

Before the  
COPYRIGHT ROYALTY BOARD

In the Matter of	)	
	)	
ADJUSTMENT OF RATES AND TERMS FOR	)	Docket No. 2006-1 CRB DSTR
PREEXISTING SUBSCRIPTION SERVICES,	)	
AND	)	
SATELLITE DIGITAL AUDIO RADIO SERVICES	)	
	)	
	)	
	)	

**TESTIMONY OF DAVID J. DEL BECCARO**

My name is David J. Del Beccaro and I am the President and CEO of Music Choice. I have overseen all aspects of Music Choice since the company’s inception in 1987. I submit this testimony in connection with the above-captioned proceeding, in which the Copyright Royalty Board (“CRB”) will adjust the rates for the statutory license used by Music Choice for the public performance of sound recordings as a pre-existing subscription service pursuant to 17 U.S.C. § 114(f)(1).

**My Background**

I helped commercialize Music Choice (formerly named Digital Cable Radio Associates) beginning in 1987, when I served as Vice President, Business Development for Jerrold Communications (“Jerrold”), a division of General Instrument Corporation (“GI”). After approximately 4 years of product development and market testing within Jerrold, I helped secure financing for the digital music service concept through a partnership of major cable and music companies, beginning in 1991 when the company launched as a stand-alone entity. Between 1991 and 2000, a number of major companies became investors in the venture through various

predecessors and affiliates. Those companies are now: Comcast Corporation; Cox Communications, Inc.; EMI Music, Inc.; Motorola, Inc.; Microsoft Corporation; Sony Corporation of America; and Time Warner Inc. In my capacity as President and CEO of Music Choice over the past 15 years, I have devised, implemented and overseen various changes in the company's services and technologies, as the company has had to adapt to an increasingly difficult and competitive market for music delivery. In this time, I have become intimately familiar with various facets of the music industry, including the production and promotion of sound recordings, artist promotion, and the many forms of broadcasting and music delivery. I have been quoted in The New York Times, Associated Press, Reuters, MultiChannel News and Billboard, among other national publications on various topics related to music and technology. A list of my recent speaking engagements on these topics is submitted as Exhibit MC 1.

Prior to holding my current position, I served as the Vice President of New Business Development at Jerrold, as noted above. Before joining Jerrold, I held various marketing and financial positions at GI and Ford Motor Company. I have B.S. and M.S. degrees in Industrial Engineering from Stanford University and a B.A. in Management Engineering from Claremont McKenna College.

I am familiar with the operations of Music Choice and with its relationships with copyright owners and their representatives, including the American Society of Composers, Authors and Publishers, ("ASCAP"), Broadcast Music, Inc. ("BMI"), SESAC, Inc. ("SESAC"), the Recording Industry Association of America ("RIAA"), SoundExchange and other licensing entities. As part of my responsibilities as President and CEO of Music Choice, I also keep myself generally apprised of the copyright costs faced by similar businesses in the United States and other countries. The following testimony is based upon my personal knowledge and

information available to me in the course of performing my duties as President and CEO of Music Choice.

### **The Music Choice Service**

Music Choice's residential service that is the subject of this proceeding is a music service comprised of 53 channels of diverse audio programming. Each channel provides a distinct musical genre or sub-genre to the listener. Our service is delivered to customers primarily by cable operators as part of a package of offerings to customers in the home (e.g., the Music Choice service is included by cable operators as part of their digital basic cable service to their customers). Most customers receive between 47 and 52 of our channels through our residential service. Our programming currently reaches over 31 million residential customers across the United States.

Music Choice provides services to residential customers under the statutory license for the public performance of sound recordings by a "pre-existing subscription service" ("PES"), as that term is defined in Section 114(j)(11) of the Copyright Act. We fully comply with the sound recording performance complement, as required by the statutory license. Accordingly, we do not play more than three different selections of sound recordings from any one phonorecord within a three hour period on any of our channels. We do not consecutively play more than four sound recordings by the same artist or from a compilation set of phonorecords within a three hour period on any of our channels. We do not pre-announce our play list. We make regular reports of our programming, and regularly remit the required license fees to SoundExchange. Since the statutory license was enacted in 1995, Music Choice has paid the record labels [REDACTED] in royalties.

## Summary

As a PES, the Music Choice residential audio service is subject to a special standard under Sections 114(f)(1) and 801(b)(1) of the Copyright Act. This standard was designed to protect the business expectancies of services that were making digital performances of sound recordings prior to 1995, when the limited digital performance right for sound recordings first came into existence, and 1998, when the rate standards for certain statutory licenses were modified for other services. Consequently, PES status was granted only to three companies doing business at the time: Music Choice, DMX and Muzak. Unlike most other statutory licenses for the sound recording digital performance right, the PES license standard provides for a “reasonable royalty” that is set as a below-market rate. According to the statute, the reasonable royalty rate is set based upon evaluation of the following policy objectives:

- (A) To maximize the availability of creative works to the public.
- (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
- (C) To reflect the relative roles of the copyright owner and the copyright user with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
- (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

17 U.S.C. § 801(b)(1).

During the first rate-setting proceeding for pre-existing subscription services, commenced in 1996, the Copyright Arbitration Royalty Panel (“CARP”) initially set the royalty rate at 5 percent of gross domestic revenue from the licensed residential service. On appeal, in 1998, the Librarian of Congress adjusted the rate to 6.5 percent. That original royalty rate has not been

reevaluated through the CARP (now the CRB) process since that time. The first time the rate was subject to adjustment, Music Choice settled with SoundExchange solely to avoid the prohibitive costs associated with the CARP process. This time, settlement was not possible, as SoundExchange refused even to propose a negotiated settlement rate.

Music Choice proposes a sound recording performance license rate for our preexisting subscription service of 2.6 percent of service revenues. The original 6.5 percent rate was the product not only of a full CARP but also two levels of appeal. While the standard and method for setting the rate by the Librarian of Congress in that proceeding was upheld by the District of Columbia Circuit and remains applicable to this proceeding, the Librarian specifically noted that changed factual circumstances considered by that standard might justify adjusting the rate in future proceedings. Ten years later, every relevant change in circumstance indicates that the royalty rate should be lowered.

First, the Librarian correctly used the sum of the services' license rates for the digital performance of the underlying musical compositions paid to ASCAP, BMI and SESAC to establish the highest possible marketplace benchmark rate for the equivalent digital sound recording performance license. The Librarian relied upon the CARP's estimate of [REDACTED] percent of revenues as the sum of the composition performance licenses. That figure was estimated because certain of the licenses were in a period of negotiation and had not been finally set. As it turned out, the CARP's estimate was too high. In fact, the sum of Music Choice's current license fees paid to ASCAP, BMI and SESAC is [REDACTED] of the estimate upon which the original rate was based. This change in circumstance alone warrants a significant reduction in the sound recording performance rate.

