Public Version

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

In the Matter of: Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III)	Docket No. 16-CRB-0001 SR/PSSR (2018-2022)

SOUNDEXCHANGE, INC. AND COPYRIGHT OWNER AND ARTIST PARTICIPANTS' REPLIES TO MUSIC CHOICE'S PROPOSED CONCLUSIONS OF LAW

July 7, 2017

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I. Legal History Of The Sound Recording Performance Right

A. Music Choice's Recitation Of Ancient History Is Irrelevant

Response to ¶ 1. Music Choice is right to acknowledge that the technology used in the distribution of recorded musical performances has a long history, and was not all invented by Mr. Del Beccaro and his team at Jerrold Communications in the late 1980s. *See* Trial Ex. 55, at 19, 38 (Del Beccaro WDT). Music Choice is also right to note that various entrenched interests – first music publishers and later radio broadcasters – successfully blocked enactment of a performance right in sound recordings for many years. *E.g.*, Barbara A. Ringer, Copyright Law Revision, Study No. 26, Subcomm. on Patents, Trademarks, and Copyrights, of the S. Comm. on the Judiciary, 86th Cong., 2d Sess. at 22-23, 25-27, 29, 33-34, 37 (Comm. Print 1961). However, the relevant point for this proceeding is that Congress eventually *did* enact a performance right in sound recordings along with the statutory license that provides the impetus for this proceeding. The Judges must apply current law as written without regard to the politics that led to it (or delayed it). 17 U.S.C. §§ 114(f)(1)(A), § 801(b)(1)(B).

B. The 1971 Copyright Act Has Nothing To Do With This Proceeding

Response to ¶ 2. SoundExchange agrees that Congress did not extend federal copyright protection to sound recordings until 1971, principally as a result of political opposition initially by music publishers and later by radio broadcasters. *E.g.*, Barbara A. Ringer, Copyright Law Revision, Study No. 26, Subcomm. on Patents, Trademarks, and Copyrights, of the S. Comm. on the Judiciary, 86th Cong., 2d Sess. at 22-23, 25-27, 29, 33-34, 37 (Comm. Print 1961).

This ancient history is legally and factually irrelevant to the Judges' mandate in this proceeding. The Judges are required to apply current copyright law, not the law as it existed in 1971 (or earlier). 17 U.S.C. §§ 112(e)(3)-(5), 114(f)(1), 801(b)(1). Under current law, the

Judges are required to set "reasonable rates and terms" for the next five years, not the last century, 17 U.S.C. § 114(f)(1)(A), and to consider "existing economic conditions." 17 U.S.C. § 801(b)(1)(B). Information about existing conditions is to be found in the record of this proceeding, not the House Report cited by Music Choice, which is more than 45 years old.

Response to ¶ 3. The reasons why copyright law in 1971 was what it was are even less relevant to this proceeding. No useful information about setting "reasonable rates and terms" for the next five years, or about "existing economic conditions," is to be found in the reports cited by Music Choice: one fully 60 years old and the other almost 40 years old.

C. The Digital Performance Rights In Sound Recordings Act

Response to ¶ 4. The reason Music Choice's detour through copyright history is irrelevant to this proceeding is that in 1995, Congress enacted the Digital Performance Rights in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (the "DPRA"). That statute granted copyright owners of sound recordings the exclusive right "to perform the[ir] copyrighted work publicly by means of a digital audio transmission." 17 U.S.C. § 106(6). That right is limited only in the same sense that all of the rights granted by Section 106 of the Copyright Act are subject to various limitations and exceptions. *See generally* 17 U.S.C. §§ 107-122. Because this is a rate-setting proceeding, not an infringement action, the details of the scope of the performance right are not relevant here.

