to the report's 2011 forecast. Fratrik WDT, Ex. 8 at 187, Live365 Trial Ex. 30.

395. The AccuStream report that Dr. Fratrik relied on forecasts continued growth in ad-supported online listening hours through 2012 and significant growth in audio inventory sales over that same time period. Fratrik WDT, Ex. 3 at Section 2, Live365 Trial Ex. 30.

396. Similarly, the eMarketer Report that Dr. Fratrik relied on predicts growth in the online advertising market. Fratrik WDT, Ex. 4 at 1, Live365 Trial Ex. 30. And Dr. Pelcovits referenced a number of different revenue projections for internet radio advertising, all of which point to continued growth. Pelcovits WDT at 11, SX Trial Ex. 2.

397. In addition, advertisers are developing techniques that will help sustain the long-term viability of statutory webcasting. Dr. Pelcovits testified about the developing "ability of advertisers to obtain detailed demographics on listeners." Pelcovits WDT at 11, SX Trial Ex. 2. Specifically, a number of firms provide advertisers access to demographic measurements designed to allow "seamless ad insertion, geo-targeting, and campaign optimization." Pelcovits WDT at 11, SX Trial Ex. 2. As Dr. Pelcovits explained "[t]he growth of sophisticated analytical services and the creased ad revenue associated with internet radio . . . provide compelling evidence of an industry that has both short and long-term viability." Pelcovits WDT at 11, SX Trial Ex. 2.

### C. The Number of Statutory Webcasting Performances Continues to Grow.

398. Usage of statutory webcasting services, as measured by number of performances, has increased steadily since early 2006. In February of 2006, just over 1.8 billion performances were reported to SoundExchange. That number ballooned to 4.65 billion performances reported

in May of 2009. Pelcovits WDT at 8, SX Trial Ex. 2; Live365 Trial Ex. 14; *see also* 7/28/10 Tr. 249:6-9 (Smallens) (total webcasting performances have grown from 2007 to 2009).

**D. The Number of Listeners Continues to Grow.**

399. The evidence shows that the number of webcasting listeners has increased significantly over the past few years. Dr. Fratrik did not dispute the fact that "total industry listeners and performances have been increasing." 4/27/10 Tr. 1243:5-6 (Fratrik).

400. For example, according to Live365 witness Smallens, the percentage of people who have listened to online radio in the past week grew by more than 50% from 2007 to 2009. Smallens WRT at 7, Table 1, Live365 Reb. Ex. 2. It has reached an all-time high of 17% in 2009 and 2010. *Id.*

401. As Chief Judge Sledge observed at trial, this portion of Smallens' written testimony shows that "listenership has grown steadily in the last decade and that each time it's grown it stays stable for a few years and then grows again," meaning that "listenership has been very consistent over the last decade in a growth pattern." 7/28/10 Tr. 188:14-19 (Smallens).

402. In 2008 approximately 33 million people, listened to "online radio" on a weekly basis. In 2009, the same survey showed an increase to 17% of Americans over the age of 12, or approximately 42 million people. Pelcovits WDT at 9, SX Trial Ex. 2. There has been growth in the frequency of listening by desirable demographics, and online radio listeners are "typically well-educated, upper-income, full-time employed, and technologically savvy individuals." Pelcovits WDT at 9-10, SX Trial Ex. 2.

403. This growth is expected to continue. Smallens testified that total listening hours will expand in 2011. 7/28/10 Tr. 263:10-13 (Smallens). Similarly, the forecasts in the AccuStream report relied upon by Dr. Fratrik predict yearly growth of 20% in online listening through 2012. Fratrik WDT, Ex. 3 at Section 3, Live365 Trial Ex. 30.

### E. Customized and Mobile Webcasting Are Growing.

404. Dr. Pelcovits observed "two major developments" in the statutory webcasting market. 4/19/10 Tr. 123:8 (Pelcovits). The first development is "increasingly tailored music streams to the listener." 4/19/10 Tr. 123:10-11 (Pelcovits); Pelcovits WDT at 12, SX Trial Ex. 2. Although these streams are not on-demand, in the sense that the user cannot select a specific song to hear, they offer "a much more customized selection of music to suit [the listener's] taste." 4/19/10 Tr. 123:14-123:16 (Pelcovits).

405. Dr. Pelcovits testified about the growth of so-called custom radio services which "provide highly customized radio-type stations for each subscriber, based on the listener's stated preference for certain songs or artists." Pelcovits WDT at 12, SX Trial Ex. 2. He explained that the increased customization "is in marked contrast to the situation three or four years ago when all of the statutory webcasters that I analyzed -- except for Live365 -- provided less than four hundred channels of preprogrammed streaming music." Pelcovits WDT at 12, SX Trial Ex. 2. The popularity of custom radio services like Pandora, Last.fm and Slacker "demonstrates that there is a significant demand for what is termed 'push' type services, which provide a continuous stream of music programmed to suit the subscriber's tastes." Pelcovits WDT at 12, SX Trial Ex. 2.

406. The other significant development that Dr. Pelcovits observed is "the increased use of [statutory webcasting] services over mobile platforms." 4/19/10 Tr. 123:18-19 (Pelcovits); Pelcovits WDT at 12, SX Trial Ex. 2. As Dr. Pelcovits explained, devices such as the iPhone, "provide the listener or the owner with the ability to listen to a stream of music that's coming over the web and can be essentially the same as what the listener would get sitting at home listening over the computer." 4/19/10 Tr. 124:1-4 (Pelcovits). And "[m]any webcasting services feature mobile device applications, such as Slacker, Pandora, Live365, and Last.fm, all

of which have apps for the iPhone and Blackberry." Pelcovits WDT at 12, SX Trial Ex. 2. The increased mobility of webcasting services "enables the webcasters to provide an important and valuable service to consumers, which in a free market would generate additional payments to the owners of the copyright in sound recordings." Pelcovits WDT at 13, SX Trial Ex. 2.

407. Both of these developments have, in Dr. Pelcovits's opinion, "increased the value of the service to the subscriber." 4/19/10 Tr. 124:7-8 (Pelcovits). "Certainly more customization of the stream is valuable, and absolutely greater mobility is -- allows the subscriber to listen for more hours and enjoy the music in other settings." 4/19/10 Tr. 124:8-12 (Pelcovits).

408. And as Dr. Pelcovits testified, both of these trends "may be particularly important for this proceeding in light of the recent decision by [the] U.S. Court of Appeals for the Second Circuit, *Arista Records, et al. v. Launch Media, Inc.*, [578 F.3d 148 (2d Cir. 2009)]." Pelcovits WDT at 13, SX Trial Ex. 2. The *Launch Media* decision, which held that a custom radio service was covered by the statutory license as non-interactive, "may be interpreted by webcasters and record companies to loosen the constraints on the capabilities of the statutory services and bring more customized services under the statutory license." Pelcovits WDT at 14, SX Trial Ex. 2. This increased customization appears to be valued by consumers and "[t]he greater ability to offer customization under the statutory license pursuant to the *Launch* decision renders the license more valuable." Pelcovits WDT at 14, SX Trial Ex. 2.

409. Ultimately, Dr. Pelcovits concluded that statutory webcasting services "are now adding more functionality and becoming increasingly valuable to consumers," and that these "[t]echnological advances and refined interpretations of the limits of the statutory license are likely to lead to significant future growth in the webcasting industry." Pelcovits WDT at 14, SX Trial Ex. 2.

## IX. PROMOTION, SUBSTITUTION, CONTRIBUTION, COST AND RISK

410. In applying the willing buyer/willing seller standard contained in Sections 112 and 114, the Court may consider evidence submitted by the parties concerning (1) "whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings," 17 U.S.C. §§ 112(e)(4)(A) and 114(f)(2)(B)(i); and (2) "the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to the relative creative contribution, technological contribution, capital investment, cost, and risk," 17 U.S.C. §§ 112(e)(4)(B) and 114(f)(2)(B)(ii).

411. In *Webcasting II*, this Court adopted a benchmarking approach to rate-setting and held that "we agree with *Webcaster I* that such considerations 'would have already been factored into the negotiated price' in the benchmark." 72 Fed. Reg. at 24,092 (citation omitted). Accordingly, the Court considered these factors through its analysis of the appropriate benchmarks, and found that "no further adjustment is necessary to account for any of these considerations." 72 Fed. Reg. at 24,095.

412. In particular, the Court recognized that, in the context of a benchmarking analysis (where all of these factors are built into the negotiated price in the benchmark market rate), only a relative difference between the benchmark market and the hypothetical target market would justify an adjustment to the benchmark. 72 Fed. Reg. at 24,095. The Court then concluded that "Dr. Pelcovits explicitly examined the promotion and substitution issues and ultimately found no empirical evidence to suggest a net substitution/promotion difference between the interactive and the non-interactive marketplaces." 72 Fed. Reg. at 24,095. The lack of empirical evidence related to relevant contribution, cost and risk led the Court to the same conclusion with respect to those factors. 72 Fed. Reg. at 24,095.

## A. Promotion and Substitution

### 1. There Is No Credible Evidence That Statutory Webcasting Is Promotional.

413. Live365 and IBS have failed to produce any credible evidence that webcasting of any kind is net promotional for the sale of sound recordings. Absent any quantification of promotion, the record in this proceeding provides no basis for adjusting the royalty rate based on promotion. *See Webcasting II*, 72 Fed. Reg. at 24,095 (holding that "even if the absolute levels of promotional/substitution in the market alone were somehow relevant, as the Services appear to suggest, we find that the Services presented no acceptable empirical basis for quantifying promotion/substitution for purposes of adjusting rates in that market").

414. Indeed, the evidence adduced from Live365's own witnesses confirms that no promotional effect has been established.

#### a. Dr. Fratrik

415. Live365's principal witness on the issue of promotion/substitution was Dr. Fratrik. Dr. Fratrik claimed that statutory webcasting is promotional because Live365 "has agreements with several independent labels waiving the sound recording performance royalty in exchange for promotion of their artists." Fratrik WDT at 34, Live365 Trial Ex. 30.

416. His claim does not withstand scrutiny. The evidence actually shows that Live365 has not been able to convince a single label to waive its royalty rights over the past five years. 4/26/10 Tr. 1026:10-1027:6 (Floater). Dr. Fratrik admitted that he was aware of only three or four agreements with independent record labels, all of which were entered into in 2005 or earlier, and that he was unaware of any major label ever waiving its royalty rights in exchange for some perceived promotional effect. 4/27/10 Tr. 1253:9-1254:8 (Fratrik).

417. Dr. Fratrik also asserted that "the amount of click-through buying" of CDs and downloads from statutory webcasters was "[a]nother indicator of promotional value." Fratrik WDT at 34, Live365 Trial Ex. 30. His testimony, however, was not supported by any evidence. Indeed, Dr. Fratrik conceded that he could not say how many sales result from consumers hearing recordings through webcasting. 4/27/10 Tr. 1254:13-15 (Fratrik). While he touted a third-party survey purporting to show that people listen to webcasting to hear new artists, he admitted that he did not know if those people buy more recordings as a result of listening to webcasting or if webcasting is satisfying their musical needs so that they do not feel the need to buy CDs and downloads. 4/27/10 Tr. 1254:15-1255:16 (Fratrik).

418. With respect to click-through purchases via Live365, Dr. Fratrik could not say if any of the sales were actually in addition to sales that would have been made anyway. He conceded that he simply did not know if the consumers would have bought the same recordings through some other method. 4/27/10 Tr. 1257:20-1258:16 (Fratrik).

419. Furthermore, Live365 offers 6,000 stations. Dr. Fratrik acknowledged that this large number of stations might satisfy a consumer's desire to listen to a very narrow slice of a music genre without having to buy any particular recordings. 4/27/10 Tr. 1256:8-16 (Fratrik). Indeed, Dr. Fratrik conceded that there is probably some substitution effect when record companies provide sound recordings to webcasters, though he does not believe that it is significant. 4/27/10 Tr. 1135:15-1136:9 (Fratrik). In any event, Dr. Fratrik acknowledged that he did not take into account or try to quantify any such substitution effect in his model. 4/27/10 Tr. 1136:10-14 (Fratrik).

**b. Smallens**

420. To bolster its promotion argument, Live365 also presented testimony from Smallens. He claimed that statutory webcasting offers promotional benefits to copyright holders.

Smallens WRT at 24, Live365 Reb. Ex. 2. But this claim was supported by nothing more than his personal opinion and unspecific hearsay. *See, e.g.*, Smallens 7/28/10 Tr. 234:11-235:11 (Smallens) (offering testimony about promotion "that's more of a personal experience" and testifying that "just generally it stands to reason that noninteractive plays will spur more sales, and Russ Crupnick confirmed that").

421. Smallens made no attempt to quantify any alleged promotional effect of webcasting, except to quote a snippet of what Russ Crupnick stated in a news article. The Court excluded the news article itself from the record. Smallens looked at no underlying data, could not be sure at trial about how to interpret Crupnick's statements, and did not know whether Crupnick contemplated the possibility of increased digital sales cannibalizing CD sales. 7/28/10 Tr. 268:1-269:9, 270:19-271:1 (Smallens).

**c. Lockhart**

422. Live365 witness Lockhart also testified about the alleged promotional value of webcasting. Her testimony, however, reinforced the conclusion that webcasting is not promotional. After this Court issued its decision in *Webcasting II*, Lockhart tried to negotiate a license with Uproar Records, an independent label, that would waive or lower the statutory rate set in *Webcasting II*. But the record label refused to agree to lower rates. Lockhart WDT at 3, Live365 Trial Ex. 33; 4/28/10 Tr. 1338:1-22 (Lockhart).

423. Thus, given the choice between having its recordings played, but receiving a lower royalty rate, or not having its recordings played at all, the copyright owner chose the latter option. 4/28/10 Tr. 1339:1-5 (Lockhart). In fact, Lockhart explained that the copyright owner was "very vehement" about not agreeing to lower rates. 4/28/10 Tr. 1354:7 (Lockhart).

424. Nor was this an isolated incident -- Lockhart searched diligently for record labels and artists to "direct license and waive royalties," including "new artists" who "needed the air play," "[b]ut nobody came forward." 4/28/10 Tr. 1354:11-20 (Lockhart).

### 2. The Evidence Suggests That the Record Industry Treats Statutory Webcasting as Substitutional.

425. In today's marketplace, copyright owners give careful consideration to whether business models are substitutional for CD sales or downloads. For example, McCrady explained that WMG "examine[s] each new business model or proposal, not just for its likely substitutional impact on sales of physical products, but for its likely substitutional impact on other revenue sources." McCrady WDT at 2, SX Trial Ex. 7. And although WMG lacks a quantitative method for making that analysis, "[w]e think our hardest about this and do our best to figure out what the impact on the overall business is going to be with any new service that comes up." 4/22/10 Tr. 717:9-12 (McCrady).

426. The current trend in consumer behavior is toward an access model where consumers can have access to digital music rather than own it. 4/19/10 Tr. 79:9-15 (Kooker). This access model, which includes statutory webcasting, competes with Sony's other revenue streams because there is only a limited amount of time in a day when people can listen to music. 4/19/10 Tr. 80:13-18 (Kooker). Thus, time spent listening to statutory webcasting may detract from copyright owners' other revenue sources.

427. The goal in licensing digital content, as McCrady explained, is to "ensure that any particular digital exploitation of our sound recordings does not damage potentially more lucrative digital exploitations of our sound recordings." McCrady WDT at 2, SX Trial Ex. 7.

428. WMG does not generally enter into free or low-revenue digital agreements for the use of its sound recordings solely with the hope of stimulating sales of CDs. Rather, the WMG's

strategy requires that "each digital business model needs to provide a distinct revenue stream that either contributes meaningfully to our bottom line, or helps to develop a business model that may, over time." McCrady WDT at 3, SX Trial Ex. 7.

429. WMG uses a number of different deal components, including security requirements, specifications regarding audio quality, and limitations on catalog availability in an effort to limit the substitutional effect of any given exploitation of its sound recordings as it relates to other revenue sources. McCrady WDT at 10-11, SX Trial Ex. 7.

### 3. There Is No Basis in the Record for Adjusting Dr. Pelcovits's Interactive Benchmark Based on Any Alleged Promotional Effect of Statutory Webcasting.

430. As discussed, this Court has recognized that, in the context of a benchmarking analysis, only a relative difference between the benchmark market and the hypothetical target market would justify an adjustment to the benchmark rate. *Webcasting II*, 72 Fed. Reg. at 24,095. In this proceeding, as in *Webcasting II*, there is no basis for adjusting Dr. Pelcovits's interactive benchmark to account for any alleged promotional effect on sales of phonorecords.

431. Dr. Pelcovits "continue[d] to find no evidence" "that there was a difference between these two types of on-line services with respect to their substitutional (or promotional) effects." Pelcovits WDT at 34, SX Trial Ex. 2; 4/19/10 Tr. 146:8-18 (Pelcovits). To the contrary, Pelcovits testified that based on developments in the market "there is even more reason to believe that non-interactive (i.e., statutory) services would be as much of a substitute for purchasing music as the interactive services." Pelcovits WDT at 34, SX Trial Ex. 2. Specifically, "[a]s customers have been increasingly able to customize their listening experience on non-interactive services, and as the legal framework appears to permit much of this to happen under the statutory license, I would expect that subscribers to these services will substitute this listening for the playing of CDs and downloads." Pelcovits WDT at 34, SX Trial Ex. 2.

432. Nevertheless, Dr. Pelcovits repeated the sensitivity analysis he performed in *Webcasting II* to show the effect on his rate recommendation *if* -- contrary to the evidence -- interactive services did in fact substitute for CD sales to a greater degree than non-interactive statutory services. Pelcovits WDT at 34-35, SX Trial Ex. 2; Live365 Trial Ex. 5 at 51. Just as in *Webcasting II*, Dr. Pelcovits conducted his sensitivity analysis by assuming that subscribing to an interactive, on-demand music service "will cause the consumer to purchase two fewer CDs per year than if the consumer had subscribed to a non-interactive service instead." Pelcovits WDT at 34-35, SX Trial Ex. 2; Live365 Trial Ex. 5 at 51. He also assumed, as in *Webcasting II*, that the profit margin on a CD was $5.60 and that therefore "the differential effect of a subscription to on-line services on the profit earned from the average subscriber would be equivalent to 93¢ per month. Pelcovits WDT at 35, SX Trial Ex. 2; Live365 Trial Ex. 5 at 51.

433. Dr. Pelcovits testified that the loss in CD sales can be thought of "as an increase in the marginal costs of the copyright holder of providing (or licensing) music to on-line services." Pelcovits WDT at 35, SX Trial Ex. 2. He assumed that one-half of the increased marginal cost will be passed on to the subscribers and he converted that into a per-play adjustment of 0.162¢. Pelcovits WDT at 35, SX Trial Ex. 2. The result of this calculation is an adjusted interactive per-play fee of $0.02031. Pelcovits WDT at 35, SX Trial Ex. 2. Using that adjusted per-play rate to calculate a recommended rate for statutory services results in a simple average rate of $0.0033. Pelcovits WDT at 36, SX Trial Ex. 2.

434. As discussed above, however, neither Live365 nor IBS submitted any credible evidence of a quantifiable difference between the substitutional effect of interactive versus non-interactive webcasting. Accordingly, there is no need to adjust the proposed Pelcovits benchmark based on promotion or substitution.

### B. The Contributions, Costs and Risks of Copyright Owners and Recording Artists in the Creation of Copyrighted Works

435. Under the willing buyer/willing seller standard, another factor that the Court may consider is "the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to the relative creative contribution, technological contribution, capital investment, cost, and risk." 17 U.S.C. §§ 112(e)(4)(B) and 114(f)(2)(B)(ii).

436. In *Webcasting II*, this Court adopted a benchmarking approach to rate-setting and held that "we agree with *Webcaster I* that such considerations [including relative roles] 'would have already been factored into the negotiated price' in the benchmark." 72 Fed. Reg. at 24,092 (citation omitted).