Next, the Librarian considered the various evidence relevant to the mandated policy objectives contained in the statute, including our licenses with Warner, Sony and EMI, and used those considerations to set the reasonable royalty rate at 6.5 percent, █████ of the aggregate musical composition rate. Changes in circumstances during the intervening ten years, however, have only strengthened Music Choice's case under each of the policy factors. Consequently, the rate should be adjusted to less than █████ of the composition performance benchmark.

Ten years later, the evidence of the benefits to the record labels from the Music Choice service is even stronger than it was at the time of the original CARP. Our service drives record sales, particularly in genres where the labels most need the help. The record labels themselves have repeatedly acknowledged these key facts. Moreover, it is now clear that Music Choice promotes artists who are not promoted by terrestrial radio and are therefore at the greatest risk of losing their recording contracts. Our promotion of these artists therefore leads to the creation of more music.

Music Choice continues to invest in technology and improvements to the Music Choice service, particularly in improvements like on-screen display of promotional graphics and information about the sound recording, which have increased the promotional value of our service to the record labels. Since the first CARP it has become increasingly clear that Music Choice provides numerous acknowledged benefits, at no additional risk, to the record labels and artists.

At the same time, Music Choice's residential business has not been stable or profitable on a cumulative basis, and shows no prospect for significant additional growth. While the business has grown since 1996 in terms of overall revenue and subscribers and has finally generated a modest profit on an annual basis, the business is still basically flat. Fifteen years after launch,

the residential service is a mature business, with no new expectation or avenue for growth. Various market forces have driven the average fee per customer paid to Music Choice down from [REDACTED] at the time of the first CARP to [REDACTED] today. Of the three original pre-existing subscription services, Music Choice is the only significant service left. DMX declared bankruptcy and sold off its assets last year. Muzak's revenues from its residential service are apparently so inconsequential that it is not actively participating in this proceeding. Indeed, Muzak is only carried on the same single residential outlet – Echostar/DISH CD – as it was in 1996. Consolidation in the cable industry has increased the leverage of our cable affiliates in contract negotiations. At the same time, we are subject to increasing competition from much larger companies like XM, Sirius, and MTV, which further reduces our negotiating leverage.

Our attempts over the years to increase our profitability through advertising revenue and other initiatives have failed. To maintain its viability as a business, Music Choice has been developing an on-demand music video service for our cable affiliates, which is not covered by the statutory license and presents its own challenges. After 15 years as a stand-alone company, Music Choice is still not profitable on a cumulative basis and still has not returned the initial capital investment of its investors. Music Choice has been burdened with the existing rate, and if that rate is left in place, Music Choice may never be able to return our investors' capital.

Finally, it is clear that reducing the royalty rate will minimize the disruptive impact on the industries involved. Music Choice is still a very small company, both in size and in revenues. As indicated above, lowering the royalty rate will help Music Choice withstand the various market pressures it is experiencing. Any resulting reduction in revenues to the record labels (which would still provide more revenue than if Music Choice were forced to discontinue its service), would represent a tiny fraction of the labels' overall revenues and would not even be

felt by that industry. Notably, the record labels do not incur any additional costs in connection with the Music Choice service. Every penny paid to them is pure profit, generated at significant cost and risk to Music Choice.

After consideration of the marketplace benchmark provided by Music Choice's musical composition performance licenses, the sound recording performance licenses between Music Choice and three of the major record labels, and the statutory policy objectives, the sound recording performance license rate for Music Choice should be reduced to 2.6 percent. Because the ephemeral copies made by Music Choice have no independent economic value and recent agreements covering the ephemeral right have folded the ephemeral copy license into the performance fee, the Section 112 ephemeral license should be included within the 2.6 percent royalty rate. If any additional value is ascribed to the ephemeral license, that value should be set no higher than 4 percent of the performance license rate.

**I. Marketplace Benchmarks For The Digital Performance Right**

For the first several years of Music Choice's existence, there was no performance right for sound recordings. Historically this was due to the judgment of Congress that the public performance of sound recordings served to promote record sales. This judgment makes sense, because customers usually buy recordings that they like. They usually do not know whether they like a recording until they hear it. Nonetheless, the record labels repeatedly lobbied Congress to create a public performance right for sound recordings, without success.

In 1995, amid the rising popularity of the Internet and other new digital modes of delivering data and music performances, the record labels persuaded Congress that certain digital performances had a unique potential to displace record sales. In particular, the labels argued that performances made in a digital medium were more likely to displace record sales than analog



performances (such as those on terrestrial radio), warranting the creation of a narrow performance right for the digital performance of sound recordings.

Nonetheless, in recognition that Music Choice and other PES operators had invested significant capital in building businesses with the expectation that there would be no performance royalty due for sound recordings, Congress created a statutory license. Rather than institute a market-based, willing buyer / willing seller standard to set the rate for that license, a lower-than-market rate was instituted, as I discussed above.

**A. Music Choice's Licenses With Record Labels**

In 1993 and 1994, prior to the creation of the digital performance right, certain of the major record labels, namely Warner Music Group, Sony Music and EMI Music, invested in Music Choice. In connection with that investment, and for the purpose of establishing that there was a recognized value to the performance of sound recordings, the record labels insisted that Music Choice agree to pay those labels a license fee for performing their sound recordings. The royalty rate was █ percent of revenue, adjusted for the percentage of each record company's music played on the Music Choice service so that █ percent would cover the entire record industry. Copies of these licenses are submitted as Exhibits MC 2 – MC 4. Although these royalty payments were agreed to before there was an independent obligation to pay for the performance of sound recordings, I believe based upon my experience negotiating these deals that the █ percent rate (allocated among the whole record industry) represented the value the record labels hoped to place on the sound recording performance right.

**B. Music Choice's Composition Performance Licenses**

The Librarian set the highest possible marketplace benchmark rate as the sum of all three blanket licenses from ASCAP, BMI and SESAC for the performance of the musical compositions. Although those licenses covered a different (but related) copyrighted work, the

underlying musical composition performed in the sound recording, the Librarian used the composition performance licenses as the benchmark because they covered the exact same service and extrinsic evidence indicated that the marketplace value for the composition right was equivalent to or greater than the value of the sound recording right in analogous scenarios.

Based upon my knowledge and experience in the music industry, and my research and inquiries into the licensing practices of other copyright users, I still believe that where both the sound recording right and composition right are licensed, the fee for those licenses is equal or the composition right is slightly higher. In the first CARP proceeding, Music Choice introduced a study conducted on behalf of Music Choice Europe (“MCE”), an affiliated company at that time, which provides a very similar service to ours in Europe. The study was conducted for the purpose of allowing MCE to negotiate its performance licenses in Europe, where there already was a sound recording performance right. A copy of that study is submitted as Exhibit MC 5. That study shows that the average royalty paid for the sound recording performance right is equal to or less than the royalty paid for the composition performance right.