Response to ¶ 5. It is appropriate to consult legislative history as an aid in the interpretation of a statutory provision only if the statute is ambiguous. *E.g., Exxon Mobil Corp. v. Allapattah Serv., Inc*., 545 U.S. 546, 568 (2005) ("[T]he authoritative statement is the statutory text, not the legislative history or any other extrinsic material. Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature's

understanding of otherwise ambiguous terms."). Music Choice has not suggested that any of the statutory provisions controlling this proceeding is ambiguous. However, to the extent that the Judges may wish to consult legislative history relevant to the digital performance right, the first sentence of explanatory text in both the House Report and Senate Report accompanying the DPRA could not be clearer that "[t]he purpose of [the DPRA] is to ensure that performing artists, record companies and others whose livelihood depends upon effective copyright protection for sound recordings, will be protected as new technologies affect the ways in which their creative works are used." H.R. Rep. No. 104-274, at 10 (1995); *see also* S. Rep. No. 104-128, at 10 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 356, 357.

Response to ¶ 6. The statutory performance license is an exception to the general rule that copyright owners of sound recordings have exclusive rights to control the use of their works. 17 U.S.C. § 106(6). As a general matter in construing statutory provisions, when "a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision." *Commissioner v. Clark*, 489 U.S. 726, 739 (1989); *see also Tasini v. N.Y. Times Co.*, 206 F.3d 161, 168 (2d Cir. 2000) (applying *Clark* in a copyright context), *aff'd*, 533 U.S. 483 (2001).

Consistent with that general principle, Congress has expressly recognized when enacting statutory licenses that they are an exception to the usual exclusive rights of a copyright owner and should be interpreted in a way that minimizes the effects of government intrusion into the marketplace. S. Rep. No. 106-42, at 10 (1999) ("[I]n creating compulsory licenses, [Congress] is acting in derogation of the exclusive property rights granted by the Copyright Act to copyright holders and . . . it therefore needs to act as narrowly as possible to minimize the effects of the Government's intrusion on the broader market in which the affected property rights and

industries operate); *see also* H.R. Rep. No. 108-660, at 8-9 (2004) (compulsory licenses constitute an "abrogation of copyright owners' exclusive rights"); *Fame Publ'g Co. v. Ala. Custom Tape, Inc.*, 507 F.2d 667, 670 (5th Cir. 1975) (Section 115 compulsory license is "a limited exception to the copyright holder's exclusive right to decide who shall make use of his composition . . . [and] must be construed narrowly, lest the exception destroy, rather than prove, the rule").

Creation of the statutory license did not reflect a congressional determination that services eligible for the statutory license posed no threat to record companies' traditional business of selling records. To the contrary, the legislative history of the DPRA notes a concern that subscription services like the ones now known as the PSS "might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for use of their work." S. Rep. 104-128, at 15, reprinted in 1995 U.S.C.C.A.N. at 361. The D.C. Circuit recently confirmed that the protective purposes of the DPRA extended to the services now known as the PSS. After noting that the absence of a performance right allowed those services to use sound recordings without obtaining a license, the court explained, "sensing that emerging technology posed a threat to copyright owners' interests, Congress stepped in." *SoundExchange, Inc. v. Muzak LLC*, 854 F.3d 713, 714 (D.C. Cir. 2017).

II. Legal History Of The Statutory License For PSS

A. Congress Creates A Statutory License For Noninteractive Subscription Services

Response to ¶ 7. The purpose of the DPRA was to provide copyright owners of sound recordings a performance right where there had not been one, and thus to either afford them control over, or at least reasonable remuneration from, digital performances of their works. As the relevant congressional committees put it, "[t]he purpose of [the DPRA was] to ensure that

performing artists, record companies and others whose livelihood depends upon effective copyright protection for sound recordings, will be protected as new technologies affect the ways in which their creative works are used." H.R. Rep. No. 104-274, at 10; *see also* S. Rep. 104-128, at 10 (1995), *reprinted in* 1995 U.S.C.C.A.N. at 357. The linkage between protection and compensation was made explicit by the Congressional Budget Office, which said the "[b]ill purpose" was to "create a system to ensure that recording artists and companies are compensated for public performances of their works by means of certain types of digital audio transmissions." S. Rep. No. 104-128, at 46 (1995), *reprinted in* 1995 U.S.C.C.A.N. at 393.