437. As with promotion and substitution, this Court in *Webcasting II* recognized that the relative contributions, costs and risks "are implicitly accounted for in the rates that result from negotiations between the parties in the benchmark marketplace." 72 Fed. Reg. at 24,095. Accordingly, the Court considered the relative roles of the copyright owner and webcasting service, but found that "no further adjustment is necessary to account for any of these considerations." *Webcasting II*, 72 Fed. Reg. at 24095.

438. Here, in any event, the evidence makes clear that copyright owners and recording artists make very significant creative contributions, technological contributions and capital investments in the creation of sound recordings, and that they incur substantial costs and risks, all of which vastly outweigh the webcasters' contributions, costs and risks. There is no need to adjust the proposed Pelcovits benchmark based on these factors.

### 1. Relative Contributions, Investments and Costs

439. Even as sound recordings can be made widely available on the Internet, record companies continue to play a critically important role in making sound recordings available to the public.

> With the development of the Internet, it is tempting to think that recording artists have greater opportunities than ever before to deliver their recordings directly to their fans and that the role of record companies may have diminished. In reality, record companies continue to serve the interests of artists, and foster the availability of sound recordings to the public. Without record companies, many of the sound recordings that webcasting services play might never get created.

Roberts Hedgpeth WDT at 7, SX Trial Ex. 3.

440. Record companies invest considerable time and expense in the discovery of talent, typically through Artist and Repertoire ("A&R") departments. Kooker WDT at 3-4, SX Trial Ex. 1. Indeed, successful A&R executives and investment are the "life blood" of the recording industry. 4/19/10 Tr. 70:1-7 (Kooker).

441. Once star-power talent is identified, the recording costs themselves become some of the most significant talent-related costs that record companies incur. Kooker WDT at 4, SX Trial Ex. 1. These costs include artist advances, backup musicians, producers, sound engineers, and various other creative talents. Kooker WDT at 5, SX Trial Ex. 1. For example, Sony's expenditures on talent and recording were roughly [[redacted]] in FY 2009. Kooker WDT at 5, SX Trial Ex. 1.

442. Put plainly, this funding enables artists to create recordings. Roberts Hedgpeth WDT at 7, SX Trial Ex. 3.

> Record companies also help recording artists create the sound recordings that webcasting services play by providing artists with some measure of financial security and stability. For example, not only do they fund the creation of recordings, but record companies

> often pay artists advances that provide an important source of income for artists before their recordings are able to generate revenue.

Roberts Hedgpeth WDT at 8, SX Trial Ex. 3.

443. Without this initial investment by the copyright owners, derivative industries such as webcasting would not be able to exist on the same scale on which they exist today -- if at all. Kooker WDT at 3-4, SX Trial Ex. 1; Roberts Hedgpeth WDT at 7-8, SX Trial Ex. 3 (record companies provide the recordings that webcasters play).

444. In turn, distribution of digital products requires substantial cost and effort. Kooker testified that Sony spends considerable energy on the recorded music files and organization of the metadata that is presented by digital service providers. 4/19/10 Tr. 72:13-20 (Kooker). Likewise, physical products require enormous costs such as manufacturing, packaging, warehousing, and shipping. Sony's expenditures on manufacturing and distribution were roughly [redacted] and [redacted], respectively, in FY 2008. Kooker WDT at 5, SX Trial Ex. 1. Even these costs related to physical product, of course, inure to the benefit of webcasters and other digital services because without them, the record companies as they are known today could not exist and could not continue investing in the discovery and creation of popular music. 4/19/10 Tr. 75:5-21 (Kooker) (testifying about the benefits that webcasters derive from Sony's investments); *id.* at 108:4-109:2 (Kooker) (explaining that investment in A&R and manufacturing "make it possible for Sony to engage in the digital business").

445. After sound recordings have been created, record companies play a central role in marketing and promoting recordings. As Roberts Hedgpeth explained,

> [a]lthough an artist could always try simply to post his or her songs on a website and hope that they will somehow become popular and generate income, those are not realistic expectations. The entertainment market, including the Internet, is so diffuse and so crowded with options that a recording artist cannot rely on

> releasing a recording into the digital space and then waiting for the revenue to start flowing. It is far too easy for a sound recording to get lost on the Internet.

Roberts Hedgpeth WDT at 7-8, SX Trial Ex. 3.

446. To generate consumer interest -- and ultimately revenue -- from recordings, record companies pay for and execute coordinated marketing and promotional campaigns. Roberts Hedgpeth WDT at 7-8, SX Trial Ex. 3. For example, Sony's expenditures on marketing were roughly [redacted] in FY 2009 and [redacted] in FY 2008. Kooker WDT at 5, SX Trial Ex. 1.

447. At their own expense, record companies have developed the infrastructure and expertise necessary to provide this important service for their artists. They marshal their resources and expertise to determine how best to position a recording so that it is targeted to the appropriate audience in an appealing way. Roberts Hedgpeth WDT at 7-8, SX Trial Ex. 3. A record company's investment in advertising and promotion is what allows the public to become aware of artists' music. 4/19/10 Tr. 71:11-19 (Kooker).

448. By contrast to all of this, the evidence demonstrates that Live365 has virtually no programming costs, 4/27/10 Tr. 1274:11-21 (Fratrik), and that webcasters generally can enter the market with low barriers to entry, low streaming costs, and, like Live365, with potentially zero programming costs. 4/27/10 Tr. 1168:14-:22 (Fratrik) (webcasting "has relatively low barriers to entry."); SX Trial Ex. 15 at 2 (Live365 webpage offering royalty included webcasting packages for as low as $6 per month). Indeed, the costs to Live365 of operating its infrastructure are actually *paid for* by the fees that its webcasters pay to Live365 for the various service packages they purchase. SX Trial Ex. 13 at 150:1-8.

### 2. The Risks Incurred by Copyright Owners

449. The sound recording business is speculative and full of risk. A record company has to make large upfront investments in artists and music production even though many artists and recordings never become profitable on the back end. Kooker WDT at 5, SX Trial Ex. 1 ("Even with these substantial investments that would seemingly guarantee success, the vast majority of new releases are not profitable for the company.").

450. The evidence in the record demonstrates that, in today's environment, the investments made by owners and artists are more at risk than ever before. Across the record industry, sales of CDs dropped from $12.8 billion in 1999 to $5.5 billion in 2007. Kooker WDT at 8. In fact, the decline in revenue from physical goods has accelerated and is unlikely to stop. 4/19/10 Tr. 81:17-18 (Kooker). "[T]he physical business has been cut in half." 4/19/10 Tr. 76:14-16 (Kooker).

451. Digital revenue is growing, but not fast enough to account for the decline in physical sales. Thus, record companies' net revenue continues to decline. 4/19/10 Tr. 81:14-82:1 (Kooker). In addition, digital revenue growth is decelerating, while physical revenue decline continues at a constant pace. It is thus unlikely that net revenue will stabilize anytime soon. 4/19/10 Tr. 82:2-12 (Kooker).

452. For example, Sony's U.S. Sales of physical product has fallen from [redacted] in 2005 to [redacted] in 2007, and [redacted] in FY 2009. Kooker WDT at 9, SX Trial Ex. 1. Over the same period, digital revenues rose [redacted] in 2005 to [redacted] in 2007, and [redacted] in FY 2009. Kooker WDT at 9, SX Trial Ex. 1. The gap caused by the loss in physical sales continues to persist and remains sizeable. Because Sony's market share has not changed substantially over the past few years, its decline is consistent with the overall business performance of the industry. 4/19/10 Tr. 113:11-17 (Kooker).

453. Sony has dealt with its falling revenue by cutting its operational costs. Cost-cutting measures have included reducing staff by 30-40%, decreasing expenditures on variable marketing, and reducing investments in talent. Generally speaking, all aspects of its business have seen reductions. 4/19/10 Tr. 109:12-111:5 (Kooker).

454. Declining CD sales also hurt artists, "because with fewer sales, there is less revenue for artists." Roberts Hedgpeth WDT at 8-9, SX Trial Ex. 3.

455. As a result, as CD sales continue to decline, statutory webcasting royalties are becoming more important to both copyright owners and artists. On the artist side, these royalties do not by themselves replace lost income from declining CD sales, but they are one of the relatively few ways for recording artists to generate income through the Internet. Roberts Hedgpeth WDT at 8-9, SX Trial Ex. 3.

456. Record companies have also come to depend on digital revenues from all sources, including the performance royalty income from statutory license. "Accordingly, digital revenue is a 'core' (not 'incidental') source of revenues that is increasingly vital in order to make the continued investment necessary to record, produce and market the recording stars of tomorrow." Kooker WDT at 8, SX Trial Ex. 1.

## X. THE MINIMUM FEE

457. For both commercial webcasters and noncommercial webcasters, SoundExchange is seeking essentially the same minimum fee as adopted by this Court on remand in *Webcasting II* for 2006-2010. *See* 75 Fed. Reg. 6,097, 6,098 (Feb. 8, 2010); *Amendment to Determination Pursuant to Remand Order*, Docket No. 2005-1 DTRA Webcasting II (June 30, 2010).

458. As this Court observed in *Webcasting II*, the *Webcasting I* decision "affirmed the notion that all webcasters -- all Noncommercial Webcasters as well as all Commercial

Webcasters -- should pay the same minimum fee for the same license." *Webcasting II*, 72 Fed. Reg. at 24,099.

### A. Minimum Fee for Commercial Webcasters

459. For commercial webcasters, SoundExchange is seeking a $500 annual, nonrefundable minimum fee for each calendar year or part of a calendar year, for each channel or station, subject to an annual cap of $50,000 for a licensee with 100 or more channels or stations. Under this proposal, upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalty fees payable in the same calendar year. *See Second Revised Proposed Rates and Terms of SoundExchange*, at 2 (July 23, 2010).

#### 1. Live365 Has Stipulated to the Proposed Minimum Fee for Commercial Webcasters.

460. This minimum fee proposal for commercial webcasters is undisputed. When the parties submitted their written direct cases, Live365, RealNetworks and SoundExchange all submitted proposals for a $500 minimum fee with a $50,000 cap for licensees with 100 or more channels or stations.

461. Live365 and SoundExchange subsequently submitted a Stipulation to the Court with respect to the minimum fee for commercial webcasters. *See Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings* (May 14, 2010). The minimum fee that SoundExchange has proposed for commercial webcasters in its *Second Revised Proposed Rates and Terms* (July 23, 2010) is consistent with the Stipulation.

#### 2. The Evidence Supports the Proposed Minimum Fee for Commercial Webcasters.

462. This minimum fee proposal has a strong evidentiary basis.

### a. The WSA Agreements

463. The two precedential WSA agreements for commercial webcasters that SoundExchange submitted as evidence in this proceeding -- the NAB Agreement and the Commercial Webcasters Agreement with Sirius XM -- both support SoundExchange's proposed minimum fee for commercial webcasters. Kessler WDT at 21, SX Trial Ex. 5.

464. The NAB Agreement covers the time period 2006 through 2015, and includes an annual minimum fee of $500 per station or channel, subject to a $50,000 cap. McCrady WDT, Ex. 101-DP at § 4.1, SX Trial Ex. 7. Over 400 entities have opted into the NAB agreement on behalf of several thousand individual stations. Kessler WDT at 21, SX Trial Ex. 5.

465. The Commercial Webcasters Agreement covers the time period 2009 through 2015, and likewise includes an annual minimum fee of $500 per station or channel, subject to a $50,000 cap. McCrady WDT, Ex. 102-DP at § 4.1, SX Trial Ex. 7. Several commercial webcasters have opted into the agreement for their webcasting service. Kessler WDT at 21, SX Trial Ex. 5; Live365 Trial Ex. 25 at 18.

466. As McCrady explained, the minimum payment included in the WSA agreements "is an important element of these deals from WMG's perspective because it ensures a minimum amount of compensation for the use of WMG's copyrighted sound recordings." McCrady WDT at 4, SX Trial Ex. 7. But McCrady also noted that "[t]he minimum included within . . . the . . . WSA settlements . . . is substantially smaller and less valuable than the type of minimum payments and revenue guarantees that are generally included within WMG's digital deals." McCrady WDT at 4, SX Trial Ex. 7. The minimum fees in the WSA agreements were "obviously based on the statutory minimum," and serve as "an example of how negotiating in the context of a statutory licensing regime leads to below-market outcomes." McCrady WDT at 4-5, SX Trial Ex. 7.

467. These agreements show that hundreds of willing buyers have agreed to the same $500 minimum fee that SoundExchange is proposing. Indeed, in the *Webcasting II* remand, this Court cited these agreements as evidence "that the industry accepts this minimum fee." *Amendment to Determination Pursuant to Remand Order*, at 7, Docket No. 2005-1 DTRA (June 30, 2010).

**b. SoundExchange's Estimated Administrative Costs**

468. In addition, as discussed below, the reasonableness of SoundExchange's proposed minimum fee is confirmed by SoundExchange's estimation of its costs in administering the statutory licenses.

**B. Minimum Fee for Noncommercial Webcasters**

469. For noncommercial webcasters, SoundExchange is seeking a $500 annual, nonrefundable minimum fee for each calendar year or part of a calendar year, for each channel or station, without a cap such as is proposed for commercial webcasters. Under this proposal, upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalty fees payable in the same calendar year. Because SoundExchange's proposed royalty rate for noncommercial webcasters is $500 for the first 159,140 ATH per month, the minimum fee is expected to cover the entire royalty obligation of most noncommercial webcasters. *See Second Revised Proposed Rates and Terms of SoundExchange*, at 2 (July 23, 2010).

470. The minimum fee SoundExchange is proposing for noncommercial webcasters is essentially the same minimum fee as adopted by this Court on remand in *Webcasting II* for 2006-2010. *See Amendment to Determination Pursuant to Remand Order*, Docket No. 2005-1 DTRA (June 30, 2010).

471. A cap on the number of $500 minimum fees paid by a noncommercial webcaster would be inappropriate because of the proposed 159,140 ATH of usage covered by each minimum fee payment. McCrady WDT, Ex. 103-DP at § 4.1, SX Trial Ex. 7. As Kessler explained, for example, if a noncommercial webcaster offered 150 channels, but was subject to a cap of $50,000 at a minimum fee rate of $500 per channel, that noncommercial webcaster should not get 159,140 aggregate tuning hours of usage on 50 channels for free. Kessler WDT at 22, SX Trial Ex. 5.

472. SoundExchange has submitted substantially similar evidence related to the minimum fee in this proceeding as it submitted in the *Webcasting II* remand, and SoundExchange's proposal in this proceeding should be adopted for all the same reasons it was adopted in *Webcasting II*.

**1. The Noncommercial Educational Webcasters Agreement with CBI**

473. In the absence of direct licenses between copyright owners and noncommercial webcasters, the precedential WSA agreement between SoundExchange and CBI covering noncommercial educational webcasters is particularly important. Kessler WDT at 21, SX Trial Ex. 5. That agreement provides rates and terms for the same class of webcasters represented by IBS in this proceeding.

474. The Noncommercial Educational Webcasters Agreement covers the time period 2011 through 2015 (with special reporting provisions for 2009-2010), and includes an annual minimum fee of $500 per station or channel. The $500 minimum fee covers 159,400 ATH of usage. McCrady WDT, Ex. 103-DP at § 4.1, SX Trial Ex. 7. Like SoundExchange's proposed minimum fee for noncommercial webcasters, the minimum fee in the Noncommercial Educational Webcasters Agreement has no cap on the number of stations or channels subject to the minimum fee. The majority of noncommercial services never pay more than $500, and no

individual noncommercial licensee that pays SoundExchange reports more than ten stations on its statements of account, let alone the 100 that would reach the $50,000 cap in the commercial webcaster context. Kessler WDT at 21-22, SX Trial Ex. 5.

475. When the Judges published the Noncommercial Educational Webcasters Agreement in the Federal Register for comment, twenty-four noncommercial webcasters submitted comments supporting its adoption. That is strong evidence that noncommercial webcasters are willing and able to pay a $500 minimum fee.

#### 2. SoundExchange's Estimated Administrative Costs

476. In addition, as described below, the reasonableness of the proposed minimum fee is confirmed by SoundExchange's estimation of its costs in administering the statutory licenses.

### C. SoundExchange's Estimation of Its Administrative Costs

477. In the *Webcasting II* appeal, the D.C. Circuit accepted that minimum fees at a certain level can be justified on the basis that they "cover 'administrative costs of the copyright owners in administering the license.'" *Intercollegiate Broad. Sys., v. Copyright Royalty Bd.*, 574 F.3d 748, 761 (D.C. Cir. 2009) (quoting *Webcasting I*, 67 Fed. Reg. at 45,262); *see also Webcasting II*, 72 Fed. Reg. at 24096 (noting that one rationale for the minimum fee that has been raised in past proceedings is that it should cover SoundExchange's administrative expenses even in the absence of royalties).

478. SoundExchange does not track its administrative costs on a licensee-by-licensee, station-by-station or channel-by-channel basis in the ordinary course of business. Kessler WDT at 23, SX Trial Ex. 5. But as a check on whether SoundExchange's proposed minimum fee is reasonable in light of SoundExchange's administrative costs, SoundExchange estimated its administrative costs per service and per channel. Kessler WDT at 22-26, SX Trial Ex. 5.

479. As Kessler testified, "the minimum fee should ensure that every licensee makes an appropriate contribution to the costs of administering the statutory license, as well as a reasonable payment for usage of sound recordings." Kessler WDT at 22, SX Trial Ex. 5. If the minimum fee covered only administrative expenses, then copyright owners and performers collectively would receive no payment for the use of their sound recordings by services paying only the minimum fee. Kessler WDT at 22, SX Trial Ex. 5.

480. The expenses that SoundExchange incurs in relation to particular services vary widely depending on the quality of data that a service provides to SoundExchange and on the additional work that SoundExchange may need to do when it receives poor quality data. Kessler WDT at 23, SX Trial Ex. 5. SoundExchange's costs also vary depending on the breadth and obscurity of a service's repertoire, with services that play a great deal of repertoire that is relatively unique imposing greater research costs. Kessler WDT at 23, SX Trial Ex. 5. In addition, many of SoundExchange's costs are effectively shared across services -- including things like research of repertoire used by multiple services, costs of artist outreach and distributing royalties once individual services' allocations are loaded, information technology and corporate overhead. Kessler WDT at 23, SX Trial Ex. 5.

481. Indeed, Kessler explained that payments from services that pay larger amounts of royalties "in effect subsidize the costs associated with processing payments and information from smaller services that typically pay only the minimum fee." Kessler WDT at 25-26, SX Trial Ex. 5.

482. Kessler estimated SoundExchange's administrative costs as follows: in 2008, SoundExchange's expenses (including staff, facilities, amortized and depreciated equipment, operating expenses and other costs) were approximately $8.4 million; in 2008, SoundExchange

had 1,454 licensees at the statement of account level. Dividing this cost by this number of licensees results in a per licensee cost of approximately $5,777. Kessler WDT at 23-24, SX Trial Ex. 5.

483. The vast majority of these licensees (1,371) operated only one station or channel. However, some operated more. Kessler WDT at 24, SX Trial Ex. 5. SoundExchange determined that in 2008 the average webcaster licensee operated approximately seven stations or channels. Kessler WDT at 25, SX Trial Ex. 5. In order to determine the per station or channel cost for webcasters in 2008, SoundExchange divided the average licensee costs of $5,777 by seven. Kessler WDT at 25, SX Trial Ex. 5. The result was $825. Kessler WDT at 25, SX Trial Ex. 5; 4/20/10 Tr. 452:9-453:13 (Kessler) (explaining calculation of estimated costs per station or channel).

484. Thus, the minimum fee estimation conducted by Ms. Kessler shows that SoundExchange's proposal of a $500 minimum fee for both commercial and noncommercial services is more than reasonable.

485. In the *Webcasting II* remand, Kessler presented essentially the same estimation of SoundExchange's administrative costs. This Court credited and relied on that same testimony as a basis for setting the noncommercial minimum fee at $500. *Amendment to Determination Pursuant to Remand Order*, at 4, Docket No. 2005-1 DTRA (June 30, 2010). There is no reason to reach a different conclusion here.

## XI. NONCOMMERCIAL SERVICES

486. Two entities participated in this proceeding on behalf of noncommercial services. College Broadcasters, Inc. ("CBI") submitted written testimony for the purpose of supporting the

WSA agreement it reached with SoundExchange as the basis for setting statutory rates and terms for noncommercial educational webcasters.