In 2002, as we were preparing for the CARP proceeding that ultimately settled, we again contacted MCE and to our understanding the respective rates actually being paid across Europe by MCE for the sound recording performance right were roughly equal to the royalty rates paid for the composition right. In the United Kingdom, the performance license rates charged to terrestrial radio for musical compositions and sound recordings are administered by The Performing Rights Society (“PRS”) and Phonographic Performance Limited (“PPL”), respectively. The websites for PRS and PPL indicate that the current license rate for the musical composition performance are slightly higher than the rate for the sound recording performance. A printout of those rates from the PRS and PPL websites is submitted as Exhibit MC 6.

I do not believe that these facts about licensing in Europe necessarily determine what the specific market rate in the United States would be for the sound recording right. These facts do, however, demonstrate that when both rights are licensed for the same performance, the value attributed to the performance of the sound recordings, relative to the value attributed to the performance of the underlying musical compositions, is equal or less.

I am also aware that in the first CARP proceeding to determine the statutory license rates for webcasters and in the currently-pending CRB proceeding to adjust those rates, various testimony and evidence was introduced supporting the fact that, when licensed for the same product or service, the sound performance right is valued no higher than the composition right. That prior testimony is submitted by Music Choice as part of its direct case. The equivalence of the sound recording and musical composition performance rates is further supported by the testimony of George Strong, submitted by Music Choice as part of its direct case.

Because there have not been any other comparable marketplace licenses negotiated since the first PES CARP, the musical composition blanket licenses paid to ASCAP, BMI and SESAC remain the best benchmark of the highest possible marketplace rate. The relevance of the composition licenses was previously determined by the Librarian of Congress and affirmed by the District of Columbia Circuit. However, the Librarian had to rely upon the CARP's estimate of that aggregate rate because Music Choice had interim licenses with ASCAP and BMI at the time. Those rates were not final, and were therefore subject to change. The Librarian used the CARP's estimate of the aggregate musical composition performance license fees, ■ percent of gross revenue, as the highest point in the benchmark range of possible reasonable rates. The actual rates now paid by Music Choice to ASCAP, BMI and SESAC, however, are much lower than the estimate used by the Librarian. Music Choice pays ■■■■■ to ASCAP and

BMI, and pays [REDACTED] to SESAC. [REDACTED]

[REDACTED]

[REDACTED]

Copies of Music Choice's current licenses with these performing rights organizations are submitted as Exhibits MC 7- 9. Consequently, [REDACTED] [REDACTED], our effective aggregate rate for the public performance of musical compositions is actually [REDACTED] percent. [REDACTED] percent should therefore be the highest point in the range of possible benchmark rates.

**C. There Have Been No Other Comparable Benchmarks**

Since the implementation of the statutory royalty, there have not been any negotiated licenses covering the sound recording digital performance right for a service comparable to Music Choice. Consequently, the composition performance rate and the negotiated licenses between Music Choice and the three major record labels remain the only viable benchmarks. SoundExchange may argue that the settlement rate agreed to by Music Choice in 2003 or the statutory rate set for webcasters provide possible benchmarks, but they do not.

1. The 2003 settlement is not a valid benchmark

In January 2003, rather than proceed with another expensive CARP proceeding, which would easily have cost Music Choice millions of dollars, Music Choice agreed to increase the 6.5 percent rate to 7 percent for 2002-2003 and 7.25 percent for 2004 through 2007. This increase was in no way indicative of any of the statutory policy objectives relevant to this proceeding, nor was it a true marketplace transaction. Although it was already clear that the original royalty rate was set too high, Music Choice could simply not, from a business perspective, justify the expense in money and staff resources of another proceeding so soon after the conclusion of the appeal process of the first proceeding. [REDACTED]

[REDACTED]  
[REDACTED]. In addition to the costs noted above, these proceedings consume an enormous amount of my and my staff's time. A small company such as ours cannot afford to undertake these expensive proceedings with each copyright holder each time a renewal or rate adjustment is required.

2. The subscription webcaster rate is not a valid benchmark

Pursuant to another settlement under threat of immense litigation expense, subscription webcasters and other new subscription services settled on a royalty structure with three options for calculating the fee. A copy of the notice published in the Federal Register, announcing the rate set by the settlement, is submitted as Exhibit MC 10. The first two options were a per-performance option and an aggregate-tuning-hour option. Neither of these other two options could possibly apply to Music Choice, because they both require a service to know how many customers hear each song. We have no way of knowing which of our customers is listening to a particular channel at a given time. Consequently, the per-performance rate and the aggregate-tuning-hour rate cannot possibly provide a valid benchmark for our service.

The third option was a percentage of revenue option, with a rate of 10.9 percent and a minimum payment of 27 cents per subscriber per month. This cannot provide a valid benchmark for several reasons. Similarly to our 2003 settlement, this rate was not the product of a true marketplace negotiation, nor was it devised with consideration of any of the statutory policy objectives applicable to a PES. Instead, it was a rate driven primarily by the threat of expensive litigation. This expense could easily be borne by the industry trade association for the record labels, the RIAA, whose sole "business" is lobbying and litigation.

Another reason the webcaster rate does not provide a valid benchmark is that the webcasting service and business model are different from Music Choice's in material ways. One

obvious difference is that Music Choice provides its service through intermediaries, such as cable operators, and is usually packaged with other programming services in a bundled offering. This dependency on intermediaries carries the significant risk of losing carriage, a risk that is not priced into the webcasting model. Because we do not provide our service directly to consumers, we also do not collect subscription fees from the customer – we are paid license fees by the our distributors. In addition, the webcasting business model is largely dependent on advertising revenues, even for the subscription services. We have virtually no advertising revenue, and only a fixed license fee revenue stream. Another material difference between Music Choice and the webcasters is that we must compete directly with other cable television offerings for the cable subscriber’s attention.

The webcasting industry is still in a relatively undeveloped state, with enormous potential for growth. Music Choice has been operating its service for over 15 years now, and has seen its revenue per customer shrink to [REDACTED]. It is a fully mature business, with no possibility of untapped upside. Unlike webcasters’, Music Choice’s business model could never include taking a loss in the short term to build volume through market share. We already have achieved full market share and our prices are dropping, not rising.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

**II. Downward Adjustment In Consideration Of The Statutory Policies**

The Librarian recognized that the reasonable rate provided by the statutory license was not the same as a marketplace rate. The District of Columbia Circuit affirmed on this point,

holding that a reasonable rate under this license need not be within the range of market rates. Indeed, the District of Columbia Circuit held that a reasonable rate, taking into account the statutory policy objectives, would generally be less than the market rate, and did not even have to take a market rate into consideration, as long as the rate furthered the statutory policy objectives. A reasonable rate could not be higher than a market rate, however. Taking the policy objectives into account, and also considering [REDACTED] licenses struck by Music Choice with the record labels, the Librarian set the reasonable rate at [REDACTED] percent of the highest possible point in the range delimited by the composition performance licenses [REDACTED], or 6.5 percent of revenues. Even if changes in circumstance had not strengthened Music Choice's case for a lower rate under the statutory policies, the use of actual data instead of an estimate for Music Choice's composition performance licenses, alone, justifies a change in the rate from 6.5 percent to [REDACTED]. Circumstances *have* changed, however, and in ways that warrant a further reduction of the statutory license rate to a maximum of [REDACTED], or 2.6 percent of gross revenues, [REDACTED]. This rate is further supported by the testimony of George Strong, submitted as part of Music Choice's written direct case. I will address each of the statutory policy objectives in turn.