Foreseeing the shift to performance-based services that is now occurring, Congress explained:

> [I]n the absence of appropriate copyright protection in the digital environment, the creation of new sound recordings and musical works could be discouraged, ultimately denying the public some of the potential benefits of the new digital transmission technologies. Current copyright law is inadequate to address all of the issues raised by these new technologies dealing with the digital transmission of sound recordings and musical works and, thus, to protect the livelihoods of the recording artists, songwriters, record companies, music publishers and others who depend upon revenues derived from traditional record sales.

H.R. Rep. 104-274, at 13; *see also* S. Rep. 104-128, at 14, *reprinted in* 1995 U.S.C.C.A.N. at 361.

Similarly, Senator Feinstein, a co-sponsor of the DPRA, stated upon the occasion of its passage:

> Why should the digital transmission businesses be making money by selling music when they are not paying the creators who have produced that music?
>
> If this should occur without copyright protection, investment in recorded music will decline, as performers and record companies produce recordings which are widely distributed without

> compensation to them. This would result in the decline of what presently constitutes one of America's most important, productive and competitive industries.

141 Cong. Rec. 22,790 (1995) (statement of Sen. Feinstein).

The D.C. Circuit recently confirmed the protective purposes of the DPRA. After noting that the absence of a performance right allowed the services now known as the PSS to use sound recordings without obtaining a license, the court explained, "sensing that emerging technology posed a threat to copyright owners' interests, Congress stepped in." *Muzak LLC*, 854 F.3d at 714.

Response to ¶ 8. To be sure, Congress intended "to strike a balance among all of the interests affected" by the new performance right. H.R. Rep. 104-274, at 14; *see also* S. Rep. 104-128, at 14, reprinted in 1995 U.S.C.C.A.N. at 361. However, Music Choice mischaracterizes the interests that Congress perceived as being at stake. The DPRA was not backward-looking legislation seeking to protect the record companies' traditional business of selling records, but rather forward-looking legislation designed to "provide copyright holders of sound recordings with the ability to control the distribution of their product by digital transmissions, without hampering the arrival of new technologies." H.R. Rep. 104-274, at 14; *see also* S. Rep. 104-128, at 15, reprinted in 1995 U.S.C.C.A.N. at 362.

Response to ¶ 9. One of the ways the DPRA accommodated established interests was by the creation of a statutory license. However, Congress never suggested that copyright owners should get less than full and fair compensation for the use of their recordings under the statutory license, or that digital music services should receive the benefit of below-market rates for their exploitation of the labor, creative efforts, and financial investment of artists and copyright owners.

Response to ¶ 10. The statutory license has various conditions. As to the PSS, these are currently set forth in 17 U.S.C. § 114(d)(2)(A) and (B). However, Music Choice's suggestion that a service satisfying these conditions could not have a negative effect on record sales has no basis in the legislative history it cites. The closest that legislative history comes to stating the proposition for which Music Choice cites it is a statement that on-demand services "pose the greatest threat to traditional record sales." H.R. Rep. 104-274, at 14; *see also* S. Rep. 104-128, at 16. But that is well less than a congressional prediction that other services would have little or no risk on sales.

To the contrary, the legislative history also notes a concern that subscription services like the ones now known as the PSS "might adversely affect sales of sound recordings and erode copyright owners' ability to control and be paid for use of their work." S. Rep. 104-128, at 15, reprinted in 1995 U.S.C.C.A.N. at 362. Anticipating the shift to streaming that is now occurring, Congress sought to protect artists and copyright owners by giving them at least the right to reasonable compensation from all digital performance-based uses of their works, including by the PSS. The D.C. Circuit recently confirmed that the protective purposes of the DPRA extended to the services now known as the PSS. After noting that the absence of a performance right allowed the services to use sound recordings without obtaining a license, the court explained, "sensing that emerging technology posed a threat to copyright owners' interests, Congress stepped in." *Muzak LLC*, 854 F.3d at 714.