487. Intercollegiate Broadcasting System, Inc. ("IBS") participated in this proceeding on behalf of an undetermined number of noncommercial educational webcasters for the purpose of submitting a rate proposal that differs from SoundExchange's only with respect to so-called "small" and "very small" noncommercial educational webcasters.

488. IBS itself does not stream sound recordings on the Internet, is not a webcaster, and does not pay royalties. 4/22/10 Tr. 771:15-772:17 (Kass). Rather, it is a membership organization for radio stations affiliated with educational institutions. IBS provides "technical and other guidance to member stations," and has "assisted many member stations in streaming." Kass WDT at 4, IBS Trial Ex. 4.

### A. SoundExchange's Rate Proposal for Noncommercial Services

489. SoundExchange has proposed that noncommercial webcasters pay a royalty of $500 per station or channel per year, subject to an ATH cap. This base royalty would be paid in the form of a $500 per station or channel per year minimum fee. If a channel or station exceeds 159,140 ATH in any month, then SoundExchange proposes that the noncommercial webcaster pay at the commercial usage rates for any overage. *See Second Revised Proposed Rates and Terms of SoundExchange*, at 3-4 (July 23, 2010). Under SoundExchange's proposal, if a noncommercial service does not exceed the ATH cap, then it will pay only the minimum fee.

490. For the vast majority of noncommercial services that never exceed the ATH cap, *see* Kessler WDT at 21-22, SX Trial Ex. 5, SoundExchange's proposal is essentially a continuation of the rates that apply to noncommercial services during the 2006-2010 period.

491. In the *Webcasting II* remand, based on evidence similar to the evidence presented in this proceeding about SoundExchange's administrative costs and the WSA agreements, this

Court set the minimum fee for noncommercial services at $500. This Court had previously set the royalty payable by noncommercial webcasters at $500 for the first 159,140 ATH per month. The Court's findings and holding in *Webcasting II* remain timely and apply with equal force here.

### B. Evidence Supporting SoundExchange's Proposal for Noncommercial Services

492. SoundExchange's rate proposal for noncommercial services has a strong evidentiary basis.

#### 1. Hundreds of Noncommercial Webcasters Have Demonstrated Their Willingness to Pay Annual Royalties of $500.

493. As this Court observed in the *Webcasting II* remand, 363 noncommercial webcasters paid SoundExchange in 2009 pursuant to rates that are in large part the same as SoundExchange is proposing in this proceeding. Of those 363 services, 305 paid only the minimum fee of $500, and the remaining 58 paid more for exceeding the ATH cap or streaming more than one station or channel. *Amendment to Determination Pursuant to Remand Order*, at 4, Docket No. 2005-1 DTRA (June 30, 2010).

494. These facts are clear evidence under the willing buyer/willing seller standard that noncommercial services are willing to pay the rates that SoundExchange is proposing. *See Amendment to Determination Pursuant to Remand Order*, at 4, Docket No. 2005-1 DTRA (June 30, 2010) (holding that these payments "demonstrate that noncommercial services are able and willing to pay the minimum fee").

#### 2. Minimum Fee Analysis

495. In addition, as described *supra* at Section X.C, the reasonableness of the proposed minimum fee is confirmed by SoundExchange's estimation of its costs in administering the statutory licenses. Because most noncommercial services never pay more than the $500

minimum fee, these estimated costs are relevant to showing that SoundExchange's proposal for noncommercial services is reasonable.

### 3. Noncommercial Services Tend to Impose Disproportionate Costs on SoundExchange.

496. Processing payments and information from smaller services (such as noncommercial services) is often more costly and is effectively subsidized by payments from larger services. Kessler WDT at 22, SX Trial Ex. 5. Services that play more obscure repertoire, such as noncommercial services, impose greater research costs on SoundExchange. Kessler WDT at 23, SX Trial Ex. 5; s*ee also Amendment to Determination Pursuant to Remand Order*, at 7, Docket No. 2005-1 DTRA (June 30, 2010) (finding that "at lesser levels of sound recording usage, the establishment and conduct of such administrative processes cannot simply be dispensed with" and "smaller users may even result in larger proportionate administrative processing time than larger users").

497. IBS appears to believe that SoundExchange's administrative costs are proportionately related to the number of performances made by a service. But as this Court found in the *Webcasting II* remand, IBS has "fail[ed] to establish any credible nexus" between the number of a service's performances and SoundExchange's costs. *Amendment to Determination Pursuant to Remand Order*, at 6, Docket No. 2005-1 DTRA (June 30, 2010).

### 4. The Noncommercial Educational Webcasters Agreement with CBI

498. In further support of its rate proposal for noncommercial services, SoundExchange presented its agreement with CBI entered pursuant to the WSA (the "Noncommercial Educational Webcasters Agreement"). The Noncommercial Educational Webcasters Agreement covers the time period 2011 through 2015 (with special reporting provisions for 2009-2010). It includes an annual minimum fee of $500 per station or channel,

which functions as the royalty payable by that station or channel for usage up to 159,140 ATH per month. McCrady WDT, Ex. 103-DP at §§ 4.1, 4.2, SX Trial Ex. 7; 4/22/10 Tr. 657:3- 9 (McCrady). Those noncommercial educational webcasters that exceed the 159,140 ATH per month of usage covered by the minimum fee are subject to the following per-performance royalty structure:

| *Year* | *Rate per performance* |
|---|---|
| 2011 | $0.0017 |
| 2012 | $0.0020 |
| 2013 | $0.0022 |
| 2014 | $0.0023 |
| 2015 | $0.0025 |

McCrady WDT, Ex. 103-DP at § 4.2, SX Trial Ex. 7; 4/22/10 Tr. 656:19-657:2 (McCrady).

499. There is no cap on the minimum fee in the Noncommercial Educational Webcasters Agreement (*i.e.*, no limit on the number of stations or channels for which a noncommercial service must pay a minimum fee). McCrady WDT, Ex. 103-DP at § 4.1, SX Trial Ex. 7; 4/22/10 Tr. 657:8-657:9 (McCrady). However, the "huge majority" of stations pay no more than $500, and no individual noncommercial licensee that pays SoundExchange reports more than ten stations on its statement of account. Kessler WDT at 21-22, SX Trial Ex. 5. In addition, for noncommercial services, $500 covers the first 159,140 ATH per channel or station, so that a cap would be inappropriate. For example, if a noncommercial webcaster offered 150 channels, but was subject to a cap of $50,000 at a minimum rate of $500 per station or channel, then the noncommercial webcaster would get 159,140 aggregate tuning hours of usage on 50 channels for free. Kessler WDT at 21-22, SX Trial Ex. 5.

500. The treatment of Section 112(e) and 114 royalties under the Noncommercial Educational Webcasters Agreement is also similar to what SoundExchange is proposing here.

Royalties under Sections 112(e) and 114 are bundled together in the payments described above, and then are to be allocated to Sections 112(e) and 114. McCrady WDT, Ex. 103-DP at §§ 4.1, 4.3, SX Trial Ex. 7.

501. This rate structure was obviously influenced by the *Webcasting II* decision. However, Noncommercial Educational Webcasters Agreement is strong evidence of the rates and terms that noncommercial webcasters are willing to pay. Moreover, noncommercial webcasters have demonstrated their support for the rates and terms in the agreement. When this Court published the agreement for comments in the Federal Register, twenty-four noncommercial webcasters submitted comments supporting the agreement, and IBS submitted comments opposing it.

### C. Noncommercial Services Can Afford $500 a Year.

502. The relevant evidence in the record shows that noncommercial services can afford to pay SoundExchange's proposed rates.

503. The only noncommercial webcaster that submitted information about its financial condition is WHUS, the radio station at the University of Connecticut. In 2009, WHUS generated total revenues of $527,364.21 and had a profit of $87,041.55. SX Trial Ex. 6; 4/21/10 Tr. 583:13-584:14, 586:8-19 (Murphy).

504. IBS's members receive funding from a number of sources, "from academic budgets to student activity funds to advertising dues." Kass WDT at 5, IBS Trial Ex. 4.

505. The 2009 budget for WHUS -- the only noncommercial webcaster to provide financial information in this proceeding -- shows revenue from 16 different line items. SX Trial Ex. 6. WHUS's revenues included over $288,000 in student fees. SX Trial Ex. 6; 4/21/10 Tr. 584:18-585:2 (Murphy).

506. Noncommercial services pay significantly more than $500 for things that are less central to their purpose than sound recordings. For example, WHUS's expenses included over $4,700 for "Refreshments for Organization," over $3,800 for "Refreshments for Events," and over $9,000 for "Donations and Gifts." SX Trial Ex. 6.

507. Furthermore, IBS's members' payments to IBS show that the members have access to funds that are more than enough to pay $500 a year to stream sound recordings. IBS itself collects between $50,000 and $100,000 a year in revenue from membership fees, conference fees and other sources. 4/22/10 Tr. 805:7-10 (Kass). IBS members pay an annual $125 membership fee to IBS. They also pay $85 per person, or $480 per station, to attend IBS's annual conference, plus the cost of hotel rooms in New York City. 4/21/10 Tr. 593:12-594:3 (Murphy).

508. IBS does not claim that these hundreds of dollars per station in payments to IBS are an undue burden on its members -- to the contrary, these costs are "meant to be affordable for stations" that are IBS members. 4/21/10 Tr. 593:12-594:3 (Murphy).

509. IBS claims -- without providing any underlying documents in support -- that a survey in the 1990s showed that its member stations' annual budgets were about nine thousand dollars a year. Kass WDT at 6, IBS Trial Ex. 4; 4/22/10 Tr. 835:15-22 (Kass). As this Court recognized with respect to the very same evidence in the *Webcasting II* remand, $500 represents "6% of revenue" for services with a budget of $9,000, which is "a large discount for Noncommercial Webcasters off the negotiated license agreements for commercial webcasters." *Amendment to Determination Pursuant to Remand Order*, at 3-4, Docket No. 2005-1 DTRA (June 30, 2010).

510. As in the *Webcasting II* remand, the record in this proceeding shows that negotiated free market agreements for commercial webcasters include minimum advance payments that "can be significantly higher than the minimum payment requirements under the statutory rate and the WSA settlements," and in fact can be tens or even hundreds of thousands of dollars. McCrady WDT at 10, 13, SX Trial Ex. 7; 4/22/10 Tr. 659:5-6 (McCrady).

511. As further evidence that IBS's members can afford SoundExchange's rate proposal, it should be noted that IBS itself originally appeared to propose in this proceeding that some noncommercial webcasters should pay an annual royalty rate of $500. In Kass's written direct statement, IBS proposed that the rates and terms from a "Joint Petition for Adjustment of Rates and Terms for Statutory Licenses Applicable to Noncommercial Webcasters Making Eligible Nonsubscription Transmissions" filed with the Copyright Office on August 26, 2004 "are appropriate for its stations" and "should be extended to the 2011-2015 period for IBS member stations." Kass WDT at 8-9, IBS Trial Ex. 4. That Joint Petition provided that noncommercial educational entities would pay a $500 nonrefundable minimum annual fee, except that small institutions or institutions where "substantially all" of the programming was news, talk or sports would pay $250. Kass WDT, Exhibit, IBS Trial Ex. 4.

**D. IBS's Rate Proposal**

512. IBS did not submit a separate rate proposal with its written direct case as required by 37 C.F.R. § 351.4(b)(3). Rather, its original rate proposal was included within the written testimony of Kass.

513. On May 21, 2010, IBS filed a Restated Rate Proposal.

514. On July 29, 2010, IBS filed an Amplification of IBS' Restated Rate Proposal ("Amplification"), which SoundExchange understands to be IBS's final rate proposal to date.

515. In its Amplification, IBS proposes setting three different minimum fees, based on the amount of usage by a webcaster. Specifically, it proposes (i) that noncommercial webcasters that use 6,365 ATH per month or less should pay an annual minimum fee of $20; (ii) that noncommercial webcasters that use between 6,366 and 15,914 ATH per month should pay an annual minimum fee of $50; and (iii) that noncommercial webcasters that use more than 15,914 per month should pay an annual minimum fee of $500. *Amplification of IBS' Restated Rate Proposal* (July 28, 2010).

516. With respect to performance rates for usage in excess of those proposed ATH caps, IBS's rate proposal simply states: "as proposed by SoundExchange." This presumably means that IBS agrees with SoundExchange's proposed performance rates for usage over 159,140 ATH per month.

### 1. IBS Agrees with SoundExchange's Rate Proposal for Noncommercial Webcasters with More Than 15,914 ATH Per Month.

517. According to the express language of IBS's Amplification, with respect to noncommercial webcasters with usage in excess of 15,914 per month, IBS agrees with the rates proposed by SoundExchange. *See Amplification of IBS' Restated Rate Proposal*, at 2 (July 28, 2010). That is, IBS agrees that noncommercial webcasters with more than 15,914 ATH per month should pay a $500 minimum fee creditable to a $500 royalty, and the per performance rates for usage over 159,140 ATH per month, as proposed by SoundExchange.

518. Thus, there is no dispute with respect to the rates for noncommercial webcasters with more than 15,914 ATH per month.

519. The only disputed rates are for noncommercial services with 15,914 ATH per month or less. IBS has failed to present any evidence to support its rate proposal for these services.

520. First, there is no evidence in the record to support the two ATH levels that IBS proposes to use as a basis for determining the royalties owed by a service: "very small" noncommercial webcasters with 6,365 ATH or less per month paying $20 and "small" noncommercial webcasters with 15,914 ATH or less per month paying $50. *Amplification of IBS' Restated Rate Proposal*, at 1-2 (July 28, 2010).

521. Second, IBS's proposed payments of $50 and $20 for so-called small and very small noncommercial webcasters ignore SoundExchange's administrative costs. There is no evidence in the record that noncommercial webcasters generate lower administrative costs for SoundExchange. *See Webcasting II*, 72 Fed. Reg. at 24,099 ("There is no evidence in the record to suggest that the submarket in which a Noncommercial Webcaster may reside would yield a different administrative cost for SoundExchange as compared to the administrative costs associated with Commercial Webcasters . . . . We also find no basis in the record for distinguishing between Commercial Webcasters and Noncommercial Webcasters with respect to the administrative cost of administering the license.").

522. To the contrary, the evidence shows that smaller webcasters often impose disproportionate administrative costs on SoundExchange. Kessler WDT at 22-23, SX Trial Ex. 5. Given that SoundExchange has presented evidence that its estimated administrative costs exceed $500 per service, it is not reasonable to set royalty rates at $20 or $50 for any service. No willing seller would agree to such rates.

523. Third, to the extent that IBS attempted to present any relevant evidence at all, it did so in extremely confusing fashion. As Chief Judge Sledge observed at trial, Captain Kass – the only witness to try to explain the IBS proposal – offered "three different proposed rates,"

"changed [his] position twice" on the witness stand, and provided testimony that conflicted with itself. 4/22/10 Tr. 794:2-14 (Kass).

524. IBS offered scant evidence to support its original rate proposal -- and no evidence whatsoever to support its final rate proposal (as contained in IBS's Amplification). When asked by Judge Roberts about the evidentiary basis for part of IBS's original rate proposal, Captain Kass admitted that "I just picked that number." 4/22/10 Tr. 799:15-19 (Kass). In the Court's words, Captain Kass's testimony was particularly "hard to follow," because "[i]t seems to change a lot." 4/22/10 Tr. 813:1-2 (Kass).

525. Fourth, as the basis for its original rate proposal, IBS relied on a payment made in 2004 pursuant to a 2001 agreement between SoundExchange and NPR. 4/22/10 Tr. 795:12-796:19 (Kass). It is unclear to what extent, if at all, IBS's revised rate proposal contained in its Amplification relies on the 2001 NPR agreement.

526. This Court, however, squarely rejected the use of that 2001 NPR agreement as a basis for setting noncommercial rates in the *Webcasting II* proceeding. In *Webcasting II*, this Court found that the agreement, along with other benchmarks proposed by noncommercial webcasters, "suffer[ed] from serious flaws." *Webcasting II*, 72 Fed. Reg. at 24,098. The Court found that the 2001 NPR agreement "does not provide clear evidence of a per station rate that could be viewed as a proxy for one that a willing buyer and a willing seller would negotiate today." *Webcasting II*, 72 Fed. Reg. at 24,098. The Court concluded that the agreement was not "adequate to provide a basis for determining the rates to be applicable to that part of the noncommercial market." *Webcasting II*, 72 Fed. Reg. at 24,099. The passage of years has not changed these fundamental flaws in use of the 2001 NPR Agreement as a benchmark.

527. IBS offers no reason for this Court to re-visit its conclusion that the 2001 NPR agreement is a "seriously flaw[ed]" and inadequate basis for setting noncommercial rates. Indeed, Kass -- IBS's chief proponent of relying on the agreement -- admitted he was unaware that the Court rejected the agreement in *Webcasting II*. 4/22/10 Tr. 797:2-16 (Kass).

528. For the same reasons set forth by this Court in *Webcasting II*, and because the NPR agreement is now even more out-of-date, this Court should reject IBS's reliance on the 2001 NPR agreement as a basis for setting noncommercial rates in this proceeding.

529. There is no other evidence in the record supporting IBS's rate proposal.

**2. IBS's Proposed Terms Should Be Rejected**

530. IBS has made two terms proposals, both of which should be rejected.

531. First, IBS has proposed recordkeeping requirements for noncommercial webcasters. But this Court recently addressed recordkeeping requirements for statutory webcasters in a separate rule-making proceeding, Docket No. RM 2008-7. In that proceeding, this Court issued final recordkeeping regulations in October 2009. 74 Fed. Reg. 52,418 (Oct. 13, 2009). Those regulations are final, and there is no reason to re-visit recordkeeping in this proceeding.

532. Furthermore, IBS has offered no evidence to support its recordkeeping proposals. Accordingly, IBS's recordkeeping proposals should be rejected.

533. Second, IBS has proposed to make collective payments to SoundExchange on behalf of so-called small and very small noncommercial webcasters. IBS made no mention of this proposal until it filed its Amplification during the rebuttal hearing on July 29, 2010. IBS presented no evidence in support of this proposal throughout the entire proceeding.

534. With no testimony or other evidence related to this proposal in the record, the Court lacks a sufficient evidentiary basis to consider, let alone adopt, this proposal.

535. The proposal is also peculiar -- IBS has put brackets around it, and has introduced it by saying "[IBS is prepared to offer to SoundExchange a proposal for a collective payment in essentially the following terms: . . . .]" *See Amplification of IBS' Restated Rate Proposal*, at 3 (July 28, 2010). This phrasing seems to suggest that IBS may be interested in making a settlement offer to SoundExchange, but is not proposing a term to be decided by this Court. If that is the case, then it is inadmissible as evidence and the Court should not consider it.

### 3. IBS Undermined Its Credibility by Advising Webcasters to Violate the Law.

536. IBS has undermined its own credibility by advising its members to violate the law with respect to paying royalties in compliance with the statutory license.

537. First, IBS has issued a so-called "IBS facilitated Webcasting License to stream music and radio over the Internet" to some of its members. SX Trial Ex. 9. These "licenses" were issued under the name and electronic signature of Captain Kass. SX Trial Ex. 9. As recently as February 2010, IBS indicated to its members that IBS membership included an "IBS facilitated Webcasting License for 2010." SX Trial Ex. 8.

538. As Chief Judge Sledge and Judge Roberts both noted, this so-called Webcasting License would "confuse" IBS members and give them the impression they were not required to pay SoundExchange. 4/22/10 Tr. 814:17-815:2, 816:2-13 (Kass).

539. Second, after this Court issued its decision in *Webcasting II*, IBS advised its members that they could choose to continue streaming without complying with the statutory license. IBS stated on its web site that "Some IBS Members May Decide to Defer Impracticable Royalty and Reporting Terms Pending Conclusion of IBS-RIAA/SoundExchange Negotiations. IBS Members should keep webcasting, enjoy the education benefits of webcasting, and relax." SX Trial Ex. 10. With respect to the *Webcasting II* decision, IBS's web site said that "IBS

Members remain protected by IBS. IBS Members should do nothing until they receive written advice from IBS." SX Trial Ex. 10. This incorrect information remained on IBS's web site for at least seven months. 4/22/10 Tr. 840:7-21 (Kass).