**A. To Maximize The Availability Of Creative Works To The Public**

Music Choice maximizes the availability of creative works to the public in a number of ways, and to a much greater degree than it did at the time of the first CARP. First, Music Choice invests a significant amount of energy and expense in creating its channels. Each of these channels is programmed in a creative manner calculated to appeal to listeners. Each day of programming involves creative choices in the selection and ordering of many individual songs.

The programs created by Music Choice constitute creative works in their own right. We have greatly increased the size and depth of our programming staff, from 16 in 1996 to 34 today.

Each channel also includes original on-screen content created by Music Choice, including not only promotional information designed to promote sales of the recordings, but also creative visuals and graphics, designed to stimulate customers to look at the screen, all to the benefit of the record labels. Surveys have shown that our customers frequently view the promotional information displayed on the television screen during play and also specifically that our customers purchase music after hearing it on Music Choice. These survey results are submitted as Exhibits MC 11-12. Examples of Music Choice's on-screen layouts are submitted as Exhibit MC 13. Since the time of the original CARP, Music Choice has expanded its channels from 31 to 53, thereby almost doubling the output of its programming and greatly increasing the amount of its creative works made available to the public through the Music Choice service. A copy of the current entire Music Choice channel lineup is submitted as Exhibit MC 14. 53 of these channels are available through our residential audio service.

The Music Choice service also stimulates the creation of new sound recordings. As described in more detail below and in the testimony of Damon Williams, the Music Choice service promotes and increases the sale of sound recordings, as acknowledged by the record labels and artists themselves. The promotional effect of the Music Choice service is also proven by the conduct of the record labels, which provide Music Choice with free copies of every new recording and actively seek to have those recordings played on Music Choice. This increase in sales, which costs the record labels nothing, obviously leads to an increase in the record labels' profits, which in turn gives the labels more money to sign and produce new artists. While this fact is relevant to the other policy objectives, discussed below, it is also relevant to the first



objective because our service promotes many artists that cannot be promoted by the labels themselves or by terrestrial radio.

The labels have chosen to organize their business in a way that only allows them to focus their promotional activities on a very small fraction of the artists who they believe are most likely to be successful. This often becomes a self-fulfilling prophecy: without promotion new recordings do not sell in any significant number. At the same time, the number one promotional vehicle for sound recordings, terrestrial radio, has been significantly consolidated over the past ten years. A small handful of companies now own almost all of the radio stations. To achieve economies of scale, programming responsibilities have been consolidated. Moreover, in order to promote the few signed artists predicted to succeed, as noted above, the labels encourage the radio stations to play the new recordings from those artists, to the exclusion of others. All of these and other factors have led to a broadcasting landscape where there are few programming formats played on the radio, which leads to fewer and fewer songs getting radio airplay.

The Music Choice service is free of these limitations, because the service programs 53 different stations available through its residential audio service, covering a wide variety of genres and sub-genres, including many formats that do not receive significant airplay on terrestrial radio. Consequently, and as explained further in the testimony of Damon Williams, the Music Choice service helps sell recordings by artists who would otherwise be much less likely to succeed. When an artist's album does not sell a large number of copies the artist is usually dropped by the label, a fate common among artists who are not actively pushed by the labels and not played in heavy rotation on terrestrial radio. Therefore, the sales generated by exposure on Music Choice allow artists, who otherwise might fail, to keep their recording contracts and create new recordings.

The promotional effect of the Music Choice service driving the increase in production of sound recordings is much greater now than it was at the time of the original CARP. The number of Music Choice residential customers has vastly increased in that time, from under 2 million to over 31 million. Music Choice has also improved its service in various ways that increase the promotional effect, as described in detail below. All of these developments have occurred since the first CARP.

**B. To Reflect The Relative Roles Of Copyright Owners And Users In Making The Product Made Available To The Public With Respect To The Relative Creative Contribution, Technological Contribution, Capital Investment, Cost, Risk And Contribution To The Opening Of New Markets For Creative Expression And Media For Their Communication**

The Librarian construed “the product made available to the public” as referring to both the sound recordings and the Music Choice service, and went on to find that all but the first sub-factor favored Music Choice and weighed in favor of setting a lower rate. The intervening ten years have only made Music Choice’s case for a lower rate stronger.

1. Relative creative contribution

In the original CARP, the Librarian adopted without comment the CARP’s conclusion that the record labels’ and artists’ creative contribution to the creation of sound recordings was greater than Music Choice’s creative contribution to its service. In the intervening ten years, Music Choice has greatly increased its creative contribution to the service. As noted above, we have increased the channels offered through our service from 31 channels to 53. Most customers with access to the Music Choice service receive between 47 and 52 channels. Each of these channels is individually programmed, using creative choices in the selection and ordering of songs. Music Choice also has increased the quantity and quality of its on-screen visual content included with the service. In 1996, we had no on-screen component of our service other than basic song identification information. Music Choice also develops and produces, at its own

expense, various promotional content for broadcast in partnership with the record labels and artists, such as on-screen advertisements, artist interviews, shows, live performance recordings and other types of creative content.

In short, Music Choice's creative contribution to its service is much greater than was the case in 1996 and goes far beyond the mere "programming concepts" noted by the Librarian.

## 2. Relative Technological Contribution

In the original proceeding, the CARP and Librarian found that this factor weighed in favor of Music Choice, based upon the fact that Music Choice had created various technological components of its system for the purpose of opening new avenues for transmitting sound recordings to a larger and more diverse audience. This technology included technology to uplink the programming signals to satellites and transmit them through cable services, technology to identify the name of the sound recording and artist during the performance, and technology for programming, encryption and transmission of the programming containing the sound recordings. The CARP and Librarian contrasted these technological contributions with the fact that the record labels created no new technology related to the Music Choice service.