Twenty years of experience with streaming services confirms that Congress' concern was well-founded. Streaming services of all kinds – including services relying on the statutory license – have had significant negative effects on the traditional business of selling copies of recordings. Trial Ex. 28 at ¶¶ 16-30 (Willig WDT).

Response to ¶ 11. The DPRA was only possible because the two subscription streaming services then in operation – Music Choice and DMX – agreed not to oppose the bill. The CEO of DMX testified that he "believe[d] that sound recording copyright owners and recording artists deserve compensation" for their use of recordings. S. Rep. 104-128, at 15, reprinted in 1995 U.S.C.C.A.N. at 362. Music Choice agreed to support the DPRA to secure investment from record company affiliates in the early 1990s. SE FOF at ¶ 1969. Congress never suggested that copyright owners should get less than full and fair compensation for the use of their recordings under the statutory license.

Response to ¶ 12. The choice of the Section 801(b)(1) rate standard to set rates under the statutory license is barely mentioned at all in the legislative history of the DPRA, and no rationale for its selection is specified. S. Rep. 104-128, at 30, reprinted in 1995 U.S.C.C.A.N. at 377. That standard had governed Section 115 statutory royalty rates for almost 20 years at that time and had been noncontroversial. Copyright Act of 1976, Pub. L. No. 94-553 § 801(b)(1), 90 Stat. 2541, 2594-95. Because the DPRA made significant revisions to Section 115 that in significant respects paralleled the new Section 114 statutory license, it seems most likely that Section 801(b)(1) was employed in Section 114 to maintain parallelism with Section 115.

The Section 801(b)(1) objectives were originally enacted to provide additional specificity concerning the concept of a reasonable rate, and thereby avoid possible constitutional issues as to the delegation of rate-setting authority to the Copyright Royalty Tribunal. *In the Matter of Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 FR 4080, 4082 (2008) (hereinafter "*SDARS I*"). By the time of the DPRA, there had been only two litigated proceedings under Section 801(b)(1). In the 1980 Section 116 proceeding, the Copyright Royalty Tribunal gave scant consideration to the Section

801(b)(1) objectives, and simply concluded that the rate it had derived from "marketplace analogies" was consistent with each of the objectives. *SDARS I*, 73 FR at 4082 (citing 46 FR at 889). In the 1981 Section 115 proceeding, the Copyright Royalty Tribunal "nearly doubled the existing rates" after applying the objectives to marketplace evidence. *SDARS I*, 73 FR at 4083. Nothing in these decisions would have caused Congress in 1995 to think that by incorporating the Section 801(b)(1) rate standard, it was favoring the services or calling for a rate that would be maintained at below-market levels for decades. That would have been contrary to its expressed purpose of protecting artists and record companies. H.R. Rep. 104-274, at 10; *see also* S. Rep. 104-128, at 10, *reprinted in* 1995 U.S.C.C.A.N. at 357. Certainly in its consideration of the DPRA, Congress never suggested that copyright owners should get less than full and fair compensation for the use of their recordings under the statutory license.

B. Congress Passes The Digital Millennium Copyright Act

Response to ¶ 13. After enactment of the DPRA, it quickly became apparent that there was a lack of agreement concerning how it applied to webcasters, who were just emerging at the time and had not been a focus of the DPRA. H.R. Conf. Rep. No. 105-796, at 80 (1998), *as reprinted in* 1998 U.S.C.C.A.N. 639, 656; Section-by-Section Analysis of H.R. 2281 as Passed by the United States House of Representatives on August 4, 1998, H. Comm. on the Judiciary, 150th Cong. 50-52 (Comm. Print 1998). As part of the legislative negotiations leading to enactment of the Digital Millennium Copyright Act ("DMCA"), a compromise was reached to accommodate webcasters within the statutory license structure. However, the predecessors of Sirius XM and the services now known as the PSS opposed having those changes apply to them. Accordingly, an agreement was reached to "grandfather" certain of their service offerings under

the statutory license conditions and rate standard that had applied under the DPRA. H.R. Conf. Rep. No. 105-796, at 80-81, 85, 88-89, reprinted in 1998 U.S.C.C.A.N. at 656-57, 661, 664-65.