540. In this way, IBS advised its members to violate statutory law. Under § 803(d)(2)(C)(i), the pendency of an appeal does not relieve services from the obligation to make royalty payments.

541. SoundExchange repeatedly informed IBS in writing that the IBS web site "continues to mislead your constituents, essentially counseling them to break the law," and demanded that IBS correct it "immediately." SX Trial Ex. 11; SX Trial Ex. 12.

542. IBS's advice had its intended effect. Based on the information posted on the IBS web site, "multiple IBS members have informed SoundExchange that they do not have to pay webcasting royalties because IBS told them they did not have to as a result of their IBS membership." SX Trial Ex. 11.

543. For example, in 2009, WHUS streamed sound recordings, but did not pay royalties or submit a report of use to SoundExchange, even though it knew it was required to do so. 4/21/10 Tr. 579:21-580:8, 581:14-582:3 (Murphy). When asked by Judge Roberts, why WHUS decided not to pay SoundExchange, IBS witness John Murphy explained that it was because at IBS conferences, "we had talked to many stations about the possibility of not having to pay the fee and that we were being granted an exemption because of our noncommercial educational nature." 4/21/10 Tr. 592:10-17 (Murphy). Murphy explained that the basis of his understanding about not paying royalties included "IBS staff trying to decide how to handle this as a system." 4/21/10 Tr. 596:2-4 (Murphy).

## XII. TERMS

544. Sections 112(e)(3) and 114(f)(2)(A) of the Copyright Act require the CRJs to adopt terms for the Section 112(e) and 114 statutory licenses. The willing buyer/willing seller standard applies to the setting of terms. *Webcasting II*, 72 Fed. Reg. at 24,102.

545. This Court has held that in setting terms, it "should consider matters of feasibility and administrative efficiency." *Webcasting II*, 72 Fed. Reg. at 24,102; s*ee also SDARS*, 73 Fed. Reg. at 4,098 ("As we stated in Webcaster II, we are obligated to 'adopt royalty payment and distribution terms that are practical and efficient.'").

546. This Court has also emphasized the importance of consistency of terms across statutory licenses. This Court has stated that in adopting terms, "we seek to maintain consistency across the licenses set forth in Sections 112 and 114. Consistency promotes efficiency thereby reducing the overall costs associated with the administration of the licenses." *SDARS*, 73 Fed. Reg. at 4,098-99.

547. Although terms across the statutory licenses may vary, the "burden is upon the parties to demonstrate the need for and the benefits of variance." *SDARS*, 73 Fed. Reg. at 4,099.

### A. SoundExchange's Proposed Terms

548. On July 23, 2010, SoundExchange submitted its *Second Revised Proposed Rates and Terms*. That submission included draft proposed regulations, which were marked to show the differences between the current webcasting regulations and SoundExchange's proposed regulations.

549. In this proceeding, in the interests of consistency and efficiency, SoundExchange has generally proposed the same terms that this Court previously set in *Webcasting II* and *SDARS*, subject to several revisions described below. Where the *Webcasting II* and *SDARS* terms differ in ways that seem purely editorial, SoundExchange has proposed a number of

changes to conform the webcasting terms to changes made in *SDARS*. *See Second Revised Proposed Rates and Terms of SoundExchange, Inc.*, Section III and Proposed Regulations (July 23, 2010).

550. Although the Judges did not rule in SoundExchange's favor on all of the terms issues raised in *Webcasting II*, the terms adopted in that proceeding represented an important step forward. Kessler WDT at 26, SX Trial Ex. 5. In the *SDARS* proceeding, Docket No. 2006-1, the Judges adopted terms that were largely similar to the terms adopted in *Webcasting II*. Kessler WDT at 26, SX Trial Ex. 5.

551. Kessler explained that SoundExchange recognizes the value in having consistency of terms across licenses, and in allowing time to fully assess the effectiveness of those terms. Consistency among the terms regulations for the various types of services and over time aids SoundExchange's administration of the licenses and makes licensees' compliance with the terms more efficient. Kessler WDT at 26, SX Trial Ex. 5.

552. Live365 has now stipulated to some of the terms proposed by SoundExchange, and SoundExchange and Live365 are submitting those Stipulated Terms to the Court. *See Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding Certain Proposed Terms* (Sept. 10, 2010).

553. SoundExchange proposes continuing the current terms, subject to the following proposed revisions.

**1. Server Log Retention**

554. SoundExchange proposes that the statutory license terms expressly confirm that the records a licensee is required to retain pursuant to 37 C.F.R. § 380.4(h) and that are subject to audit under 37 C.F.R. § 380.6 include server logs sufficient to substantiate rate calculation and

reporting. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section III.A, and Proposed Regulations, § 380.4(h) (July 23, 2010).

555. The evidence indicates marketplace acceptance of such a term. The Noncommercial Educational Webcasters Agreement under the WSA includes a server log retention term equivalent to the one proposed by SoundExchange in this proceeding. McCrady WDT, Ex. 103-DP at § 5.3, SX Trial Ex. 7.

556. SoundExchange believes that the current regulations already require licensees to maintain their server logs for at least a three-year period, because they are "records of a Licensee . . . relating to payments of . . . royalties." 37 C.F.R. § 380.4(h). Kessler WDT at 27, SX Trial Ex. 5.

557. However, SoundExchange has proposed this clarification because in practice licensees often do not retain the actual server logs showing which transmissions were made when. Kessler WDT at 27, SX Trial Ex. 5. Kessler testified that "[t]his data is critical for verifying that licensees have made the proper payments." Kessler WDT at 27, SX Trial Ex. 5.

558. The current royalty rate structure and SoundExchange's proposed rates are based on the actual performances transmitted. Every webcaster's transmissions are made by computer servers that typically generate original records of what recordings they transmitted to how many users and when. Those logs should become the basis for a licensee's statements of account and reports of use. Kessler WDT at 27, SX Trial Ex. 5. However, if SoundExchange cannot compare those logs to the statements of account, reports of use and other records maintained by the licensee that purportedly were derived from the server logs, then SoundExchange does not have the most important link in the chain of records that establish actual usage. Kessler WDT at 27, SX Trial Ex. 5.

559. This proposal is not limited to webcasters that have their server logs in their possession. In the case of a webcaster whose server logs are in the possession of a third party service provider, SoundExchange believes the webcaster should be responsible for obtaining the server logs in the event of an audit. 4/20/10 Tr. 455:20-456:10 (Kessler).

**2. Late Fees for Reports of Use**

560. SoundExchange proposes that reports of use be added to the list in 37 C.F.R. § 380.4(e) of items that, if provided late, would trigger late fees of 1.5% per month. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section III.B, and Proposed Regulations, § 380.4(e) (July 23, 2010)

561. SoundExchange made a similar proposal in the notice and recordkeeping proceeding, Docket No. RM 2008-7. However, the Judges ruled that the proposal was "beyond the scope" of that proceeding. 74 Fed. Reg. 52,418, 52,422 (Oct. 13, 2009).

562. During the direct case hearing, Judge Roberts inquired about the statutory authority for the Court to set late fees for reports of use. 4/20/10 Tr. 458:3-10 (Kessler). Section 803(c)(7) of the Copyright Act provides that the Judges "may include terms with respect to late payment," which is a permissive, but not limiting, grant of authority. Nothing in this provision or any other provision of the governing statutes precludes the Court from setting late fees for reports of use. Indeed, this Court set late fees for statements of account in *Webcasting II* and *SDARS*, even though nothing in the governing statutes expressly directs the Judges to do so. *See* 37 C.F.R. § 380.4(e), 382.13(d). There is no difference between this Court's authority to set late fees for statements of account and its authority to set late fees for reports of use.

563. Moreover, a late fee for a report of use is a "term[] with respect to late payments." 17 U.S.C. § 803(c)(7). As Kessler testified, SoundExchange needs to receive a payment, a report of use and a statement of account from a licensee in order to distribute royalty payments.

4/20/10 Tr. 443:21-444:5 (Kessler). Without a report of use, a payment is useless to SoundExchange. 4/20/10 Tr. 444:6-16 (Kessler) ("Absent a report of use, you would not be able to allocate a payment to the royalties . . . ."); Kessler WDT at 28, SX Trial Ex. 5 ("Reports of use are at least as important to timely distribution as statements of account, which are subject to late fees.").

564. The evidence supports imposing late fees for reports of use. Both the NAB Agreement and the Noncommercial Educational Webcasters Agreement under the WSA provide for late fees of 1.5% for reports of use. McCrady WDT, Ex. 101-DP at § 4.8, SX Trial Ex. 7; McCrady WDT, Ex. 103-DP at § 4.5, SX Trial Ex. 7.

565. The evidence also shows that late fees for reports of use are needed. Kessler WDT at 28, SX Trial Ex. 5 (stating that "widespread noncompliance with reporting requirements demonstrates that it is important to provide greater incentives to compliance than in the past"); *id.* at 13. SoundExchange receives no reports of use from many webcasters, and the reports it does receive are often late or grossly inadequate. Kessler WDT at 13, 28; 4/20/10 Tr. 445:1-11 (Kessler) (explaining that licensees "may never report . . . or they submit reports of use delinquent. Sometimes the report of use is completely unusable and so we have to go back to the licensee and request a new one"). For example, in past years, RealNetworks failed to provide reports of use. Kessler WDT at 13, SX Trial Ex. 5. This is a significant impediment to the timely payment of copyright owners and performers. Kessler WDT at 28, SX Trial Ex. 5.

566. Other than the threat of litigation, there is no commercial incentive for a service to comply with the regulations governing reports of use. Kessler WDT at 28, SX Trial Ex. 5. As Kessler testified, "if we don't receive reports of use, we're unable to distribute the royalties . . . .

Absent a late fee, we don't really have a lot of teeth to enforce around that." 4/20/10 Tr. 458:11-17 (Kessler).

567. The possibility of late fees would provide an additional, immediate incentive to comply with the applicable reporting requirements and would greatly facilitate operation of the statutory licenses. Kessler WDT at 28, SX Trial Ex. 5; 4/20/10 Tr. 458:19-20, 459:9-11 (Kessler) (testifying that late fees "gives us another tool when we are promoting and encouraging compliance with our services" and "we have found that late fees in other areas does help us with our compliance situation").

### 3. Identification of Licensees

568. SoundExchange proposes that statements of account and reports of use identify the licensee in exactly the way it is identified on the corresponding notice of use and report of use, and that they cover the same scope of activity (e.g., the same channels or stations). SoundExchange also proposes that the regulations should be clarified to explain that the "Licensee" is *the entity* identified on the notice of use, statement of account, and report of use, and that each Licensee must submit its own notice of use, statement of account, and report of use. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section III.C, and Proposed Regulations, § 380.4(f) (July 23, 2010).

569. The evidence indicates marketplace acceptance of similar identification requirements that will allow SoundExchange readily to match statements of account and reports of use to each other and to the proper licensee, channel and station. For example, the NAB Agreement under the WSA requires broadcasters to submit separate statements of account corresponding to each of their reports of use, and to identify the broadcaster in each statement of account and report of use "exactly as it appears on its notice of use." McCrady WDT, Ex. 101-DP at § 5.2(f), (h), SX Trial Ex. 7. Similar requirements apply under the WSA agreement for

Noncommercial Educational Webcasters. McCrady WDT, Ex. 103-DP at §§ 4.4.3, 5.2.2, SX Trial Ex. 7.

570. Because SoundExchange receives statements of account and reports of use from hundreds of webcasting payors covering thousands of channels and stations, it devotes considerable effort to reconciling changes and variations in licensee names and matching statements of account to reports of use covering different combinations of channels and stations. Kessler WDT at 29, SX Trial Ex. 5. SoundExchange's work would be greatly simplified at little or no evident cost to licensees if licensees were required to provide notices of use, statements of account and reports of use on a consistent basis, and to use consistent names to refer to themselves in such documents. Kessler WDT at 29, SX Trial Ex. 5.

571. In addition, SoundExchange is seeking a regulation requiring licensees to use an account number assigned to them by SoundExchange on their statements of account and reports of use. This unique identifier would make it easier for SoundExchange to identify each licensee in SoundExchange's system, and to distinguish between services with similar names. This proposal would not burden licensees, and indeed might simplify their reporting and accounting efforts. Kessler WDT at 29, SX Trial Ex. 5.

#### 4. Standard Forms for Statements of Account

572. SoundExchange proposes that licensees should be required to submit statements of account on standardized forms made available by SoundExchange. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section III.D, and Proposed Regulations, § 380.4(f) (July 23, 2010).

573. The WSA agreement for Noncommercial Educational Webcasters requires that licensees use a SoundExchange-supplied form of statement of account. McCrady WDT, Ex. 103-DP at § 4.4.1, SX Trial Ex. 7.

574. The evidence established that most webcasters that pay SoundExchange already use the template statement of account forms that SoundExchange makes available on its web site. Funn WRT at 3, SX Trial Ex. 46; 8/2/10 Tr. 491:18-492:14 (Funn) (explaining that "much more than half" of commercial and noncommercial webcasters used the template statement of account forms that SoundExchange makes available). At the request of the Judges, SoundExchange submitted copies of the template statement of account forms to the Court. *See SoundExchange's Submission of Statement of Account Forms* (Aug. 6, 2010).

575. The template forms are designed to make it as easy as possible for webcasters to calculate the royalties they owe to SoundExchange, and they facilitate SoundExchange's efficient collection of information from licensees. Funn WRT at 2-3, SX Trial Ex. 46. However, some services such as Live365 do not use the template forms. Funn explained that webcasters' failure to use the template statement of account forms "creates additional work for SoundExchange because the information that is submitted in a non-standard format cannot be processed as easily." Funn WRT at 3, SX Trial Ex. 46.

**5. Electronic Signatures**

576. SoundExchange proposes eliminating the requirement in 37 C.F.R. § 380.4(f)(3) that the signature on a statement of account be handwritten. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section III.D, and Proposed Regulations, § 380.4(f) (July 23, 2010). This revision would allow licensees to submit statements of account with electronic signatures rather than only handwritten signatures, which would make it easier for licensees to submit statements of account. Funn WRT at 3 n.1, SX Trial Ex. 46.

577. All of the WSA agreements in evidence refer specifically to a requirement to submit statements of account, and none requires that statements of account bear a handwritten signature. McCrady WDT, Ex. 101-DP at § 4.6, SX Trial Ex. 7 (NAB); McCrady WDT, Ex.

102-DP at § 4.5, SX Trial Ex. 7 (Commercial Webcasters); McCrady WDT, Ex. 103-DP at § 4.4, SX Trial Ex. 7 (Noncommercial Educational Webcasters).

#### 6. Technical and Conforming Changes

578. SoundExchange has proposed a few technical and conforming changes, as reflected in its draft proposed regulations, for the sake of consistency across statutory licenses and clarity. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Section IV, and Proposed Regulations, (July 23, 2010); Kessler WDT at 29, SX Trial Ex. 5.

### B. Live365's Proposed Terms

579. Live365 has proposed only a single term -- a so-called aggregator discount. Live365 has proposed no other terms.

#### 1. Aggregator Discount

580. Live365 has proposed that "a streaming service that operates a network of at least one hundred (100) independently-operated 'aggregated webcasters'" should receive a 20% discount from the royalty rate set for commercial webcasting services. *See* Live365 Rate Proposal, Section I.B (Sept. 29, 2009). This proposed discount is unwarranted, for several reasons.

581. Live365 submitted testimony from Dr. Fratrik to support its request. According to Dr. Fratrik, services like Live365 are entitled to this discount because they provide administrative efficiency, ensure compliance with webcasting regulations and provide other benefits to copyright owners and SoundExchange. Fratrik WDT at 38-39, Live365 Trial Ex. 30; 4/27/10 Tr. 1117:9-13 (Fratrik).

### a. Live365 Failed to Present Sufficient Evidence in Support of the Proposed 20% Aggregator Discount.

582. Dr. Fratrik based his proposed 20% discount on 2006 and 2007 agreements with Performance Rights Organizations ("PROs"). Fratrik WDT at 39, Live365 Trial Ex. 30. The record shows that these agreements do not justify an aggregator discount in this proceeding.

583. Dr. Fratrik principally looked at a 2006 agreement that BMI made available to certain Live365 webcasters (the "Live365 Minicaster Agreement"). Fratrik WDT at 39, Live365 Trial Ex. 30. As an initial matter, the Live365 Minicaster Agreement says nothing about an "aggregator discount." It does not provide a discount to Live365 for aggregating webcasters. 4/27/10 Tr. 1261:18-1262:10 (Fratrik). Rather, the agreement provides a discount directly to very small webcasters ("minicasters") that use Live365 and have fewer than 500 simultaneous listeners. 4/27/10 Tr. 1261:22-1262:15 (Fratrik). Thus, Dr Fratrik's suggestion that the Live365 Minicaster Agreement includes an "aggregator discount" is incorrect.

584. Second, Dr. Fratrik admitted that he does not know how many minicasters have opted into the Live365 Minicaster Agreement or the extent to which the rates in the agreement are in effect. 4/27/10 Tr. 1263:1-8 (Fratrik). The most that Dr. Fratrik could say was that someone at Live365 "gave me the impression that there were some" minicasters that have opted into the Live365 Minicaster Agreement. 4/27/10 Tr. 1263:9-1264:1 (Fratrik).

585. In further support of the proposed aggregator discount, Dr. Fratrik said he used information from agreements with the other PROs. 4/27/10 Tr. 1264:2-15 (Fratrik). But Dr. Fratrik provided almost no information about the agreements. For example, he did not even provide the dates of the agreements. This absence of information was problematic, because Dr. Fratrik lacked sufficient familiarity with them. When asked about whether those agreements

provided discounts to minicasters similar to the Live365 Minicaster Agreement, Dr. Fratrik said he did not know. 4/27/10 Tr. 1264:5-15 (Fratrik).

586. In sum, Fratrik's testimony and the agreements upon which it is purportedly based provide an inadequate foundation for establishing an aggregator discount.

**b. Live365's Poor Compliance Undermines Its Claim for a Discount.**

587. Although Live365 has styled the discount it seeks as a generic aggregator discount, it appears that it would in fact apply only to Live365. Funn testified that he is not aware of any other services that pay SoundExchange that meet Live365's definition of a webcast aggregation service. 8/2/10 Tr. 442:22-443:3 (Funn).

588. The evidence establishes that Live365 should not receive any discount for the alleged benefits it provides by aggregating webcasters. As Funn testified, "Live365 has engaged in conduct that has created more work for SoundExchange, not less." Funn WRT at 2, SX Trial Ex. 46.

589. Live365 increased the burden on SoundExchange by paying royalties at the incorrect royalty rate for more than two years after this Court issued its decision in *Webcasting II*. Kessler WDT at 13-14, SX Trial Ex. 5; Funn WRT at 2, SX Trial Ex. 46; 8/2/10 Tr. 443:4-10 (Funn). Indeed, Live365 acknowledged that through the direct phase of this hearing, Live365 was paying royalties at the pre-*Webcasting II* 2005 royalty rates. 4/26/10 Tr. 959:15-20 (Floater); SX Trial Ex. 13 at 56:15-16.

590. Live365 persisted in violating the statute in this way, even after SoundExchange sent it three letters demanding that Live365 comply with the requirements of the statutory license. Funn WRT at 2, SX Trial Ex. 46; 8/2/10 Tr. 443:11-444:19 (Funn); SX Trial Ex. 13 at 101:9-102:6.

591. An entity that willfully violates the statutory licenses should not be rewarded with a discount. A willing seller would not agree to a 20% discount for a buyer that failed to pay the correct amounts due for over two years. SoundExchange had to spend time and money analyzing Live365's lack of compliance and repeatedly notifying Live365 about its failure to pay royalties at the correct rates. Funn WRT at 2, SX Trial Ex. 46. Moreover, because Live365 pays royalties to SoundExchange on behalf of thousands of webcasters, when Live365 was paying at the incorrect rates, it was causing thousands of webcasters to be out of compliance with the statutory license, even as those webcasters may have believed that they were compliant. Funn WRT at 2, SX Trial Ex. 46; 8/2/10 Tr. 446:10-16 (Funn) (explaining that "because we don't know who Live365 is paying for . . . there could be instances where we would contact a service that we believe should be operating under the statutory license and only to find out that they are operating under Live365 and believe that they are in compliance with the license").