Music Choice has made numerous additional technological contributions to its service since the original CARP, designed to further increase the exposure of the sound recordings to new and larger audiences, and specifically to enhance the promotional value of the service to the record labels. Examples include improvements to the screen displays containing promotional information such as album art, interesting facts and news about the artist, banners directing customers to record stores or band websites, and song title information; the creation of a production studio where artists visit and record the value-added promotional recordings discussed above that are featured on the Music Choice service, improvements to the digital playback system to improve the programmers' flexibility to provide deeper music lists and more

interesting mixes on more channels; and improvements in the Music Choice website, such as allowing customers to purchase CDs played on the Music Choice service. We have also continued to improve the satellite uplink and other technologies noted by the CARP and Librarian, to put more channels on satellite for distribution.

3. Relative capital investments

This factor is closely related to the prior factor, because each of the improvements listed above required significant financial investments. In finding that this factor weighed in favor of Music Choice at the time of the first CARP, the CARP and Librarian noted that Music Choice had spent [REDACTED] on equipment and technology, while the record labels had not invested any money at all with respect to the equipment and technology used to transmit their sound recordings to the public in connection with our service. While the record labels still have not had to make any investments in equipment or technology to facilitate Music Choice's transmission of their sound recordings to the public, Music Choice, as noted above, has made substantial additional investments since the original CARP for equipment and technology. Examples include [REDACTED] to develop our on-screen displays containing the promotional artwork and information described above; [REDACTED] in the creation of an office and production studio in Manhattan where artists visit and record value-added promotional recordings that are in turn featured on the Music Choice service, [REDACTED] to build the new digital playback system referenced above and to move the system to Manhattan; and [REDACTED] to improve the Music Choice website, including to allow the purchase of CDs played on the Music Choice service. Thus, Music Choice's total investment in equipment and technology is now [REDACTED] the original capital investment noted by the CARP and Librarian. Moreover, even taking this factor as strictly limited to capital investments as that term is used in

the accounting field, Music Choice has made [REDACTED] in such capital investment in its business since 1996.

4. Relative costs and risks

The CARP and Librarian properly found that the costs and risks incurred by Music Choice outweighed any costs and risks incurred by the record labels for the purpose of this factor. In particular, the Librarian noted that the Music Choice service actually decreased the risk to the record labels by promoting record sales. Ten years later, the relative costs and risks still weigh in favor of allowing Music Choice a lower royalty rate.

(a) Music Choice lowers the record labels' costs

As a preliminary matter, it is important to note that all of the costs incurred by the record labels in connection with their sound recordings are sunk costs. The Music Choice service does not increase those costs in any way. In fact, Music Choice substantially lowers the cost to the record labels for the promotion of their sound recordings. As described in more detail in the testimony of Damon Williams, Music Choice provides various value-added promotions to the record labels and artists. The record labels frequently thank us and recognize the promotional value they receive. These special promotions, which began after the original CARP proceeding, are provided free of charge to the record labels.

(b) Music Choice lowers the record labels' risks

The Librarian correctly noted that even back in 1997, the Music Choice service lowered the record labels' risk by increasing record sales. This fact is even more true today, as the promotional impact to the record labels is much stronger, as described in more detail in the testimony of Damon Williams. As a preliminary matter, the number of customers with access to the Music Choice service has greatly increased, from under 2 million in 1996 to over 31 million

today. This increased audience alone greatly increases the promotional value of the service to the record labels.

Additionally, we have greatly improved various features of the service that promote record sales. For example, we have increased the promotional information displayed on the television screen when a recording is played, and also redesigned the screen to add graphics so that the customer is more likely to view the screen while listening. We have commissioned surveys that show the vast majority of customers look at the screen to see the name of the artist or title of the song being played. A recent survey conducted by Arbitron shows that almost 40 percent of our customers actually purchase recordings due to hearing them on the Music Choice service. Copies of those survey results, which also include data about customer screen viewing habits, are submitted as Exhibits MC 11-12.

At the time of the original CARP, Music Choice used a toll-free telephone number displayed on screen to allow customers to purchase music they heard on the service. Since then, we have moved to a more effective and user-friendly web-based system. From 1998 through the third quarter of 2006, Music Choice has sold in excess of 380,000 CDs through our service, generating over \$4,875,000 in sales for the record labels.

The record labels themselves frequently acknowledge that Music Choice increased record sales. In addition to specific written and oral testimonials the labels and artists routinely give us, they also send us plaques noting our role in achieving high sales benchmarks. Of course, the very fact that the labels send us all of their new CDs and lobby to have us put the recordings on our service, speaks volumes about their view of our role in promoting sales. This behavior has also increased substantially since the original CARP. Indeed, this lobbying effort has increased so much that some of our programmers have had to limit the days and times when the labels are

allowed to call and lobby us for promotion and airplay. As noted above, Music Choice also provides various other value-added promotions to the record labels, which further increase exposure and record sales. The labels would obviously not work so hard to get us to play their records if airplay on Music Choice did not have promotional value. Likewise, they would not develop the special promotions with us if those promotions were not effective.

Finally, the CARP and Librarian found that the Music Choice service presented no risk of displacing record sales. This is still true. The Music Choice service complies with the sound recording performance complement, as I described above, which is specifically designed to avoid such sales displacement. It would be very inconvenient for a Music Choice customer to try to record our broadcasts, and even if they did, we do not pre-announce our playlists, so a customer would not know which songs they were going to record. Any recording made would also be a lower-quality analog recording, not a digital one. There are far easier ways for a consumer who wants free music to get it, including digital file sharing. There is simply no reason to believe that our service displaces sales. To the contrary, as noted above, we generate sales for the record labels.

- (c) Music Choice continues to incur significant costs and its risks have increased

The road to financial viability upon which Music Choice has traveled - and continues to travel-- is neither straight nor short. For almost twenty years, Music Choice has struggled to launch, sustain, and grow our domestic residential services in a highly competitive and rapidly changing marketplace. To date, our investors have invested [REDACTED] of capital to fuel our continuing operations. Significantly, Music Choice has dedicated this capital to deploy domestic residential services that provide invaluable promotional benefits to the record industry.

Despite our best efforts, we have not yet recouped accumulated losses from our domestic residential operations, and we will not likely to do so for several years, if at all. In the prior CARP proceeding, we submitted a proposed five-year budget in which we projected that domestic residential operations of Music Choice would achieve over [REDACTED] in total gains between 1996 and 2001. Unfortunately, our domestic residential operations incurred additional losses of [REDACTED] during this period.