Response to ¶ 14. The compromise concerning accommodation of webcasters within the statutory license was reached shortly after the Librarian's *PSS I* decision was released, and while that decision was on appeal to the D.C. Circuit. *See In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 FR 25394 (1998) (hereinafter "*PSS I*"); *Recording Industry Ass'n of America, Inc. v. Librarian of Congress*, 176 F.3d 528 (D.C. Cir. 1999). While record companies opposed extension of the statutory license to webcasters without the legislation being absolutely clear that a fair-market willing buyer/willing seller rate standard would apply, *see* 17 U.S.C. § 114(f)(2)(B), the record companies and PSS were all surely mindful of interfering with the pending *PSS I* appeal.

Response to ¶ 15. The legislative history describing the DMCA's bifurcation of Section 114(f) into separate parts for the SDARS/PSS and other services could hardly devote less attention to the difference in rate standards. The two rate standards are noted in passing, but the Conference Report discusses the differing provisions concerning the timing of proceedings and the minimum fee at much greater length than the rate standards. H.R. Conf. Rep. 105-796, at 85-86, *reprinted in* 1998 U.S.C.C.A.N. at 661. Congress specified no rationale for the different rate standards other than continuing the status quo. *Id*. at 85.

Response to ¶ 16. Music Choice argues that the different rate standards were intended to prevent disruption to the PSS. However, the legislative history Music Choice cites does not actually pertain to the different rate standards in Section 114(f). Instead, that part of the Conference Report discusses the different statutory license conditions in Section 114(d)(2). It makes sense that adding a number of new statutory license conditions (now codified in Section

114(d)(2)(C)) might have had the potential of "disruption of the existing operations" of the PSS. H.R. Conf. Rep. 105-796, at 80-81, *reprinted in* 1998 U.S.C.C.A.N. at 656-57. Congress' desire to avoid adopting statutory license conditions that might be disruptive says nothing at all about its motivations for continuing the Section 801(b)(1) rate standard.

Response to ¶ 17. It is true that a 2006 decision by the Register mentions PSS investments and suggests that the DMCA was intended to protect the PSS. However, those passages must be understood in context. The purpose of the Register's opinion on which Music Choice relies was to determine which services and/or entities were entitled to claim PSS status. *See In re Designation as a Preexisting Subscription Service*, 71 FR 64639, 64646 (2006) (hereinafter "*Register's PSS Opinion*"). The decision did not address the proper application of the Section 801(b)(1) objectives and was limited to questions of PSS eligibility. It mentions the Section 801(b)(1) objectives only a few times in a background discussion, and does not purport to construe that rate standard. 71 FR at 64641.

The specific discussion cited by Music Choice and mentioning PSS investments and protection focuses on the same "existing operations" language from the legislative history that is addressed in Response ¶ 16. That part of the Conference Report discusses the different statutory license conditions in Section 114(d)(2), rather than the different rate standards in Section 114(f). 71 FR at 64645. It would be improper to read the Register's discussion of license conditions in a decision concerning PSS eligibility as conveying some broader lessons concerning the proper interpretation of Section 801(b)(1), which was hardly mentioned in the decision.

Response to ¶ 18. The legislative history cited by Music Choice is irrelevant to interpretation of Section 801(b)(1). As discussed further in Response ¶ 21, Section 801(b)(1) was originally enacted in 1976, and the four objectives continue substantively unchanged to this

day. Legislative history from a different enactment 20 years later cannot be consulted in the interpretation of Section 801(b)(1). Moreover, even if it were appropriate to consult this legislative history concerning the PSS definition, it does not actually say anything about rates or any protective purpose. It just describes the boundaries that were drawn in the definition.