592. At the hearing, Live365 tried to create the impression that it is just one of many services that do not comply with the statutory licenses. But Live365's noncompliance with the statutory licenses (by failing to pay the correct royalty rates for over two years) was qualitatively different from other services' noncompliance. Funn testified that while numerous services may have minor compliance issues, "I can't think of an instance with a service . . . that paid at the old rate" as long as Live365. 8/2/10 Tr. 469:4-11 (Funn). The majority of services paid at the correct rates within months of the *Webcasting II* decision. 8/2/10 Tr. 484:15-20 (Funn).

593. Although SoundExchange asked Live365 on multiple occasions to provide SoundExchange with a list of the thousands of webcasters for whom it purports to pay SoundExchange, Live365 never provided such a list. 8/2/10 Tr. 484:21-485:9 (Funn). Although providing such a list may not have been required, this lack of cooperation added to

SoundExchange's burden because it can be more time-consuming for SoundExchange to determine whether a webcaster is complying with the statutory licenses. Funn WRT at 2, SX Trial Ex. 46; 8/2/10 Tr. 445:8-446:2 (Funn) (testifying that when Live365 paid at incorrect rates "we basically had to put them on hold to . . . resolve whatever discrepancy there was on a month-to-month basis").

594. Live365 also interfered with SoundExchange's collection and distribution processes by submitting doctored statement of account forms. Funn WRT at 2-4, SX Trial Ex. 46. SoundExchange has "designed our processes of collecting and distributing the royalties based on the regulations as they are in effect at the time." 8/2/10 Tr. 445:4-7 (Funn). To that end, SoundExchange makes standard template statement of account forms available to licensees. While licensees are not required to use these forms, most of them do so. Funn WRT at 3, SX Trial Ex. 46; 8/2/10 Tr. 491:18-492:14 (Funn) (explaining that "much more than half" of commercial and noncommercial webcasters used the template statement of account forms that SoundExchange makes available). When licensees use the forms, it "makes it easier to review, and decreases the potential for errors due to human intervention and discretion." Funn WRT at 3, SX Trial Ex. 46.

595. Instead of using the current statement of account form, Live365 doctored out-of-date statement of account forms and designed them to look like current forms, but with the old royalty rates. Funn WRT at 3-4, Ex. 1 and 2, SX Trial Ex. 46. As Funn explained, this created "additional work for SoundExchange," "delays processing," and further "undermines the claim that Live365 should receive a discount." Funn WRT at 4, SX Trial Ex. 46; 8/2/10 Tr. 448:6 (Funn).

596. In sum, Live365's history of noncompliance undermines any claim that a discount is justified on the basis of administrative efficiency or savings.

#### c. Live365 Already Obtains an Aggregator Benefit from the Cap on Minimum Fees.

597. Live365's claim for a discount is also undermined by the fact that under the May 14, 2010 Stipulation it executed with SoundExchange, and the current regulations (37 C.F.R. § 380.3(b)(1)) it already receives a substantial benefit by virtue of the $50,000 cap on minimum fees for services with 100 or more stations or channels. Funn WRT at 4, SX Trial Ex. 46. As Funn testified, "a service such as Live365 that aggregates thousands of stations already receives a substantial benefit because it is required to pay only $50,000 in minimum fees as opposed to, for example, the $2.5 million it would have to pay in minimum fees if it paid minimum fees for 5,000 stations or channels." Funn WRT at 4, SX Trial Ex. 46. In seeking an aggregator discount in addition to the $50,000 cap on minimum fees, Live365 is seeking two bites at the same apple.

#### d. The 100-Webcaster Qualification Is Arbitrary

598. Live365 has proposed that a service "that operates a network of at least one hundred (100) independently-operated 'aggregated webcasters'" should get the 20% discount. *Rate Proposal for Live365, Inc.*, at 2 (Sept. 29, 2009).

599. Live635's selection of a 100-webcaster threshold is arbitrary. When asked how he decided upon 100 channels as the threshold, Dr. Fratrik admitted that he did not perform any analysis of cost savings. 4/27/10 Tr. 1270:16- 1271:3 (Fratrik). Rather, "[i]t was just a number that sort of indicates that that's when it becomes substantial benefits." 4/27/10 Tr. 1270:18-20.

### 2. No Other Proposed Terms

600. Live365 did not propose any other terms.

### C. IBS's Proposed Terms

601. IBS has made two terms proposals (concerning reports of use and collective payment for small and very small noncommercial webcasters). Both of these proposals should be rejected as described *supra* at Section XI.D.2. In other respects it appears that IBS has no objection to the Judges' continuing substantially the current terms.

## XIII. DESIGNATION OF A COLLECTIVE

602. SoundExchange proposes that it should be designated as the sole Collective to collect and distribute statutory royalties for the period 2011-2015. *See Second Revised Rates and Terms of SoundExchange, Inc.*, Proposed Regulations, § 380.4(b) (July 23, 2010)

### A. SoundExchange Should Be the Sole Collective.

603. In *Webcasting II*, the Judges found "that selection of a single Collective represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses." 72 Fed. Reg. at 24,104. Furthermore, the D.C. Circuit held that "in selecting SoundExchange as the sole collective, the Judges fulfilled Congress's expectation that they would designate a single entity to receive royalty payments from licensees." *Intercollegiate Broad. Sys., v. Copyright Royalty Bd.*, 574 F.3d 748, 771 (D.C. Cir. 2009).

604. In *Webcasting II*, the Judges designated SoundExchange "as the Collective to receive statements of account and royalty payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g)." 37 C.F.R. § 380.4(b); *see Webcasting II*, 72 Fed. Reg. at 24,105 ("SoundExchange is the superior organization to serve as the Collective for the 2006-2010 royalty period.").

605. In *SDARS*, the Judges again designated SoundExchange as the Collective, noting that no party had requested the designation of multiple collectives, no other party requested to be selected as the Collective, no party opposed SoundExchange's designation, and that SoundExchange had a "track record of serving as the Collective." 73 Fed. Reg. at 4,099.

606. The same circumstances are true here: no party other than SoundExchange has requested to be selected as the Collective, no party has proposed multiple collectives, no party has opposed the designation of SoundExchange as the Collective, and SoundExchange has presented evidence of its proven track record of administering the statutory licenses efficiently and in the best interests of royalty recipients.

607. The evidence in this proceeding supports the same result as in past proceedings. SoundExchange should be designated the sole Collective to collect and distribute royalties for the 2011-2015 statutory period.

### 1. SoundExchange Has Experience Administering the Statutory Licenses.

608. SoundExchange has considerable experience and expertise in administering the Section 112 and 114 statutory licenses. It has distributed royalties based on billions of webcasting performances. As of September 2009, SoundExchange had conducted a total of 33 royalty distributions and had made nearly 150,000 individual payments totaling more than $250 million. Kessler WDT at 4, SX Trial Ex. 5. By April 21, 2010, the total distributions to copyright owners and artists had grown to $417 million (not limited to webcasting royalties). 4/21/10 Tr. 516:8 (Kessler). SoundExchange has nearly 2 million sound recordings in its database. Kessler WDT at 18, SX Trial Ex. 5.

609. As of September 2009, SoundExchange had approximately 9,700 record label members and 29,000 artist members. Kessler WDT at 18, SX Trial Ex. 5. SoundExchange also

distributes statutory royalties to non-members (both copyright owners and artists) as if they were also members. Kessler WDT at 3, SX Trial Ex. 5. In total, as of September 2009, SoundExchange maintained accounts for approximately 11,500 record labels and 41,000 artists, including members and non-members. Kessler WDT at 3, SX Trial Ex. 5.

610. In *Webcasting II*, this Court pointed to SoundExchange's experience in administering the statutory licenses as a factor in designating it as the sole Collective. 72 Fed. Reg. at 24,105 ("SoundExchange has a proven track record in collecting and processing section 112 and 114 royalties, having done so since the inception of the statutory licenses.").

611. SoundExchange has represented artists and record labels on a vast array of issues, including notice and recordkeeping and rate-setting through the Copyright Royalty Judges' proceedings, as well as prior CARP proceedings. In addition, SoundExchange undertakes a number of measures to protect the interests of artists and copyright owners under the statutory licenses, including by conducting audits of licensees, seeking and obtaining compliance by noncompliant licensees, and engaging in other enforcement and compliance measures. Since its founding, SoundExchange has, on behalf of all artists and record labels, sought the establishment of fair royalties and regulations that enable the prompt, fair and efficient distribution of royalties to all those artists and copyright owners entitled to such royalties. Kessler WDT at 3, SX Trial Ex. 5.

612. SoundExchange has a demonstrated record of serving the interests of recording artists, seeking to maximize royalty payments to them, and searching far and wide for recording artists (regardless of whether they are SoundExchange members) to distribute their royalty payments to them. Roberts Hedgpeth WDT at 5, SX Trial Ex. 3.

### 2. Artists and Copyright Owners Support SoundExchange as the Sole Collective.

613. SoundExchange presented artist and copyright owner testimony in support of designating SoundExchange as the sole Collective. *See Webcasting II*, 72 Fed. Reg. at 24,105 ("As the direct beneficiaries of the royalties collected under the statutory licenses, the copyright owner and performer testimony on this point is particularly persuasive.").

614. Kim Roberts Hedgpeth, the National Director of the American Federation of Television and Radio Artists ("AFTRA"), testified on behalf of AFTRA's members, who include approximately 12,000 vocalists who have performed on sound recordings. Roberts Hedgpeth WDT at 1-2, SX Trial Ex. 3.

615. Her testimony expressed "AFTRA's support for the designation of SoundExchange as the sole Collective to collect and distribute the statutory webcasting royalties at issue in this proceeding for the period 2011 through 2015." Roberts Hedgpeth WDT at 1-2, SX Trial Ex. 3. She identified several reasons why "SoundExchange is the best choice for recording artists," including that SoundExchange represents the interests of copyright owners and recording artists alike, that SoundExchange is a non-profit organization that does not reduce royalty payments by taking a profit and that makes decisions in the best interests of the royalty recipients, and that SoundExchange has "substantial and unparalleled" experience administering the statutory licenses. Roberts Hedgpeth WDT at 3-5, SX Trial Ex. 3.

616. From the copyright owner perspective, W. Tucker McCrady, Associate Counsel for Digital Legal Affairs at Warner Music Group, testified that "there should be one unified licensing collective," and that SoundExchange "has done an admirable job" and "deserves to maintain its position as the only licensing collective." McCrady WDT at 19, SX Trial Ex. 7.

### 3. SoundExchange Represents Both Copyright Owners and Recording Artists.

617. As this Court previously observed, "SoundExchange is controlled by an 18-member Board of Directors comprised of equal numbers of representatives of copyright owners and performers." *Webcasting II*, 72 Fed Reg. at 24,104. That remains true today. Kessler WDT at 2, SX Trial Ex. 5. Copyright owners are represented by board members associated with the major record companies (four), independent record companies (two), the Recording Industry Association of America (two), and the American Association of Independent Music (one). Artists are represented by one representative each from the American Federation of Musicians ("AFM") and the American Federation of Television and Radio Artists ("AFTRA"). Kessler WDT at 2, SX Trial Ex. 5. There are also seven at-large artist seats, which are currently held by artists' lawyers and managers (four), an individual artist (Martha Reeves), and individuals who are affiliated with the Future of Music Coalition and the Rhythm & Blues Foundation. Kessler WDT at 2-3, SX Trial Ex. 5.

618. This direct representation of artists and copyright owners "helps ensure the honest, efficient and fair distribution of royalties." Roberts Hedgpeth WDT at 3, SX Trial Ex. 3. The equal representation of artists gives them "an equal voice in the organization, so that SoundExchange is attentive to the particular needs and concerns of recording artists." Roberts Hedgpeth WDT at 3, SX Trial Ex. 3; 4/20/20 Tr. 384:7-385:7 (Roberts Hedgpeth) (explaining that SoundExchange serves the best interests of artists).

619. SoundExchange has "demonstrated its commitment to serving the best interests of artists." Roberts Hedgpeth WDT at 3, SX Trial Ex. 3. It engages in extensive outreach efforts, advocates for favorable royalty rates, and works "tirelessly" to administer the statutory licenses. Roberts Hedgpeth WDT at 3-4, SX Trial Ex. 3. "Perhaps the best evidence of SoundExchange's

commitment to the fair representation of artists and copyright owners is that ten of thousands of artists and copyright owners have registered with SoundExchange." Roberts Hedgpeth WDT at 4, SX Trial Ex. 3.

#### 4. SoundExchange Is a Non-Profit.

620. SoundExchange is a Section 501(c)(6) nonprofit organization established to ensure the prompt, fair and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for digital audio transmissions of sound recordings over, among other things, the Internet, wireless networks, cable and satellite television networks, and satellite radio services (hereinafter collectively "services" or "licensees"). Kessler WDT at 2, SX Trial Ex. 5.

621. As a non-profit organization, SoundExchange collects royalty payments for distribution to artists and copyright owners, not for its own financial gain, and its "incentives are properly aligned with the interests of royalty recipients." Roberts Hedgpeth WDT at 4, SX Trial Ex. 3; 4/20/10 Tr. 385:8-17 (Roberts Hedgpeth) (testifying that SoundExchange's non-profit status is "very significant" because its mission is to ensure royalties are collected and distributed to statutory recipients).

> [T]he payments should not be reduced by profits taken by a distribution collective which might occur if the license were administered by a for-profit entity. The purpose of the digital performance right is to compensate performers and copyright owners for the use of their recordings, not to create a business opportunity for organizations that collect and distribute royalties.

Roberts Hedgpeth WDT at 4, SX Trial Ex. 3. AFTRA would have grave concerns about designating a for-profit entity to collect and distribute the statutory royalty payments that are due to its members. Roberts Hedgpeth WDT at 4, SX Trial Ex. 3.

### 5. SoundExchange Administers the Statutory Licenses Efficiently.

622. SoundExchange effectively controls the administrative costs associated with royalty collection and distribution. SoundExchange has 40 full-time staff members. In 2007, based on audited expenses, its administrative rate was 4.3% of total revenue. Kessler WDT at 4, SX Trial Ex. 5. In 2008, based on unaudited expenses, its administrative rate was 5.1% of total revenue. Kessler WDT at 4, SX Trial Ex. 5. As Kessler explained, "[t]his is a remarkable accomplishment, given the short time that SoundExchange has been in existence and the lower revenue base against which this number is calculated (compared with other U.S. collection societies, which often have overall royalties approaching or exceeding $1 billion)." Kessler WDT at 4, SX Trial Ex. 5.

623. For comparison purposes, the reported administrative costs for the American Society of Composers, Authors and Publishers ("ASCAP") and BMI are typically higher. Kessler WDT at 4, SX Trial Ex. 5.

## B. Designating Multiple Collectives Would Be Inefficient.

624. This Court previously recognized that "[t]ransaction costs to the users of [a blanket] license are minimized when they can make payment to a single Collective, as opposed to allocating their payments among several." *Webcasting II*, 72 Fed. Reg. at 24,104.

625. Having more than one Collective would be inefficient, and there is no evidence in the record to support any such scheme. SoundExchange's system presently contains entries for tens of thousands of copyright owners and performers and nearly 2 million sound recordings. For the system to recognize multiple agents, SoundExchange would have to expend significant resources, both human and monetary, to create the accounting platform necessary to track numerous distributing agent relationships, keep accounts current when entitled parties change affiliation with multiple agents, and still ensure timely distributions. Adding multiple agents

would not only create administrative costs and burdens, but would also result in substantial delay in distributing royalties owed. The resulting complexity and administrative burden would serve no one and would lead only to a large number of disputes between collectives -- disputes that might end up back before the Judges. Kessler WDT at 19, SX Trial Ex. 5.

626. As Roberts Hedgpeth testified,

> I can't envision a circumstance where [having more than one collective] would make sense. By having a single collective . . . it makes it easier to administer. I think for the organizations that participate in the industry, it makes it a lot easier to understand how the collection works, to make sure that it's done in an efficient way, and to make sure we're not duplicating costs because, of course, those costs would come out of the royalties that copyright owners and performers are supposed to receive under the statute.

4/20/10 Tr. 386:20-387:8 (Roberts Hedgpeth).

627. A multi-agent system is anathema to the concept of an efficient statutory licensing system. Although proponents of a multi-collective system often point to ASCAP, BMI, and SESAC -- the musical works performing rights organizations -- it is important to understand that administering a statutory license is fundamentally different from what those organizations do. Those organizations all engage in direct, voluntary licensing. They represent their members (and only their members) and are able to compete for members by negotiating different rates and terms for collection and distribution of royalties. They only collect and distribute monies for their own members, and have no responsibility to anyone other than their members. Kessler WDT at 19, SX Trial Ex. 5.

628. Under the Copyright Act, SoundExchange is in the position of administering a statutory license whose rates and terms are set by the Judges. There cannot be "competition" between collectives on the basis of rates and terms; the only "competition" would be created by one collective trying to free-ride off the efforts of another. Moreover, because many copyright

owners and performers will be members of no organization, there must be an entity that has the responsibility of researching and identifying their recordings, locating them and ensuring that they too receive the royalties to which they are entitled. SoundExchange (or its predecessor) has undertaken that responsibility since royalties began being paid under Section 112(e) and Section 114 of the Copyright Act. Kessler WDT at 19-20, SX Trial Ex. 5.

629. Where a statutory license has specified rates and terms, it only makes sense for a single entity to provide administration. If multiple collectives were to administer the same license, the collection and distribution process would grind to a halt. Kessler WDT at 20, SX Trial Ex. 5.

630. Moreover, designating a second Collective would create greater overall costs because copyright owners and performers would have to pay for duplicative systems for license administration. 4/20/20 Tr. 386:1-4 (Roberts Hedgpeth) ("having a single collective really ensures that there is the benefit of a single administration, that we don't have duplication of effort, duplication of expenses").

631. Similarly, designating a new Collective to replace SoundExchange would be inefficient. SoundExchange has invested substantial time, effort and money into developing its collection and distribution systems, and has developed great expertise in administering the statutory license. The benefits to copyright owners and artists of that experience and expertise would be lost if a different entity were designated as the Collective. 4/20/20 Tr. 386:9-11 (Roberts Hedgpeth) (SoundExchange has "streamlined administration, you have lack of confusion in the administration of . . . the royalties"). Copyright owners and artists would also be harmed because they would subsidize the costs of transitioning to a new Collective. Kessler WDT at 20, SX Trial Ex. 5.

632. If additional entities were designated to collect and distribute royalties so that there were two or more Collectives, it would introduce counterproductive inefficiencies into the system, and would needlessly require the additional expenditure of time, money and resources. This would hurt artists and copyright owners, as they would have to pay for duplicative systems to administer the statutory licenses. Roberts Hedgpeth WDT at 5, SX Trial Ex. 3.

633. Furthermore, having multiple Collectives could lead to substantial confusion and delay in the collection and distribution of royalties -- all of which would negatively impact artists and copyright owners. For example, disputes between the Collectives would inevitably arise related to how to interpret the applicable regulations, and there would be no obvious way to resolve them. Similarly, it is not uncommon for disputes to arise related to how to allocate royalties among performers in a group. SoundExchange works to resolve these disputes, but if there were two Collectives, the Collectives might well disagree about the best resolution (especially if different artists in a group were represented by different Collectives), which would delay the distribution of royalties and might require a third party to resolve. Roberts Hedgpeth WDT at 6, SX Trial Ex. 3.

634. Adding another Collective into the mix would also make complying with the statutory license more complicated for webcasting services. The statutory and regulatory scheme for collecting and distributing royalties is already complex. It would undoubtedly be confusing and inefficient for webcasting services to have to submit payment and usage information to multiple Collectives. Roberts Hedgpeth WDT at 6, SX Trial Ex. 3.