Although Music Choice's domestic residential operations finally managed to show a small profit on an annual basis in 2001, our financial future remains as uncertain as ever. On a cumulative basis, accounting for the years of losses experienced prior to 2001, the Music Choice service has still not become profitable and by 2010 we project that we will still have a cumulative loss of [REDACTED]. Since the last CARP, Music Choice has relied almost exclusively upon licensing fee revenues from cable operators to sustain its operations, albeit at levels far below our investors' expectations. As our licensing fee rates have been driven down, Music Choice attempted to develop an advertising program to supplement revenue, but that program has been unsuccessful. I believe that our revenues for the residential service will continue to be limited to, and constrained by, our licensing fees. A schedule showing Music Choice's financial results and projections is submitted as Exhibit MC 15. This document summarizes certain key financial figures relevant to this proceeding, and also contains financial statements detailing the results of Music Choice's residential operations to date as well as projections going forward to 2010 under two different sets of assumptions. The first projections assume no significant adverse impacts going forward. The second projections assume that various likely competitive factors lead to [REDACTED]

[REDACTED]



[REDACTED]

[REDACTED]

To illustrate the potential of competition to impact our business model, we need only look to last year. Between October 1994 and November of 2005, Music Choice was carried on DIRECTV, a satellite provider of television services. [REDACTED]

[REDACTED] In November of 2005, DIRECTV removed us from their platform and replaced our music channels with those from XM Satellite Radio, a provider of satellite radio music channels. That affiliate loss alone resulted in our net income dropping by approximately [REDACTED] on an annualized basis. [REDACTED]

[REDACTED]. In the past few months, we have learned that [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

**Music Choice Is A Capital Intensive Business.**

In the original CARP proceeding, it was acknowledged that digital audio services require a tremendous capital investment to start operations and require significant ongoing operator capital to cover costs. That is certainly true in the case of Music Choice. Since January 1, 1998, Music Choice has required additional capital infusions of [REDACTED]. To date, our investors have had to make capital contributions of [REDACTED] to fund the Company. The [REDACTED] capital contribution is [REDACTED]. Even under a best case scenario, the Music Choice residential audio service will not be close to earning back this original capital by 2010.

**Music Choice Has Accumulated Significant Expenditures and Losses Since the original CARP.**

Although Music Choice has been providing domestic residential services for over 15 years, our accumulated operating expenses incurred through the end of 2005 exceeded accumulated revenues for domestic residential operations by a significant margin. We currently estimate that our accumulated revenues will not exceed total operating expenses for domestic residential operations until well after 2010, if at all.

As a result, Music Choice has not yet recouped losses from domestic residential operations. From 1996 through 2005, we experienced accumulated losses of [REDACTED] from our domestic residential operations. In contrast, we projected in the original CARP that domestic residential operations would accumulate net gains of [REDACTED] from 1996 through 2001. In the original CARP, we also projected that we would recoup all of our cumulative net losses for our domestic residential operations by the end of 2001. At present, we project that we will not recoup accumulated losses from our domestic residential operations in the foreseeable future, and will not come close by 2010.

**Music Choice Has Made Substantial Investments in Services That Provide Invaluable Promotional Benefits to the Recording Industry.**

In the original CARP, Music Choice indicated that it had dedicated approximately [REDACTED] percent of all operating expenses to “program, playback, uplink, market, and sell” Music Choice programming. At the time, more than [REDACTED] of those expenses were dedicated to marketing and sales related expenses used to obtain distribution of the service with cable systems.

Since the last CARP, Music Choice has continued to make substantial investments in these services. From 1996 through 2006, Music Choice has dedicated [REDACTED] of its operating expenditures to program, playback, uplink, market, and sell programming. Among other things, these operating expenses have been incurred to make all of the improvements I described above,

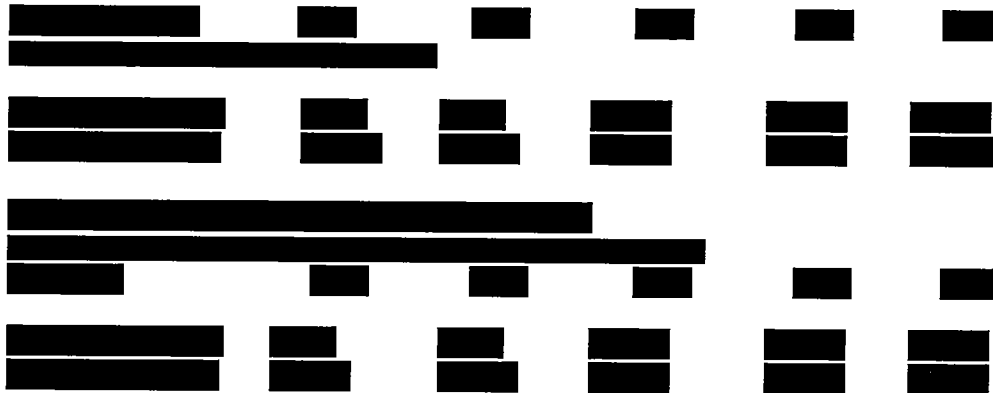
which add to the promotional value of the service to artists and record labels. In total, Music Choice has invested [REDACTED] over the past fifteen years to develop, market, program and operate the Music Choice residential service.

**Music Choice's Financial Performance and Projections Strongly Suggest That We Will Only Be Marginally Profitable Under Our Current Basic Service Model.**

Over the past ten years, Music Choice's financial performance strongly suggests that our basic service model will be only modestly profitable at best. In the original CARP, Music Choice testified that we had charged a price of [REDACTED] when our domestic residential service were sold as a premium service. Once Music Choice migrated away from our unsuccessful premium service model, we started pricing our domestic residential services as a basic digital offering for [REDACTED] per customer/per month. By 1996, Music Choice averaged only [REDACTED] per customer and this number is now down to [REDACTED] on average per customer.

Even before the original CARP was completed, Music Choice began to experience downward pressure on licensing fees. Since completion of the original CARP, the downward pressure on licensing fees has only intensified. The financial data set forth in Exhibit MC 15 illustrates this trend quite clearly. Music Choice's domestic residential customer base has grown approximately 1450% from the end of 1996 through August 2006. In contrast, domestic residential revenues have only grown [REDACTED] of our growth in customer base.

To further illustrate the downward pressure on rates, I have set forth the following chart, which breaks down the average (per customer/per month) rates for Music Choice at various points from 1996 to 2006, with projections under the two scenarios I mentioned above:



As the above chart indicates, the per customer licensing fee revenue rate that Music Choice has been able to generate has dropped significantly from the rate ranges set forth in the original CARP. Music Choice has experienced - and continues to experience - significant pricing pressure when we renegotiate licensing fee arrangements with cable affiliates, due in large part to increased competition from other programming providers. We have also suffered from consolidation in the cable industry, [REDACTED] [REDACTED] [REDACTED].

At the same time, increased competition in the residential audio market has decreased our bargaining leverage. A number of much larger and better capitalized companies have recently entered our market. Above I mentioned how we had lost our DIRECTV affiliation to XM, which cost [REDACTED]. Sirius has also recently entered the residential audio market by making its programming available on the Dish Network home satellite service. MTV has recently entered the digital audio marketplace as well with their Urge Digital Audio Radio service and is putting the same competitive pressures on our business as XM and Sirius. Any of our competitors from outside cable, including satellite providers, like

XM or Sirius, and webcasters like Rhapsody, AOL Music or Yahoo! Music, could displace us at any time. Competitors from inside cable, such as MTV, also constitute a competitive threat, as do the non-music cable network channels, such as ESPN, with which we also compete for cable licensing dollars.