Response to ¶ 19. The fact that the DMCA does not include a sunset provision for the PSS category says nothing about interpretation of Section 801(b)(1). Indeed, the lack of a sunset provision is entirely consistent with the overall legislative history, which devotes next to no attention to the difference in rate standards between the SDARS/PSS and other services.

Response to ¶ 20. The content and outcome of the recording industry's post-DMCA lobbying efforts are irrelevant to Congress's intent in passing the DMCA and the Section 801(b)(1) objectives, which were enacted as part of the Copyright Act of 1976.

Response to ¶ 21. Section 801(b)(1) was originally enacted in 1976, and the four objectives continue substantively unchanged to this day. Copyright Act of 1976, Pub. L. No. 94-553 § 801(b)(1), 90 Stat. 2541, 2594-95 (1976). Specifically, neither the DPRA nor the DMCA made any changes in the statutory text articulating that rate standard. Consistent with that, a proper review of the DMCA legislative history (as described in the preceding paragraphs) shows only that Congress intended to preserve the status quo as to the PSS rate standard.

Thus, in interpreting the Section 801(b)(1) objectives, what matters is what Congress said and meant in 1976 when it enacted those objectives, not anything that Congress might or might not have thought when it referred to them in the DPRA or continued their application to the PSS in the DMCA. *Bruesewitz v. Wyeth LLC*, 562 U.S. 223, 241-42 (2011) ("[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation"); *District of Columbia v. Heller*, 554 U.S. 570, 605 (2008) ("'[p]ostenactment legislative history'

. . . could have had no effect on the congressional vote"); *Sullivan v. Finkelstein*, 496 U.S. 617, 628 n.8 (1990) (noting the "difficulties inherent in relying on subsequent legislative history"). In this proceeding, the Judges must interpret and apply Section 801(b)(1) as to the PSS consistent with the statutory text, the same way Section 801(b)(1) has always been interpreted and applied, under both Section 114 and 115.

Because the Section 801(b)(1) objectives have remained substantively unchanged since 1976, and legislative history from the 1990s can shed no light on what Congress intended when it enacted Section 801(b)(1) in 1976, it is appropriate to look at earlier interpretations of those provisions, as Music Choice urges the Judges to do. Specifically, Music Choice points to the 1981 decision of the Copyright Royalty Tribunal in the first litigated proceeding under Section 115. *In re Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 46 FR 10466, 10478-79 (1981) (hereinafter *"1981 Phonorecords Determination"*) (reviewing the legislative history of Section 801(b)(1)). The Judges reviewed that decision when they were first called upon to interpret Section 801(b)(1) in *SDARS I*, and found that it left their path "well laid out." *SDARS I*, 73 FR at 4082-84.

Among other things, the 1981 Section 115 decision held that (1) "a reasonable adjustment of the statutory rate should work to ensure the full play of market forces, while affording individual copyright owners a reasonable rate of return for their creative works"; (2) the first Section 810(b)(1) objective is intended "to encourage the creation and dissemination" of works subject to the statutory license; (3) "in most instances, the rate of return afforded the copyright owner is determined on the free market"; (4) the licensed work is "an essential input" to the licensee's offering; and (5) even a significant statutory rate increase is not disruptive if it "is necessary to afford copyright owners a fair return" and the licensee has an ability "to absorb, or

pass on" the increase. *1981 Phonorecords Determination*, 46 FR at 10479-81. Those are principles Congress thought it was applying to the PSS in the DPRA and continuing to apply to the PSS in the DMCA.