### C. No Other Party Has Asked to Be Designated a Collective.

635. SoundExchange is the only party that has asked to be designated as the Collective and that has submitted evidence into the record relevant to the issue. There is no evidence in the

record to support the designation of any other entity as *the* Collective, or even as *a* Collective. No party has objected to the designation of SoundExchange as the sole Collective.

636. Replacing SoundExchange would be extremely inefficient, and is not supported by any evidence in the record or proposed by any party.

> To choose a new Collective now would not serve the interests of artists or copyright owners. SoundExchange has made substantial investments and developed expertise in the complex tasks of administering the statutory license. If a new Collective were selected to replace SoundExchange, the benefits of that work would be lost, and a new Collective would need to re-learn much of what SoundExchange already knows. In that circumstance, artists and copyright owners would likely suffer as administrative costs would be needlessly incurred in transitioning to a new Collective and as distributions could be delayed and processed less efficiently. The best interests of the royalty recipients will be served by renewing SoundExchange as the Collective.

Roberts Hedgpeth WDT at 5, SX Trial Ex. 3.

637. Although RLI filed a petition to participate in this proceeding, it did not submit a rate proposal, did not participate in the direct or rebuttal hearings, and did not submit any evidence into the record.

638. In selecting SoundExchange over RLI as the sole Collective in *Webcasting II*, the Judges expressed "serious reservations about the bona fides of Royalty Logic to act as the Collective under the statutory licenses." 72 Fed. Reg. at 24,105. The Judges noted that RLI is a for-profit organization that wants to enter the royalty collection and distribution business to make money; that the testimony of Mr. Gertz raised concerns "as to whether Royalty Logic will act in the best interest of all copyright owners and performers covered by the statutory licenses"; that RLI's relationship with copyright users and services "elevated" these concerns; and that RLI's arguments about the potential effects of competition between collectives were not relevant. *Webcasting II*, 72 Fed. Reg. at 24,105.

639. Because RLI presented no evidence in this case, there is no reason to think that these problems have been addressed.

640. Artists oppose the designation of RLI as a collective. Roberts Hedgpeth WDT at 6-7, SX Trial Ex. 3 ("AFTRA believes that RLI is not an appropriate entity to serve as the Collective to collect and distribute royalties for several reasons," including that it is a for-profit entity, its structure does not ensure equal participation by artists in its governance, and it has close ties to music licensees).

### D. SoundExchange's Operations

641. SoundExchange has worked for nearly ten years to develop sophisticated systems, business processes and extensive databases uniquely suited to the challenging task of distributing statutory royalties. Kessler WDT at 5, SX Trial Ex. 5. Barrie Kessler testified about the procedures SoundExchange uses to collect and distribute royalties.

642. Although the massive scope of collecting and distributing royalties, and the frequency with which novel circumstances arise, make SoundExchange's task extremely complex, SoundExchange has achieved efficiencies through experience and by employing and improving its custom software system. Kessler WDT at 11, SX Trial Ex. 5.

643. SoundExchange has automated many of its functions. Since the *Webcasting II* proceeding, it has deployed a new royalty distribution platform that has improved SoundExchange's ability to manage royalty recipient accounts, match performances to repertoire, and manage its research work flow. This new platform automates more functions, enables the processing of large volume logs more easily, and permits greater flexibility in how artist and copyright owner accounts are paid, among other things. Kessler WDT at 11, SX Trial Ex. 5; 4/20/10 Tr. 442:19-443:10 (Kessler).

### 1. Receipt of Payment

644. SoundExchange's Royalty Administration and Distribution Services Departments receive from statutory licensees royalty payments, statements of account, and reports of use. The statements of account reflect the licensee's calculation of the payments for the reporting period, and the reports of use report performances of specific sound recordings. SoundExchange also receives notices of election that indicate whether a licensee has utilized any optional rates and terms. Kessler WDT at 5-6, SX Trial Ex. 5.

645. When SoundExchange receives payment from a licensee, that payment is logged into SoundExchange's licensee database. If this is the first payment from a licensee, a new profile is created for the licensee. If the licensee has previously paid royalties, then the payment is entered under the existing profile. If the licensee operates services in multiple rate categories, the royalty payments are allocated among the applicable rate categories based on the statements of account. Similarly, block payments by a parent corporation covering corporate subsidiaries (*e.g.* by a radio station group covering individual radio stations) may be allocated among the subsidiaries if the parent provides separate statements of account for each of the covered subsidiaries. Kessler WDT at 6, SX Trial Ex. 5.

### 2. Loading Reports of Use

646. Reports of use are associated with a service's payments and statements of account for a particular period and loaded into SoundExchange's system. The reports are supposed to provide information about the sound recording title, album, artist, marketing label, International Standard Recording Code and other information, as well as information about the number of performances. Kessler WDT at 6, SX Trial Ex. 5.

647. If a report does not conform to the required format and delivery specifications, it may not load without substantial manual intervention. Instead, SoundExchange staff must

review the reports, identify the kinds of corrections that need to be made, work with the service to obtain a corrected report from the service, and then attempt again to load the report into the system. In some instances, services fail to accurately report identifying data for sound recordings, in which case SoundExchange staff has to research the partially identified sound recording in order to identify accurately the sound recording copyright owners and performers entitled to royalties. Kessler WDT at 6, SX Trial Ex. 5.

### 3. Matching

648. SoundExchange's systems seek to match the recordings reported in licensee reports of use with information in SoundExchange's database concerning known recordings and their copyright owners and performers. SoundExchange uses an algorithm to try to match identical and similar data elements and combinations of data elements from the incoming log against performance information previously received from the services. If there is a match for a particular sound recording, then the program identifies the corresponding copyright owner and performer information. However, a reported recording might not match a known recording if, for example, the service has performed a recording by an unsigned band, or a very new, old, foreign or other obscure recording that has not previously been reported to SoundExchange, or if the service has provided incomplete or incorrect identifying information. Kessler WDT at 7, SX Trial Ex. 5.

649. Matching can be difficult because many business arrangements in the recording industry are intricate and continually evolving. For a given sound recording, there may be multiple artists as well as multiple payees entitled to receive a portion of the royalties, as well as the IRS. Further, members of a band often change over the course of the band's existence. When a band that has undergone changes in membership releases multiple versions of the same

song, each release may involve payments to different people. Kessler WDT at 11-12, SX Trial Ex. 5.

#### 4. Research

650. SoundExchange has built its database of sound recordings from scratch, based on information reported to it by services. To the extent a reported recording does not sufficiently match a known recording, SoundExchange personnel will research the recording in an effort to determine whether it should be added to SoundExchange's database or whether it is in the database under different identifying information. Kessler WDT at 7, SX Trial Ex. 5.

651. This research requires a significant amount of staff time. Such research is often required for new releases, works reported for the first time, works from small labels, compilation albums and foreign repertoire. Kessler WDT at 7, SX Trial Ex. 5.

#### 5. Account Assignment

652. SoundExchange then assigns reported sound recording performances to accounts belonging to copyright owners and performers. Performances for which a copyright owner or artist account is not identifiable (e.g., because the recording reported has not yet been matched to a recording known to SoundExchange) are assigned to an account for later review and research. This is often the result of poor quality data provided by licensees. Performances assigned to these accounts are processed through the steps that follow as soon as identification is made, with the associated royalties being released in the next scheduled distribution. Kessler WDT at 8, SX Trial Ex. 5.

#### 6. Royalty Allocation

653. Once account assignment has occurred, a service's royalty payments for a given distribution period are allocated to sound recordings used by that service during that period and to SoundExchange's costs deductible under Section 114(g)(3). Before distribution of allocated

funds, SoundExchange takes several quality assurance steps to ensure accounts are payable, address and tax identification information is complete, performances in conflict are resolved and copyright owner conflicts are resolved (to the extent practicable). Kessler WDT at 8, SX Trial Ex. 5.

### 7. Adjustment

654. Once allocations are completed, it is sometimes necessary to adjust particular accounts to rectify reporting and other errors that occurred in prior distributions. Adjustments typically take the form of an additional payment or a reduced payment to an existing account in the next scheduled distribution. For copyright owners and artists who are newly identified and for whom royalties have been accruing, a new account is created and the relevant royalties attributed to the account for unidentified performances are transferred to the new account. Adjustments are also made from suspense accounts to copyright owner and artist accounts based on registrations received during the period between distributions. Kessler WDT at 8-9, SX Trial Ex. 5.

### 8. Distribution

655. This process begins with consolidating allocations across licensees' performance logs within a license category according to earning entity, which are then assigned to copyright owners, artists, or certain other payees (such as a producer who an artist directs SoundExchange to pay) based on the payment instructions for each. Next, the system generates a payment file, which SoundExchange transmits to its banking partner. SoundExchange generally provides each royalty-earning entity with an electronic or hard copy statement reflecting the performances -- and the licenses under which the sound recordings were performed -- for which the royalty payment is made. When there is a payable balance in a payee's account above the distribution

threshold, a check is mailed or funds are electronically transferred. Kessler WDT at 9, SX Trial Ex. 5.

656. SoundExchange presently conducts distributions at least four times a year for statutorily licensed uses (*i.e.*, performances pursuant to 17 U.S.C. §§ 112(e) and 114) and, at times, for non-statutorily licensed performances for which SoundExchange has collected royalties, typically from foreign performing rights organizations that have money for U.S. performers or copyright owners. Kessler WDT at 10, SX Trial Ex. 5.

657. The threshold for distributing royalties to a payee is $10. Distributing smaller amounts would incur significant additional transaction costs. Every payee with a balance greater than $10 receives at least an annual distribution. Payees with balances less than $100 receive more frequent distributions only if they have opted to be paid by electronic funds transfer rather than by check. Kessler WDT at 10, SX Trial Ex. 5.

658. Payments for which SoundExchange lacks sufficient information to distribute to the appropriate copyright owner or performer are allocated to separate accounts in accordance with 37 C.F.R. § 380.8. When SoundExchange subsequently obtains the information necessary to distribute royalties to a particular copyright owner or performer, it will do so in a future distribution. Kessler WDT at 10, SX Trial Ex. 5.

### 9. Outreach

659. SoundExchange actively engages in artist outreach. Kessler WDT at 14, SX Trial Ex. 5; 4/20/10 Tr. 448:3-449:1 (Kessler) (describing SoundExchange outreach efforts, including marketing, attending industry events, advertising online and in print media, and working with organizations to match SoundExchange's list of unpayable artists with organizations' membership rosters).

660. SoundExchange attends about 50 music industry conferences, meetings, festivals and events a year, and speaks to artist management firms, record labels, performing rights organizations and law firms that represent artists. SoundExchange also works with music associations to spread awareness of its services, and it advertises in a variety of media outlets. SoundExchange personnel are available to artists (as well as to copyright owners and licensees) to provide information and answer questions. Kessler WDT at 14-15, SX Trial Ex. 5.

661. Six SoundExchange staff members' and three consultants' responsibilities include conducting research to locate artists and obtain their payee information. Even where SoundExchange is able to determine the identity of the artist and record label, locating accurate payee information for a sound recording can be very difficult, especially if the recording is listed in a non-active, deep "catalog" or involves an artist who does not have a U.S. corporate entity designated to receive royalties on his or her behalf. Moreover, even when SoundExchange locates artists or their managers, they must return payee information so that SoundExchange can send their royalties to them. Kessler WDT at 15, SX Trial Ex. 5.

662. A particular challenge in locating royalty recipients relates to niche programming. Some webcasting services perform sound recordings of smaller, less well-known labels and performers who are hard to find (and the problem is magnified if the labels are no longer in existence). SoundExchange spends a significant amount of time addressing this problem in two ways. Kessler WDT at 15, SX Trial Ex. 5.

663. First, SoundExchange personnel publicize the organization, its mission and its functions in order to ensure that artists and copyright owners are aware that they may have royalties owed to them. Second, SoundExchange performs extensive research to locate and contact individuals who may be entitled to royalties. For example, SoundExchange relies on

databases such as Celebrity Access and All Music Guide as well as information provided by other organizations within the music industry, both domestic and foreign, to locate artists. SoundExchange also utilizes temporary employees, interns, and independent contractors to assist in locating individuals and entities entitled to royalty payments. Kessler WDT at 15, SX Trial Ex. 5.

664. Even when SoundExchange contacts artists about unpayable royalties, some of them fail to submit the proper registration information to enable payment. In addition, many artists change address frequently, and it is not uncommon that an artist SoundExchange has previously paid will move but fail to inform SoundExchange of his or her new address. SoundExchange is then unable to distribute royalties to that artist until he or she can be located again. If artist group members cannot agree to the splits among them for their repertoire or if there are multiple claims against the same repertoire (as with two foreign collecting societies claiming the same sound recording), those payments will be placed on hold, pending resolution of the dispute. Kessler WDT at 15-16, SX Trial Ex. 5.

665. SoundExchange is working to address these challenges in several ways in addition to the outreach measures discussed above. For example, instead of issuing checks, it offers royalty recipients the option of receiving their royalties through automated check clearinghouses that essentially offer direct deposit into bank accounts. Even when artists tour frequently and change their addresses, their bank accounts generally remain the same. Under this system, when an artist moves or is touring, he or she will continue to receive payments directly into his or her bank account. 4/20/10 Tr. 449:2-450:2 (Kessler). In addition, SoundExchange continues to pursue initiatives with foreign collectives to locate artists. SoundExchange has developed relationships and negotiated agreements with sister royalty

societies around the world, including SOMEXFON in Mexico, PPL in the United Kingdom, ABRAMUS and UBC in Brazil, AIE in Spain, RAAP in Ireland, and SENA in the Netherlands. Under these agreements, SoundExchange remits royalty payments due to copyright owners or performers represented by those societies. Kessler WDT at 16-17, SX Trial Ex. 5; 4/20/10 Tr. 450:3-13 (Kessler) (reciprocal relationships with foreign collection societies).

666. SoundExchange also works with organizations that have connections to the artist community to compare its unmatched lists to data they maintain about artists. When those organizations have contact information for artists for whom SoundExchange lacks information, they contact the artists and encourage them to register with SoundExchange and collect their royalties. Furthermore, SoundExchange has launched on-line registration, so that artists and copyright owners can register with SoundExchange without having to use conventional mail. Kessler WDT at 17, SX Trial Ex. 5.

### E. Problems Caused by Poor Licensee Compliance

667. SoundExchange's royalty distributions are impeded by many licensees' submitting reports of use that are inaccurate, incomplete, improperly formatted or delinquent, or by their failure to provide reports of use altogether. Kessler WDT at 13, SX Trial Ex. 5.

668. There is widespread noncompliance with the Judges' regulations among webcaster licensees. Among other problems, many services have not historically and still do not regularly provide reports of use or have submitted defective reports of use. Kessler WDT at 13, SX Trial Ex. 5. For example, in past years, RealNetworks failed to provide reports of use. This failure to comply with basic reporting requirements has caused SoundExchange to expend time and money to get RealNetworks to fulfill its obligations and prevents the prompt distribution of royalties. Kessler WDT at 13, SX Trial Ex. 5.

669. In addition to missing or defective reports of use, many services fail to provide the required statement of account or other necessary documentation with their payments, or are paying at an improper rate. All of this has the effect of delaying distribution. Kessler WDT at 13-14, SX Trial Ex. 5; 8/2/10 Tr. 443:4-10 (Funn).

670. SoundExchange has taken a number of steps to address these problems. It applies increased pressure on services to supply missing reports of use and to provide more compliant reports of use. It works with licensees to improve their reporting compliance. It also assigns more SoundExchange staff to focus their attention on resolving problems with logs, and reallocates members of its software development team to data and distribution activities. However, all such efforts require SoundExchange's attention, time and money -- all of which could be devoted to its core mission of collecting and distributing royalties. Kessler WDT at 13-14, SX Trial Ex. 5.

## XIV. SECTION 112 ROYALTY FOR EPHEMERAL COPIES

671. The record in this proceeding unanimously supports SoundExchange's proposal of a bundled rate for both the Sections 112 and 114 rights, five percent (5%) of which shall be allocated as the Section 112 royalty for the making of ephemeral copies.

### A. The Stipulation Between SoundExchange and Live365

672. The Parties submitted a joint proposal for a single bundled rate with a percentage attributable to the Section 112 license and a percentage attributable to the Section 114 license. *Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings*, at 2 (May 14, 2010). In that stipulation, the Parties proposed that "[t]he royalty payable under 17 U.S.C. § 112(e) for the making of all ephemeral recordings used by the licensee solely to

facilitate transmissions for which it pays royalties shall be included within and constitute 5% of the total royalties payable under §§ 112 and 114." *Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings*, at 2 (May 14, 2010).

673. In support of the bundled rate structure initially proposed by SoundExchange, Live365 stated that it

> concurs with SoundExchange that a bundled rate structure is consistent with 17 U.S.C. § 114(g) and with the determination by the Register of Copyrights in the SDARS proceeding with respect to assigning a value for the Section 112 license. In addition, Live365 agrees with SoundExchange's request that the Section 112 and 114 royalty rates not be unbundled. To unbundle the rates will cause confusion in the marketplace, and is otherwise unnecessary.

*Live365's Comments on SoundExchange's Brief Concerning the Bundled Rate Structure for Section 112 and 114 Royalties*, at 1 (May 5, 2010).

674. More recently, IBS -- the only other party participating in this proceeding -- joined forces with SoundExchange and Live365 and proposed an ephemeral rate "as proposed by SoundExchange." *Amplification of IBS' Restated Rate Proposal*, at 2 (July 27, 2010).

675. There is no evidence in the record suggesting that the Parties' stipulation and unanimous agreement should not be adopted. To the contrary, and as explained below, all of the evidence in the record supports it.

**B. Ephemeral Copies Have Value.**

676. As an initial matter, "webcasters must have both the ephemeral copy right as well as the performance right in order to operate their services." Ford WDT at 10, SX Trial Ex. 4. Accordingly, Dr. Ford concluded that "[e]phemeral copies have economic value to services that publicly perform sound recordings because these services cannot as a practical matter properly function without those copies." Ford WDT at 9, SX Trial Ex. 4.

677. McCrady similarly explained that the ephemeral right is "a valuable right within our arsenal." 4/22/10 Tr. 729:11-12 (McCrady). When WMG negotiates agreements with webcasters, those "services need both an ephemeral right and a performance right," and McCrady stated that he had "not yet encountered a situation where a service came to us seeking only the ephemeral right and not the performance right along with it." 4/22/10 Tr. 729:16-22 (McCrady). WMG structures its deals such that each right is granted separately. 4/22/10 Tr. 730:4-9 (McCrady); McCrady WDT, Ex. 4 and 6, SX Trial Ex. 7.

### C. The Ephemeral Royalty Typically Is Bundled with the Correlative Section 114 Royalty and Is Expressed as a Percentage Thereof.

678. Historically,

> in the marketplace deals between record companies and webcasters for non-statutory forms of licenses, it is typical for ephemeral copy rights to be expressly included among the grant of rights provided to the webcaster. Most these agreements do not set a distinct rate for those ephemeral copies, incorporating them instead into the overall rate that the webcaster pays for the combined ephemeral copy rights and performance rights.

Ford WDT at 10-11, SX Trial Ex. 4.

679. McCrady also explained that, although WMG grants the ephemeral right and the performance right separately in its marketplace agreements, "ultimately the rate that we set is a blended rate for the two." 4/22/10 Tr. 730:7-11 (McCrady). And Dr. Pelcovits confirmed, in response to a direct question from Judge Wisniewski, that "every marketplace agreement that I obtained from the record companies contains a single, bundled rate structure for the rights granted by the record companies to the services, including the right to make necessary ephemeral copies and the right to perform the sound recordings," and that the effective per-play rate he derived therefore "represents the bundled per-play value in the interactive streaming market for

both the performance right and the ephemeral right." *Post-Hearing Responses to Judges' Questions by Michael D. Pelcovits*, at 5 (May 21, 2010); 4/19/10 Tr. 163:1-12 (Pelcovits).