For the reasons noted above, we have learned that we can no longer depend upon customer growth to generate additional revenues (and profits) on a going forward basis. By 2010, I project that Music Choice will likely generate on average as low as [REDACTED] [REDACTED] for domestic residential services. At this level, Music Choice's licensing fees will be insufficient to sustain profitability for domestic residential operations if sound recording royalties remain at the current 7.25 percent rate, or even the original 6.5 percent rate.

**We Have Been Unable to Successfully Deploy a New Business Model to Ensure Our Long-Term Viability.**

In 1997, the Librarian found that Music Choice and other digital audio services were "struggling to create an industry and to stay in that business." That finding is equally true for us today. In the last CARP, we had submitted a proposed five-year budget in which we projected that our domestic residential operations would achieve [REDACTED] in total net gains between 1996 and 2001. Unfortunately, the financial performance of our residential operations during those years yielded additional losses, leaving Music Choice's accumulated losses in 2001 at [REDACTED]. As of the end of 2005, our accumulated losses have been reduced, but remain high at [REDACTED].

In light of these poor financial results, Music Choice attempted to implement an advertising revenue model to supplement the declining license fee rates. This model has failed to generate significant revenues and is not likely to do so in the future.

Having failed at moving to an advertising revenue model, Music Choice's opportunities to improve its revenues are severely limited by various risks and pressures on its license fee revenue model, including the following:

(1) Competition

Music Choice's domestic residential services face increasing competition in a rapidly changing marketplace. Music Choice competes for customers, listeners, and advertising revenue with many businesses, including traditional AM/FM radio and digital AM/FM radio, XM Radio and Sirius Satellite Radio, MTV, Internet-based audio providers and other actual or potential DBS and cable audio service providers. Record companies are another source of potential competition. We must also compete with major cable network channels, such as ESPN, for licensing fees from the cable carriers.

Traditional AM/FM radio already has a well-established and dominant market presence for its services and generally offers free broadcast reception supported by commercial advertising, rather than by a licensing fee. These radio stations are currently enhancing their existing broadcasts with additional digital quality services utilizing new technology. These incumbent providers of audio entertainment services typically maintain longstanding relationships with advertisers and possess greater resources than Music Choice does.

The explosion of XM Radio and Sirius Satellite Radio has exerted more competitive pressure on Music Choice, as those services compete with Music Choice's domestic residential operations. Both of these companies is far better capitalized and in a much stronger financial position than Music Choice. For example, XM Radio is a well-funded public company with a market capitalization of approximately \$3.6 billion. Sirius is also a well-funded public company with a market capitalization of approximately \$5.6 billion. Both XM and Sirius have deals with

major automobile manufacturers to include compatible radios in new cars, and provide free service for an introductory period with the purchase of such a car. Once an automobile customer is acquired by Sirius or XM, that customer can purchase an inexpensive receiver to attach to his or her home stereo to receive the service there, in direct competition with Music Choice's residential service.

(2) Changes in Technology

The digital audio broadcasting industry is characterized by rapid technological change, frequent new product innovation, changes in customer requirements and expectations, and changes. If Music Choice is unable to keep pace with these changes, it may ultimately prove to be unsuccessful. In addition, because Music Choice is a small company with limited financial resources and may have a limited ability to raise additional capital from our investors due to our failure to return capital, better-funded competitors may be better positioned to take advantage of unforeseen technological changes that could further enhance their own services.

(3) Continued Erosion of Licensing Fee Revenues and the Affect of Higher Royalty Rates

As noted above, Music Choice has experienced significant downward pricing pressure on its licensing fee arrangements with cable companies. While Music Choice anticipates that this trend will continue for the next several years, there is an additional risk that licensing fee revenues from cable operators may deteriorate even more quickly than currently projected. While Music Choice's continued profitability is highly sensitive to a number of variables, any erosion in per customer licensing fee revenues beyond those projected in Exhibit MC 15 would adversely affect Music Choice's financial performance and results of operations. Indeed, Music Choice has achieved sufficient penetration with cable systems that any significant increase in

licensed cable systems is unlikely. There is only down side at this point. [REDACTED]

[REDACTED]

[REDACTED]

(4) Investment and Expense Levels

Of course, it is very difficult to predict the amount of investment and expense that Music Choice will have to dedicate to its residential service in the future. If the operating costs are greater than expected, or if Music Choice has underestimated the level of investment required to take advantage of technological changes in the marketplace, our financial performance and results of operations could be adversely affected.

**Cost and Risk Summary**

In summary, the financial history of Music Choice indicates that the Company has failed to recoup investment and costs as quickly as anticipated. While Music Choice's domestic residential services finally achieved a modest level of annual profitability in 2001 after 10 years of operation, this profitability is in no way assured into the future.

A "snapshot" approach in this proceeding would provide little, if any, indication of Music Choice's financial success and viability on a going forward basis. From our investors' perspective, and in terms of their investment, the business has a long way to go towards being profitable. Indeed, the long-term profitability and viability of Music Choice is dependent upon its ability to overcome serious competitive, industry, and marketplace challenges in the next several years. Music Choice has still not achieved cumulative profitability for its residential service, and will not do so in the foreseeable future. The royalty rate set by the original CARP based on its erroneous estimate of the applicable composition performance fees has only exacerbated the pressures on Music Choice. A failure to lower the royalty will strangle our residential business and doom any hope of achieving cumulative profitability and return of capital.



Accordingly, it would be wrong to ignore these challenges in the current proceeding by extrapolating Music Choice's annual profitability and revenues (even at its modest present levels) into the future for purposes of this proceeding. This factor continues to weigh strongly in Music Choice's favor and justify a lower rate.

5. Relative contribution to the opening of new markets for creative expression and media for their communication

It was obvious to the CARP and the Librarian that Music Choice, by the very nature of its service, contributed more to the opening of new markets for creative expression for the very same reasons discussed above, including providing greater exposure to a broader range of music than terrestrial radio and promoting record sales in that broader range. As I have described above, these features of the Music Choice service have greatly increased since the original CARP.

6. Conclusion on relative roles

The Librarian set the 6.5 percent rate in the original CARP proceeding based on his finding that the relative contribution of Music Choice in all but the first of the factors above outweighed the contribution of the record labels. For the reasons stated above, Music Choice's relative contribution in all five factors has greatly increased since that time.

**C. To Minimize Any Disruptive Impact On The Structure Of The Industries Involved An On Generally Prevailing Industry Practices**

In finding that this statutory policy objective weighed in favor of setting a lower rate, the CARP and Librarian found two factors particularly compelling. First, that setting a rate too high ran the risk of having a catastrophic impact on the pre-existing subscription services. Second, because the record labels were so large and had much revenue compared to the services, the difference between a high and low royalty for the services would have a negligible impact on the recording industry. These facts have only increased in relevance and truth.

The rate set in the original CARP proceeding was obviously too high, in large part due to the CARP's inaccurate estimate of the services' composition performance right licenses. This is proven by the fact that of the three original services, only Music Choice essentially remains a substantial force in this market. As noted above, DMX declared bankruptcy and sold off its assets and Muzak's residential service is so inconsequential to its overall business that it did not bother to actively participate in this proceeding. The industry has been disrupted by the original rate, which must now be reduced pursuant to this policy objective.

As explained in detail above, Music Choice's residential service continues to be marginal and has still not achieved cumulative profitability or returned the capital investment of its investors. Moreover, Music Choice is subject to increasing competitive pressure from various new types of music services such as satellite and webcasters. The record labels remain much larger and continue to generate much more revenue than Music Choice, putting them in a far superior position to absorb the impact of a lower rate. The entire ██████████ in royalties Music Choice has paid the record labels over the last ten years amounts to less than ███ percent of the retail value of the labels' total shipment of sound recordings during that time, which was well over \$130 billion. A copy of the RIAA's 2005 Year-End Statistics, downloaded from the RIAA website, is submitted as Exhibit MC 16. In this context, it is clear that this policy objective weighs even more heavily than at the time of the original CARP.

Finally, setting a lower rate for Music Choice will not have any precedential value with respect to the record labels' negotiations or proceedings for other licenses. Section 114(f)(1) of the Copyright Act expressly provides that the terms and rates of the statutory license "shall distinguish among the different types of digital audio transmissions." The Librarian correctly

held that “[t]his language gives the Panel and the parties broad discretion in setting rates for different types of digital audio services, when such distinction is warranted.”

**D. To Afford The Copyright Owner A Fair Return For His Creative Work And The Copyright User A Fair Income Under Existing Economic Conditions**

The Librarian held that this factor was generally satisfied by the consideration of the benchmarks and the other statutory policy objectives. I would only add the observation that this objective does not end with affording the copyright owner a fair return, as SoundExchange apparently believes. Music Choice must also be allowed a fair income under existing economic conditions. As I have discussed above, Music Choice has still not become profitable on a cumulative basis, after ten years of paying the royalty. We will not be able to return our investors’ capital investments for some time, rendering it difficult to attract any new capital. In contrast, every penny paid to the record labels for this statutory license is pure profit. The labels do not invest any additional capital or incur any additional costs in connection with the royalty they get from us. Under these circumstances, this policy objective clearly weighs, along with the others, in favor of lowering the rate paid by Music Choice.

**III. Ephemeral License**

The ephemeral license provided in Section 112(e) of the Copyright Act has no independent economic value. These copies are not sold or distributed, and are not used for any purpose other than to facilitate our licensed performances. Consequently, the ephemeral license fee should be included within the 2.6 percent fee for the performance license, and attributed a negligible percentage of that fee.

Notably, we had to make such copies at the time of the first CARP. Although we operated the system using a CD jukebox, for the 60-70% of the recordings we featured on more than 1 channel, we made 1 to 5 copies of each recording. Those copies were not separately

valued at that time. Nor did the record labels ever ask for a fee to make those copies. Although we no longer play directly from CDs and therefore make more overall copies for our current system, we still make far fewer copies than other digital broadcasters, such as webcasters, make. Many webcasters choose to make several different copies of each sound recording to have versions for streaming in different bitrates. This allows their services to be used by consumers with different levels of bandwidth in their Internet access. Some webcasters also make different versions to vary the sound quality of each version, with the higher quality recordings reserved for users who pay a higher subscription fee. Each of these versions of a sound recording may be duplicated numerous times by a webcaster to create cache copies, back-ups and redundancy.

In our current system, a new song is first copied from a CD into the programming server array. That copy is automatically transmitted down to the playback server array and to a backup server array located at our corporate offices in Horsham, Pennsylvania. From there, the recording is copied to the playback and redundant Horsham playout computer for the channel in which the song is programmed. In all, this process creates 5 copies.

If a song is going to be programmed in multiple channels, this process is duplicated, resulting in 5 additional copies of that track for each extra channel on which it airs. Because we have increased our channel lineup and consequently program more narrowly focused formats, we now estimate that only approximately 15 percent of our music is programmed in more than one channel. Even fewer recordings are programmed in more than two channels. Due to this substantial decrease in the number of songs played across multiple channels, the great majority of our songs are copied only 5 times. Because some of the songs were copied 5 times under the old system, for a certain number of songs we do not make any more copies in the new system than we did at the time of the first CARP.

It bears repeating that none of these copies have independent value. Unlike webcasters, we do not make multiple “masters” of the song for various bitrates and sound qualities, which provides some value to webcasters. It is clear that even the record labels do not consider the ephemeral license to have any independent worth. In our settlement of the last CARP, the record labels did not negotiate the rate separately, and our resulting royalty rate did not break out the ephemeral license as a separate fee. We specifically discussed with RIAA and SoundExchange the fact that the copies did not in themselves provide added value to our customers. As a result, the ephemeral license is subsumed within the current performance royalty, and is not even apportioned a percentage of that rate. Even if the entire initial increase from that settlement of our rate from 6.5 percent to 7 percent were attributable to the new ephemeral license, that would mean the ephemeral license was valued at only 7.7 percent of the performance fee. Of course, the increase in our rate was not due to the ephemeral license, it was due to the threat of expensive litigation against a trade association with practically unlimited resources.

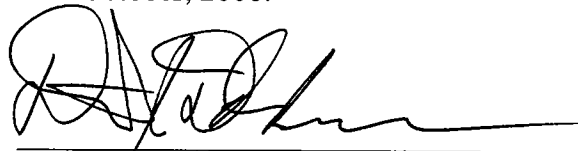
The labels did a similar thing when they settled with the webcasters. In the original webcasters CARP, the ephemeral license rate was set at 8.8 percent of the total performance license fee. When the rate came up for renewal and was settled, the settlement rates folded the ephemeral license into the performance license, although they allocated 8.8 percent of the license fee to the ephemeral license. Notably, however, the SoundExchange website does not mention the ephemeral license in its schedule of current webcasting rates, and certainly does not attribute any portion of the current fee to ephemeral copies. A copy of the relevant pages of the SoundExchange website are submitted as Exhibit MC 17. The bottom line is simple: you pay a fee for the performance, which is what digital broadcasters are in business to do, and that license includes the necessary incidental rights to operate the service. If an additional amount is set,

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however, it should be no greater than 4 percent of the performance royalty and be set as a separate rate so Music Choice has the option of re-configuring its service to avoid the need for the ephemeral license.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed in New York, New York on the 26th of October, 2006.



David J. Del Beccaro