680. In turn, Dr. Ford observed that "marketplace benchmarks show that the royalty rate for ephemeral copies, if directly established, is almost always expressed as a percentage of the overall royalty rate for combined activities under Sections 112 and 114." Ford WDT at 9-10, SX Trial Ex. 4. In this regard, the "marketplace has spoken with near unanimity in structuring the Section 112(e) ephemeral reproduction license as a percentage of the Section 114 performance royalty where such performance royalty is established." Ford WDT at 12, SX Trial Ex. 4.

681. As Dr. Ford explained, there are "numerous voluntary agreements between willing buyers and willing sellers in which the rate for the ephemeral reproduction license was expressed as a percent of the performance royalty." Ford WDT at 12, SX Trial Ex. 4. He described as one specific example as "a current agreement between a major record label and a webcaster that covers ad-supported internet radio service, subscription radio service, and on-demand streaming and recites the parties' agreement that a fixed percentage of the royalty payments made under the agreement shall be designated as payment for ephemeral copies." Ford WDT at 11, SX Trial Ex. 4.

### D. The Results of the Negotiation Between the Record Companies and the Artists Represents the Appropriate Marketplace Rate.

682. As Dr. Ford explained, "the willing buyer / willing seller market analysis suggested by Section 112(e) for ephemeral rates must reflect th[e] statutory alteration to the market dynamics whereby the artists and the record companies jointly have a real interest in negotiating the Section 112(e) rate while the webcasters (as the willing buyers) do not." Ford WDT at 14, SX Trial Ex. 4.

683. More specifically, where (as they have been everywhere) the Sections 112 and 114 royalties are bundled, the willing buyer/willing seller *rate* required by statute is that bundled rate about which Dr. Pelcovits and others have testified at length. The *allocation* of that bundled rate between the Sections 112 and 114 rights that would obtain in a willing buyer/willing seller transaction, however, would be the allocation negotiated not with the webcasting services, but between the copyright owners and the artists. As Dr. Ford explained,

> the only actors in the hypothetical three-party market established by the statute - webcasters, record companies, and artists - that have any economic interest in the measure of that allocation are the artists and the copyright owners, the agreement reached between them as to that allocation is the best measure of how a willing buyer and a willing seller would allocate royalty payments between performance royalties and ephemeral copies, and would value the ephemeral license in the course of a marketplace negotiation for public performances.

Ford WDT at 10, SX Trial Ex. 4.

684. McCrady reiterated this point in his testimony, explaining that "the only other interested party really that I've ever negotiated with on this issue is with the artists' side of the SoundExchange board who have very strong interests in what the relative weighting of those two would be." 4/22/10 Tr. 731:1-6 (McCrady).

685. And, of course, the fact that Live365 and IBS have agreed to the allocation arrived at by the artists and copyright owners essentially proves the point. *Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings* at 2 (May 14, 2010); *Amplification of IBS' Restated Rate Proposal*, at 2 (July 27, 2010).

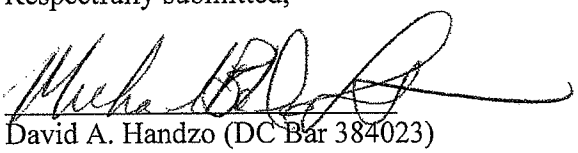
686. The evidence in the record in this proceeding shows that at the September 23, 2009 meeting of the SoundExchange Board of Directors, the "Board agreed that SoundExchange

was authorized to adopt an ephemeral rate of 5% as outlined above." Live365 Trial Ex. 19 at 2. The decision was unanimous. Live365 Trial Ex. 19 at 2.

687. As a result of the fact that the SoundExchange Board is split evenly between artists and copyright owners, its negotiated rate of 5% for ephemerals is appropriate evidence of the market rate. 4/20/10 Tr. 434:9-13 (Ford). Indeed, the 5% allocation to Section 112(e) activities "credibly represents the result that would in fact obtain in a hypothetical marketplace negotiation between a willing buyer and the interested willing sellers under the relevant constraints." Ford WDT at 15, SX Trial Ex. 4.

688. In the end, the Register made clear in its 2008 review of the *SDARS* decision that nothing prohibits the Copyright Royalty Judges from bundling the Section 114 and 112 royalties where they specify the percentage that is attributable to each license. *Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. at 9,143 (Feb. 19, 2008). The Judges adopted the same rate structure in the recent resolution of the remand of the *SDARS* proceeding, Docket No. 2006-1 CRB DSTRA, with 5% of the bundled royalty attributable to the Section 112 license and 95% attributable to the Section 114 license. *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 75 Fed. Reg. 5,513 (Feb. 3, 2010); *see also Digital Performance Right in Sound Recordings and Ephemeral Recordings for a New Subscription Service*, 75 Fed. Reg. 14,074 at 14,075 (adopting the same rate structure in Docket No. 2009-2 CRB New Subscription II). The record in this proceeding provides every reason to follow that same approach here and no reason to deviate from it.

Respectfully submitted,



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September 10, 2010

**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

| | |
|---|---|
| In the Matter of:<br><br>Digital Performance in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

# PROPOSED CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.


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September 10, 2010

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## CONCLUSIONS OF LAW

1. The purpose of this proceeding is to set rates and terms for two complementary statutory licenses created by the Digital Millennium Copyright Act ("DMCA") for eligible nonsubscription transmission services and new subscription services: (1) the performance license, 17 U.S.C. § 114, which permits eligible webcasters to perform sound recordings over the Internet; and (2) the ephemeral reproduction license, 17 U.S.C. § 112(e), which permits webcasters to make multiple temporary copies of sound recordings to facilitate such performances.

2. The Copyright Royalty Judges ("Judges," "CRJs" or "this Court") must set the rates and terms that will apply from January 1, 2011, through December 31, 2015. 17 U.S.C. § 804(b)(3)(A).

3. Pursuant to 17 U.S.C. § 803(a)(1), the Judges "shall act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress, the Register of Copyrights, and the Copyright Royalty Judges" to the extent those determination are not inconsistent with a decision of the Register pursuant to Section 802(f)(1) or decisions of the court of appeals.

## I. LEGAL ISSUES AFFECTING THE PROPOSED RATES

### A. The Willing Buyer/Willing Seller Standard

4. Section 114(f)(2)(B) of the Copyright Act requires the CRJs to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." Section 112(e)(4) requires the CRJs

to "establish rates that most clearly represent the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller."

5. Section 114 provides that in setting rates and terms, the CRJs shall base their decision "on economic, competitive and programming information presented by the parties," including the following:

> (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
>
> (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

17 U.S.C. § 114(f)(2)(B).

6. As this Court has held, the willing buyer/willing seller standard encompasses consideration of these factors. *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, Docket No. 2005-1 CRB DTRA, *Final Rule and Order*, 72 Fed. Reg. 24,084, 24,092 (May 1, 2007) ("*Webcasting II*"). In *Webcasting II*, this Court adopted a benchmarking approach to rate-setting and held that "we agree with Webcaster I that such considerations 'would have already been factored into the negotiated price' in the benchmark." 72 Fed. Reg. at 24,092 (citation omitted). In that circumstance, the Court declined to adjust the benchmark because it found that the § 114(f)(2)(B) factors were "implicitly accounted for in the rates that result from negotiations between the parties in the benchmark marketplace," and that no additional adjustment was supported by the evidence. 72 Fed. Reg. at 24,095.

7. Section 114(f)(2)(B) further states that "[i]n establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements . . . ."

8. As this Court has explained, the willing buyer/willing seller standard does not require that the rate ultimately set preserve the business of every webcaster:

> It must be emphasized that, in reaching a determination, the Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners. Furthermore, it would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act.

*Webcasting II*, 72 Fed. Reg. at 24,088 n.8.

**B. The Hypothetical Market**

9. The statutory directive to set rates and terms that "would have been negotiated" in the marketplace between a willing buyer and a willing seller requires the CRJs to replicate rates and terms that would have been negotiated in a hypothetical marketplace. The market is hypothetical because the actual marketplace for sound recordings sold to statutory webcasters is preempted by the compulsory license that is the subject of this proceeding. *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, at 21, No. 2000-9 CARP DTRA 1&2 (CARP Feb. 20, 2002). The Judges therefore are called upon to establish a rate that would exist in this market if the parties were not subject to a statutory compulsory license.

10. In *Webcasting II*, the Judges held "that in the hypothetical marketplace that would exist in the absence of a statutory license constraint, the willing sellers are the record companies." 72 Fed. Reg. at 24,091. The Judges endorsed the conclusion from *Webcasting I* that "the willing buyers are the services which may operate under the webcasting license (DMCA-compliant services), the willing sellers are record companies and the product consists of a blanket license for each record company's complete repertoire of sound recordings." *Webcasting II*, 72 Fed. Reg. at 24,091 (quoting *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2, *Final Rule and Order*, 67 Fed Reg. 45,240, 45,244 (July 8, 2002) ("*Webcasting I*")).

11. The hypothetical market need not be characterized by "perfect" competition. *Webcasting II*, 72 Fed. Reg. at 24,091. In fact, the D.C. Circuit rejected such a claim, explaining that "[t]he statute does not require that the market assumed by the Judges achieve metaphysical perfection in competitiveness." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 757 (D.C. Cir. 2009).

12. The question of competition "is concerned with whether market prices can be unduly influenced by sellers' power or buyers' power in the market." *Webcasting II*, 72 Fed. Reg. at 24,091. This Court has explained that an "effectively competitive market is one in which super-competitive prices cannot be extracted by sellers or buyers, because both bring 'comparable resources, sophistication and market power to the negotiating table.'" *Webcasting II*, 72 Fed. Reg. at 24,091 (quoting *Webcasting I*, 67 Fed. Reg. at 45,245). The question of competition is "not confined to an examination of the seller's side of the market alone." *Webcasting II*, 72 Fed. Reg. at 24,091.

13. Nothing in the DMCA, the Digital Performance Right in Sound Recordings Act ("DPRSRA") or their legislative history suggests that Congress believed the recording industry is insufficiently competitive or that Congress was calling for rates based on a hypothetical market in which sound recording copyright owners would have less bargaining power than they currently do. There is literally nothing in the statute itself or the conference reports discussing the willing buyer/willing seller standard to support that conclusion.

14. Indeed, Congress made quite clear in the DPRSRA, the DMCA, and their legislative histories that it believed that real world agreements between individual copyright owners and digital music services for both non-interactive and interactive (or on-demand) licenses to perform sound recordings were outcomes that were to be encouraged, not attacked as the product of a non-competitive market. For example:

- Congress specified in the statute that voluntary agreements between copyright owners and digital music services were to be encouraged, 17 U.S.C. § 114 (f)(2)(A), that such agreements are to be considered by the Judges in setting rates and terms for the statutory license, 17 U.S.C. § 114(f)(2)(B), and that such agreements "voluntarily negotiated at any time between 1 or more copyright owners of sound recordings and 1 or more entities performing sound recordings shall be given effect in lieu of any decision by the Librarian of Congress or determination by the Copyright Royalty Judges." 17 U.S.C. § 114(f)(3).

- Congress expressly authorized copyright owners to use common agents to negotiate voluntary license agreements. 17 U.S.C. § 114(e)(1).

- In the legislative history of the DPRSRA, Congress expressly considered placing limitations on interactive services and did so only where sound recording copyright owners offered exclusive licenses only. Congress expressly determined not to limit the authority of copyright owners to license interactive services on a non-exclusive basis. As the Senate explained in its Conference Report, "no limitations are imposed where the sound recording copyright owner licenses an interactive service on a nonexclusive basis." Rather, to the extent that there are "concerns that the copyright owners of sound recordings might become 'gatekeepers' and limit opportunities for public performances of the musical works embodied in the sound recordings," Congress specifically concluded that the limitations on exclusive licensing "set forth in subsection [17 U.S.C. § 114(d)(3)] appropriately resolve any such concerns." P.L. 104-39, Digital

Performance Right in Sound Recordings Act, Senate Report No. 104-128, at 25 (Aug. 4, 1995).

15. Nor is this a case in which the record companies have so much market power that no real-world competitive markets exist. There are in fact real-world markets in which the record companies bargain with webcasting services for sound recording licenses not covered by this or other compulsory licenses. The statute does not contemplate courts "correcting" these real-world market rates to account for imagined imperfections in real-world markets.

16. It would be unwise to eschew reliance on actual deals in the industry. For one thing, such deals are the most reliable way to predict market rates. "[I]t is extraordinarily difficult to predict marketplace results from purely theoretical premises, [and therefore] it is clearly safer to rely upon the outcomes of actual negotiations than upon academic predictions of rates those negotiations might produce." *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, at 43, No. 2000-9 CARP DTRA 1&2 (CARP Feb. 20, 2002); *see also Webcasting I*, 67 Fed. Reg. at 45,247.

**C. Benchmarking**

17. In prior proceedings, this Court has consistently relied on a benchmark approach to setting rates. *E.g.*, *Webcasting II*, 72 Fed. Reg. at 24,095-96; *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, Docket No. 2006-1 CRB DSTRA, *Final Rule and Order*, 73 Fed. Reg. 4,080, 4,093-94 (Jan. 24, 2008) ("*SDARS*").

18. Where the willing buyers are the services that may operate under the webcasting statutory license, the willing sellers are record companies, and the product consists of a blanket license, it follows that the most relevant benchmarks for the setting of rates are prices for other blanket licenses for the use of sound recordings.

19. In *Webcasting II*, SoundExchange presented an interactive services benchmark, as analyzed by Dr. Pelcovits. This Court concluded that the Pelcovits benchmark was "of the comparable type that the Copyright Act invites us to consider," and the "most appropriate" benchmark presented to it. *Webcasting II*, 72 Fed. Reg. at 24,092. Accordingly, this Court held that the Pelcovits benchmark supported the usage rates proposed by SoundExchange, and used the benchmark as the basis for the rates it set. *Webcasting II*, 72 Fed. Reg. at 24,095-96.

20. The Court explained its reasons for accepting the Pelcovits benchmark in *Webcasting II*. The Court found that the "interactive webcasting market is a benchmark with characteristics reasonably similar to non-interactive webcasting, particularly after Dr. Pelcovits' final adjustment for the difference in interactivity." *Webcasting II*, 72 Fed. Reg. at 24,092. The Court observed that "[b]oth markets have similar buyers and sellers and a similar set of rights to be licensed (a blanket license in sound recordings." *Webcasting II*, 72 Fed. Reg. at 24,092. The Court further explained the suitability of the Pelcovits benchmark as follows:

> Both markets are input markets and demand for these inputs is driven by or derived from the ultimate consumer markets in which these inputs are put to use. In these ultimate consumer markets, music is delivered to consumers in a similar fashion, except that, as the names suggest, in the interactive case the choice of music that is delivered is usually influenced by the ultimate consumer, while in the noninteractive case the consumer usually plays a more passive role. . . . But this difference is accounted for in Dr. Pelcovits' analysis.

*Webcasting II*, 72 Fed. Reg. at 24,092.

21. In this proceeding, SoundExchange has presented substantially the same Pelcovits interactive benchmark (updated with more recent information) with a similar interactivity adjustment in support of its rate proposal that it presented -- and that the Judges relied on it setting rates -- in the *Webcasting II* proceeding.

22. There is no basis for reaching a different conclusion with respect to the Pelcovits interactive benchmark in this proceeding. This Court should again rely on this benchmark.

23. By contrast, Live365 has chosen not to present a benchmarking approach. 4/27/10 Tr. 1104:1-21, 1124:1-14 (Fratrik).

**D. The WSA Agreements**

24. In addition to his interactive services benchmark, Dr. Pelcovits also uses in his analysis the rates for broadcasters negotiated by SoundExchange with the National Association of Broadcasters (the "NAB Agreement") and the rates for other commercial webcasters negotiated by SoundExchange with Sirius XM (the "Commercial Webcasters Agreement"). Live365 does not contest that reliance on these agreements is appropriate as a matter of law.

25. SoundExchange's reliance on these agreements is consistent with Section 114's directive that the Judges may consider rates and terms contained in voluntary license agreements for comparable services. 17 U.S.C. § 114(f)(2)(B). Here, of course, the NAB Agreement and Commercial Webcasters Agreement are for the very same category of statutory services.

26. Reliance on these agreements is also consistent with the Webcaster Settlement Act ("WSA") of 2008, which was extended in 2009. The WSA permitted SoundExchange and webcasters to negotiate settlements of ongoing disputes arising out of the royalty rates that were set by the Judges for the time period 2006-2010, and also permitted SoundExchange to negotiate royalty rates for the time period 2011-2015. McCrady WDT at 3, SX Trial Ex. 7; 17 U.S.C. § 114(f)(5)(A).

27. Congress's purpose in enacting the WSA was to facilitate settlements. Congress recognized that the unique business models and circumstances of some webcasters might require experimental settlements. It therefore provided that WSA agreements "shall be considered a compromise motivated by the unique business, economic and political circumstances of

webcasters, copyright owners, and performers rather than as matters that would have been negotiated between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(5)(C).

28. Congress recognized that if settlements were automatically deemed precedential in future rate-setting proceedings, the parties might be deterred from entering into creative and novel agreements that otherwise might benefit the signatories and the industry, and avoid further litigation and political disputes concerning webcasting rates. Accordingly, Congress provided that, unless the parties indicated otherwise, the "rate structure, fees, terms, conditions, or notice and recordkeeping requirements" of such agreements shall not be "admissible as evidence or otherwise taken into account" in rate-setting proceedings. 17 U.S.C. § 114(f)(5)(C).

29. Congress then made clear, however, that "[t]his subparagraph [§ 114(f)(5)(C)] shall not apply to the extent that the receiving agent and a webcaster that is party to an agreement entered into pursuant to subparagraph (A) expressly authorize the submission of the agreement in a proceeding under this subsection." 17 U.S.C. § 114(f)(5)(C).

30. The NAB Agreement and Commercial Webcasters Agreement expressly authorize their submission in rate setting proceedings. McCrady WDT, Ex. 101-DP at § 6.3, SX Trial Ex. 7; McCrady WDT, Ex. 102-DP at § 5.3, SX Trial Ex. 7. Accordingly, by its own terms § 114(f)(5)(C) does not apply to them and, by Congress's express design, their terms can and should be considered here. 17 U.S.C. § 114(f)(2)(B); 17 U.S.C. § 114(f)(5)(C).

31. It follows that, also by the statute's express terms, the strictures of § 114(f)(5)(C) *do apply* to any agreement made under the WSA that *does not* expressly authorize its submission in future rate setting proceedings. Accordingly, as the Judges have recognized throughout this proceeding, the rates and terms of those agreements are not admissible and cannot be considered here.

32. The WSA thus required the Judges to exclude evidence about the rate structures, fees, terms, conditions or notice and recordkeeping requirements of non-precedential WSA agreements from the record in this proceeding. Nor may the Judges take such information into account in reaching their final determination.

### E. The Ephemeral Royalty

33. The Parties' joint proposal of a bundled rate for both the Sections 112(e) and 114 statutory licenses, five percent (5%) of which shall be allocated as the Section 112(e) royalty for the making of ephemeral copies, is consistent with all applicable law and should be adopted.

#### 1. The Stipulation Between SoundExchange and Live365

34. SoundExchange and Live365 have submitted a joint proposal for a single bundled rate with a percentage attributable to the Section 112(e) license and a percentage attributable to the Section 114 license. *Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings*, at 2 (May 14, 2010).

35. In that stipulation, the Parties proposed that "[t]he royalty payable under 17 U.S.C. § 112(e) for the making of all ephemeral recordings used by the licensee solely to facilitate transmissions for which it pays royalties shall be included within and constitute 5% of the total royalties payable under §§ 112 and 114." *Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings*, at 2 (May 14, 2010).

36. In support of the bundled rate structure initially proposed by SoundExchange, Live365 stated that it

> concurs with SoundExchange that a bundled rate structure is consistent with 17 U.S.C. § 114(g) and with the determination by the Register of Copyrights in the SDARS proceeding with respect

> to assigning a value for the Section 112 license. In addition, Live365 agrees with SoundExchange's request that the Section 112 and 114 royalty rates not be unbundled. To unbundle the rates will cause confusion in the marketplace, and is otherwise unnecessary.

*Live365's Comments on SoundExchange's Brief Concerning the Bundled Rate Structure for Section 112 and 114 Royalties*, at 1 (May 5, 2010); *see also Brief of SoundExchange Concerning its Bundled Rate Structure for Section 112 and 114 Royalties* (May 5, 2010) (which SoundExchange expressly incorporates herein by reference).

37. More recently, IBS -- the only other party participating in this proceeding -- joined forces with SoundExchange and Live365 and proposed an ephemeral rate "as proposed by SoundExchange." *Amplification of IBS' Restated Rate Proposal*, at 2 (July 27, 2010).

**2. The Parties' Proposal Is Consistent with Sections 112(e) and 114.**

38. The Register made clear in her 2008 review of the *SDARS* decision that nothing prohibits the Copyright Royalty Judges from bundling the Section 114 and 112(e) royalties when the percentage that is attributable to each license is specified. *Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. 9,143 (Feb. 19, 2008). Indeed, the Judges adopted the same rate structure in the recent resolution of the remand of the *SDARS* proceeding, Docket No. 2006-1 CRB DSTRA, with 5% of the bundled royalty attributable to the Section 112(e) license and 95% attributable to the Section 114 license. *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 75 Fed. Reg. 5,513 (Feb. 3, 2010). That resolution has been reviewed by the Register, and the Register did not question that aspect of the Judges' decision. The Judges also adopted the same rate structure in Docket No. 2009-2 CRB New Subscription II. *Digital Performance Right in Sound Recordings and Ephemeral Recordings for a New Subscription Service*, 75 Fed. Reg. 14,074 at 14,075. There is no reason not to adopt the same rate structure here.

39. Here, like those prior cases, while the Parties propose that the two royalties be bundled together, the Section 112 and 114 royalties are nevertheless separate components of the bundled royalty, and neither component is included in the other. Thus, the Parties are proposing a bundled rate covering both Sections 112 and 114, of which 5% is the Section 112 royalty and 95% is the Section 114 royalty.

40. This is consistent with Section 114(g). Nothing in Section 114(g) circumscribes the setting of Section 112 rates or precludes a bundled Section 112 and 114 rate as long as a percentage allocation is provided. Section 114(g) addresses the distribution of Section 114 royalties. Section 114(g)(2) specifies that SoundExchange, as an agent designated to distribute receipts from statutory performance licensing, is to distribute Section 114 royalties to copyright owners and performers in accordance with a specified formula. 17 U.S.C. § 114(g)(2) (*e.g.*, 50% to copyright owners; 45% to featured artists; 2.5% each to nonfeatured musicians and nonfeatured vocalists).

41. By contrast, Section 112(e) has no corresponding provision. In the absence of a comparable statutory allocation of Section 112 royalties, Section 112 royalties are to be distributed to copyright owners. As the Register of Copyrights has explained:

> [T]he beneficiaries of the section 114 license are not identical to the beneficiaries of the section 112 license. Royalties collected under section 114 are paid to the performers and the copyright owners of the sound recordings, i.e., usually the record companies; whereas, the royalties collected pursuant to the section 112 license are not paid to performers.

*Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. 9,143, 9,146 (Feb. 19, 2008).

42. Section 114(g) does not govern the setting of Section 112 rates, because Section 114(g) addresses only the distribution of royalties – an activity that occurs after rates are set –

and only as to payments made under Section 114. *See* 17 U.S.C. § 114(g)(2) (prescribing an allocation of "receipts from the licensing of transmissions in accordance with subsection (f)").

43. Although the Judges could not lawfully adopt terms calling for distribution of Section 114 royalties in proportions different than what is provided in Section 114(g), that is not what the Parties are proposing to do in this proceeding. They are proposing a bundled rate covering both Sections 112 and 114, of which 5% is allocable to Section 112 and 95% is allocable to Section 114. So understood, there is no conflict between the structure of the Parties' joint proposal and Section 114(g). If the proposal were adopted, SoundExchange would distribute 5% of its receipts (the portion allocable to Section 112) to copyright owners pursuant to Section 112 and the other 95% of its receipts (the portion allocable to Section 114) in accordance with Section 114(g). 4/21/10 Tr. 550:3-552:18 (Kessler) (testifying about the distribution of Section 112 and Section 114 royalties).

44. This is how the current SDARS royalties function, and is fully consistent with the Register's decision reviewing the Judges' *SDARS* determination. The 2007-2012 SDARS rates are bundled rates just as SoundExchange proposes here. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 75 Fed. Reg. 5,513 (Feb. 3, 2010) (redesignating what is now 37 C.F.R. § 382.12(a) and therein referring to rates "for the public performance of sound recordings pursuant to 17 U.S.C. § 114(d)(2) and the making of any number of ephemeral phonorecords"). The bundled rates are then allocated between Sections 112 and 114 in the same manner as SoundExchange has proposed here. *Id.* (adding new 37 C.F.R. § 382.12(b) stating that "[t]he royalty payable under 17 U.S.C. § 112(e) for the making of phonorecords used by the Licensee solely to facilitate transmissions during the

Term for which it pays royalties as and when provided in this subpart shall be included within, and constitute 5% of, such royalty payments").

45. As noted, the Judges also adopted the same rate structure in Docket No. 2009-2 CRB New Subscription II. *See* 75 Fed. Reg. 14,074, 14,075 (Mar. 24, 2010).

46. In the *SDARS* proceeding, there initially was a bundled rate without a particular percentage designated "as representative of the value of the Section 112 license." 73 Fed. Reg. 4,080, 4,098 (Jan. 24, 2008). The Register then determined such resolution "*without specifying what percentage, if any, is attributable to the section 112 license*, does not fulfill the Copyright Royalty Judges' responsibility to determine the value of the section 112 license for ephemeral copies." *Review of Copyright Royalty Judges Determination*, 73 Fed. Reg. 9,143, 9,146 (Feb. 19, 2008) (emphasis added).

47. On appeal, the U.S. Court of Appeals for the D.C. Circuit accepted the Register's determination and remanded the matter to the Judges. *SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220, 1226 (D.C. Cir. 2009). A settlement reached between the parties and adopted by the Judges resulted in the percentage allocation described above.

48. The Register's decision in the *SDARS* proceeding clearly contemplates that bundling the Section 112 and 114 royalties and having a percentage allocation, as the Parties propose here, is permissible. Instead, the problem cited by the Register was the adoption of a bundled royalty without identifying the percentage allocation between Sections 112 and 114. The Parties' proposed rate structure in this proceeding is fully consistent with the Register's review of the *SDARS* decision.

49. At the hearing, Judge Wisniewski inquired about the possibility of unbundling the Section 112 and 114 rates by multiplying the proposed rates by 5% and 95% and listing the

results separately. 4/19/10 Tr. 25:13-18. As a purely mathematical matter Judge Wisniewski is of course correct that a bundled rate could be separated into equivalent separate rates by multiplying every payment amount by 5% and 95%. Thus, for example, it would be mathematically possible to provide that SoundExchange's proposed minimum fee is $25 per channel or station for Section 112 and $475 per channel or station for Section 114 (subject, in the case of commercial webcasters, to caps of $2,500 and $47,500), and that the 2011 commercial webcaster Section 112 royalty is $0.000105 per performance and the 2011 commercial webcaster Section 114 royalty is $0.001995. However, as the foregoing example makes clear, doing so would expand and complicate the rate schedule, cause confusion among licensees, impose considerable burden on SoundExchange, and bring no practical benefits to the licensees or payees.

50. Were the Judges to adopt separate rate schedules, SoundExchange would need to redesign its Statements of Account and other forms, and separately account for receipts, to reflect the new structure. In addition, licensees would be confused by the need to make two separately-identified payments for what they may view as the same activity, and SoundExchange would need to devote resources to dispelling the confusion. The trial of this proceeding illustrated that it is hard enough to get webcasters to pay the correct royalties when a single payment amount is stated. Introducing substantial new complexity into the rate structure can only exacerbate those problems.

51. Unbundling the Section 112 and 114 rates has been tried before. The 1998-2002 webcasting rate regulations specified rates for webcast performances, 37 C.F.R. § 261.3(a)(1), (2), and provided that the Section 112 royalty was an 8.8% surcharge on the performance royalty, 37 C.F.R. § 261.3(c). For 2003-2005, there was a consensus to move away from that

bifurcated rate structure to a simpler bundled rate structure under which SoundExchange would unbundle the Section 112 and 114 royalties as part of its distribution process. Doing so benefited everyone involved. Section 114(g) does not require a more complicated bifurcated rate structure, and there is no reason the Judges should return to that structure now.

52. Here, the Parties agree that to unbundle the rates will cause confusion in the marketplace, and is otherwise unnecessary. *Live365's Comments on SoundExchange's Brief Concerning the Bundled Rate Structure for Section 112 and 114 Royalties*, at 1 (May 5, 2010).

**F. Minimum Fee**

53. The Court must include, as part of the rates that it sets, "a minimum fee for each such type of service." 17 U.S.C. § 114(f)(2)(B) and 17 U.S.C. § 112(e)(4).

54. As this Court observed in *Webcasting II*, the *Webcasting I* decision "affirmed the notion that all webcasters -- all Noncommercial Webcasters as well as all Commercial Webcasters -- should pay the same minimum fee for the same license." *Webcasting II*, 72 Fed. Reg. at 24,099.

55. The D.C. Circuit, citing *Webcasting I*, has stated that a certain minimum fee can be justified on the basis that it "cover[s] 'administrative costs of the copyright owners in administering the license.'" *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 761 (D.C. Cir. 2009). Consistent with that statement, in setting the minimum fee in the *Webcasting II* remand, this Court relied in part on SoundExchange's evidence of its administrative costs. *See Amendment to Determination Pursuant to Remand Order*, at 7, Docket No. 2005-1 DTRA (June 30, 2010).

56. In this proceeding, SoundExchange has presented similar of its administrative costs, as well as other evidence supporting its minimum fee proposal.

## II. OTHER LEGAL ISSUES

### A. Designation of the Collective

57. In *Webcasting II*, the Judges found "that selection of a single Collective represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses." *Webcasting II*, 72 Fed. Reg. at 24,104. Furthermore, the D.C. Circuit held that "in selecting SoundExchange as the sole collective, the Judges fulfilled Congress's expectation that they would designate a single entity to receive royalty payments from licensees." *Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 574 F.3d 748, 771 (D.C. Cir. 2009).

58. In *Webcasting II*, the Judges designated SoundExchange "as the Collective to receive statements of account and royalty payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g)." 37 C.F.R. § 380.4(b). *See Webcasting II*, 72 Fed. Reg. at 24,105 ("SoundExchange is the superior organization to serve as the Collective for the 2006-2010 royalty period.").

59. In the *SDARS* proceeding, the Judges again designated SoundExchange as the Collective, noting that no party had requested the designation of multiple collectives, no other party requested to be selected as the Collective, no party opposed SoundExchange's designation, and that SoundExchange had a "track record of serving as the Collective." *SDARS*, 73 Fed. Reg. at 4,099.

60. The same circumstances are true here. No party other than SoundExchange has requested to be selected as the Collective, no party has proposed multiple collectives, no party has opposed the designation of SoundExchange as the Collective, and SoundExchange has presented evidence of its proven track record of administering the statutory licenses efficiently

and in the best interests of royalty recipients. Accordingly, SoundExchange should be designated as the sole Collective for 2011-2015.

**B. Terms**

61. Sections 112(e)(3) and 114(f)(2)(A) require the CRJs to adopt terms for the Section 112 and 114 statutory licenses. The willing buyer/willing seller standard applies to the setting of terms. *Webcasting II*, 72 Fed. Reg. at 24,102.

62. This Court has concluded that in setting terms, it "should consider matters of feasibility and administrative efficiency." *Webcasting II*, 72 Fed. Reg. at 24,102; *see also SDARS*, 73 Fed. Reg. at 4098 ("As we stated in Webcaster II, we are obligated to 'adopt royalty payment and distribution terms that are practical and efficient.'").

63. This Court has also emphasized the importance of consistency of terms across statutory licenses. This Court has stated that in adopting terms, "we seek to maintain consistency across the licenses set forth in Sections 112 and 114. Consistency promotes efficiency thereby reducing the overall costs associated with the administration of the licenses." *SDARS*, 73 Fed. Reg. at 4,098-99. Although terms across the statutory licenses may vary, the "burden is upon the parties to demonstrate the need for and the benefits of variance." *Id.* at 4,099.

64. In this proceeding, in the interests of consistency and efficiency, SoundExchange has in large part sought the same terms that this Court previously set in the *Webcasting II* and *SDARS* proceedings. Where SoundExchange has sought new or revised terms, it has demonstrated why such variances are necessary and beneficial.

65. One new term that SoundExchange has proposed is a late fee for the untimely submission of reports of use. During the direct case hearing, Judge Roberts inquired about the statutory authority for the Court to set late fees for reports of use. 4/20/10 Tr. 458:3-10.

66. Section 803(c)(7) of the Copyright Act provides that the Judges "may include terms with respect to late payment," which is a permissive, but not limiting, grant of authority. Nothing in this provision or any other provision of the governing statutes precludes the Court from setting late fees for reports of use.

67. Indeed, this Court has set late fees for statements of account in the *Webcasting II* and *SDARS* proceedings, even though nothing in the governing statutes expressly directs the Judges to do so. *See* 37 C.F.R. § 380.4(e), 382.13(d). There is no difference between this Court's authority to set late fees for statements of account and its authority to set late fees for reports of use.

68. Moreover, a late fee for a report of use is a "term[] with respect to late payment." 17 U.S.C. § 803(c)(7). SoundExchange needs to receive a payment, a report of use and a statement of account from a licensee in order to distribute royalty payments. Without a report of use, a payment is essentially useless to SoundExchange. *See* 4/20/10 Tr. 444:6-16 (Kessler) ("Absent a report of use, you would not be able to allocate a payment to the royalties . . . ."); Kessler Corrected WDT at 28, SX Trial Ex. 5 ("Reports of use are at least as important to timely distribution as statements of account, which are subject to late fees.").

### C. Notice and Recordkeeping

69. In this proceeding, IBS has proposed recordkeeping requirements for noncommercial webcasters. In *Webcasting II*, however, the Court concluded that recordkeeping issues would more appropriately be addressed in a separate rule-making proceeding. *Webcasting II*, 72 Fed. Reg. at 24,110.

70. This Court then convened a separate rule-making proceeding to address recordkeeping requirements for statutory webcasters, Docket No. RM 2008-7. In that

proceeding, this Court issued final recordkeeping regulations in October 2009. 74 Fed. Reg. 52,418 (Oct. 13, 2009).

71. Those regulations established in that proceeding are final, and IBS has failed to offer any reason to re-visit recordkeeping in this proceeding

**D. Adoption of Settlements Submitted to the Judges**

72. Section 801(b)(7)(A) authorizes the CRJs "[t]o adopt as a basis for statutory terms and rates . . . an agreement concerning such matters reached among some or all of the participants in a proceeding at any time during the proceeding."

73. Pursuant to § 801(b)(7), SoundExchange submitted two settlements to the Judges for publication and adoption as the basis for statutory rates and terms: (1) an agreement with the National Association of Broadcasters ("NAB"), and (2) an agreement with College Broadcasters, Inc. ("CBI").

74. Section 801(b)(7)(A)(i) provides that the CRJs "shall provide to those that would be bound by the terms, rates, or other determination" set by the agreement an opportunity to comment and "shall provide to participants in the proceeding" that would be bound, an opportunity to object to adoption of the agreement as a basis for statutory terms and rates.

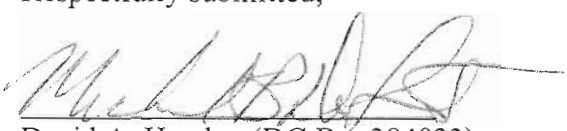
75. The Judges published the two settlement agreements with modifications in the Federal Register, and invited comments and objections. 75 Fed. Reg. 16,377 (April 1, 2010).

76. The Judges may decline to adopt an agreement as the basis for statutory terms and rates "if any participant . . . objects to the agreement and the Copyright Royalty Judges conclude, based on the record before them if one exists, that the agreement does not provide a reasonable basis for setting statutory terms or rates." 17 U.S.C. § 801(b)(7)(A)(ii).

77. The Judges also may decline to adopt settlement provisions that they find to be contrary to law. *See Review of Copyright Royalty Judges Determination*, 74 Fed. Reg. 4,537, 4,540 (Jan. 26, 2009).

78. Here, no objections were filed with respect to the NAB agreement, and nothing in the agreement is contrary to law. The statute therefore requires adoption of the settlement. With respect to the CBI agreement, IBS filed comments, but there is no basis for concluding that the CBI agreement does not provide a reasonable basis for setting rates and terms, and nothing in the agreement is contrary to law.

Respectfully submitted,



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September 10, 2010

**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

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|---|---|
| In the Matter of:<br><br>Digital Performance in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

## REDACTION LOG FOR THE PROPOSED FINDINGS OF FACT OF SOUNDEXCHANGE, INC.

Pursuant to the requirements of the Judges' September 23, 2009 Protective Order, SoundExchange, Inc. hereby submits the following list of redactions from its Proposed Findings of Fact. Attached hereto is the Declaration and Rule 11 Certification of Garrett A. Levin in support of this redaction log.

| Paragraph | General Description |
|---|---|
| ¶ 145 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreement with Napster |
| ¶ 146 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreement with Napster |
| ¶ 148 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreement with Napster |
| ¶ 151 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreements with ad-supported on-demand services |
| ¶ 152 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreement with Slacker |

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| ¶ 157 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning the "greatest of" structure in WMG streaming agreements |
| ¶ 159 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's agreement with Napster |
| ¶ 289 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's limited NAB waiver |
| ¶ 290 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's limited NAB waiver |
| ¶ 291 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's limited NAB waiver |
| ¶ 292 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning WMG's limited NAB waiver |
| ¶ 363 | Live365 filed a motion to treat this information as Restricted pursuant to the Protective Order. The motion is currently pending before the Court. |
| ¶ 366 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by Live365 |
| ¶ 441 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning Sony's financial information |
| ¶ 444 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning Sony's financial information |
| ¶ 446 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning Sony's financial information |

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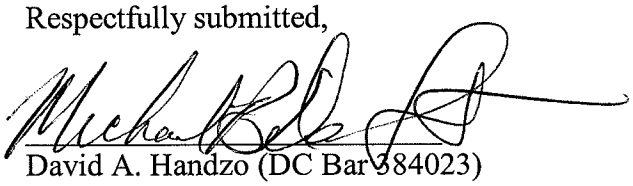
| ¶ 452 | Information admitted as Restricted by the Court pursuant to the Protective Order upon request by SoundExchange concerning Sony's financial information |

Respectfully submitted,



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September 10, 2010

**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

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|---|---|
| In the Matter of:<br><br>Digital Performance Right in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

## DECLARATION AND RULE 11 CERTIFICATION OF GARRETT A. LEVIN

I am counsel for SoundExchange, Inc. ("SoundExchange") in Docket No. 2009-1 CRB Webcasting III and authorized to submit this declaration in support of SoundExchange's Proposed Findings of Fact. I am submitting this declaration pursuant to Section 10.b of the Protective Order issued by the Court in this proceeding on September 23, 2009.

I am familiar with the materials contained in SoundExchange's Proposed Findings of Fact and have reviewed the Redaction Log (attached hereto) containing a list of the redacted material in the Proposed Findings of Fact. At the time this declaration was made, to the best of my knowledge, information, and belief, the information that has been designated as Restricted Information in the Proposed Findings of Fact either has been found by this Court to have met the definition of "Restricted" information set out in the September 23, 2009 Protective Order or is the subject of Live365's pending motion to be treated as Restricted.

Pursuant to 28 U.S.C. § 1746, I hereby declare under penalty of perjury that the foregoing is true and correct.

Garrett A. Levin

Dated: September 10, 2010

## CERTIFICATE OF SERVICE

I, Albert Peterson, do hereby certify that copies of the foregoing **Proposed Findings of Fact and Conclusions of Law of SoundExchange (Public version)** were sent via e-mail this 13th day of September, 2010, and by overnight mail on the 14th day of September, 2010, to the following:

| | |
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Albert Peterson