III. Legal Standards And Precedents Applicable To PSS Rate

A. Categories Of Precedent Applicable To Adjustment Of PSS Rate

Response to ¶ 22. 17 U.S.C. § 803(a)(1) provides that 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, copyright arbitration royalty panels (to the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights), and the Copyright Royalty Judges (to the extent those determinations are not inconsistent with a decision of the Register of Copyrights that was timely delivered to the Copyright Royalty Judges . . . or with a decision of the Registrar of Copyrights . . . and decisions of the court of appeals under this chapter before, on, or after the effective date of the Copyright Royalty and Distribution Reform Act of 2004." SoundExchange and Music Choice agree that the Judges should act in accordance with this provision.

Response to ¶ 23. SoundExchange and Music Choice agree that cases involving the application of the Section 801(b)(1) factors are highly relevant to this proceeding. However, Music Choice incorrectly asserts that this Court is somehow limited to considering only precedent involving a direct application of the Section 801(b)(1) objectives. Nothing in Section 803(a)(1), quoted above, suggests that is the case. The Judges are not required to bury their heads in the sand and ignore persuasive authority or useful analogies where they may be

relevant. Indeed, Music Choice itself cites numerous cases that do not involve application of Section 801(b)(1). *See, e.g.*, MC COL at ¶¶ 14, 19, 34, 89.

B. The 801(b)(1) Standard

Response to ¶ 24. SoundExchange and Music Choice agree that the Judges must apply Section 801(b)(1).

C. Principles From Applicable Precedent Must Guide The Judges' Application Of Section 801(b)(1)

1. Rate Setting Pursuant To Section 801(b)(1) Is Distinct, But Not Fundamentally Different, From Rate-Setting Pursuant To A Willing Buyer-Willing Seller Standard.

Response to ¶ 25. It is true that in this proceeding the Judges are required to set a rate that achieves the Section 801(b)(1) objectives, while a rate set pursuant to the willing buyer/willing seller rate standard does not necessarily need to achieve the Section 801(b)(1) objectives. Setting a rate that meets these objectives has been described as involving policy judgments and a measure of discretion. However, "[d]iscretion is not whim." *Martin v. Franklin Capital Corp*., 546 U.S. 132, 139 (2005). The Judges must apply the law, including the authority identified in Section 803(a)(1), and the rationale for making a decision must be sound. *PSS I*, 63 FR at 25409. The Judges also must "articulate[] a rational connection between the facts found and the choice made." *E. Ky. Power Co-op, Inc. v. FERC*, 489 F.3d 1299, 1307 (D.C. Cir. 2007).

> The Judges and their predecessors have developed a well-established methodology for setting rates under Section 801(b)(1), and that methodology is part of the law that Section 803(a)(1) requires the Judges to apply in this proceeding. As the Judges explained in *SDARS I*, after reviewing the history of rate-setting under Section 801(b)(1)
>
> The path for the Copyright Royalty Judges is well laid out. We shall adopt reasonable royalty rates that satisfy all of the objectives

> set forth in Section 801(b)(1)(A)-(D). In so doing, we begin with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach our decision. Section 114(f)(1)(B) also affords us the discretion to consider the relevance and probative value of any agreements for comparable types of digital audio transmission services . . . .

SDARS I, 73 FR at 4084; *see also* SE FOF ¶ 95, § XIII.B.i.

The Judges have further elaborated that consideration of the Section 801(b)(1) objectives warrants an adjustment to the benchmark rate only when a "relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment." *SDARS I*, 73 FR at 4094-95. Where a marketplace benchmark adequately addresses the statutory objectives, adjustments to that benchmark are unnecessary. *SDARS I*, 73 FR at 4094-95 (finding that the record does not support any adjustment for the first objective); *In re 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players*, 46 FR 884, 889 (1981) (hereinafter "*Jukeboxes*") (same). An adjustment under Section 801(b)(1) must be supported by sufficient evidence in the record. *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 78 FR 23054, 23066 (2013) (hereinafter "*SDARS II*").

The Judges and their predecessors have also had various things to say about interpretation of specific Section 801(b)(1) objectives, and these too are part of the law that Section 803(a)(1) requires the Judges to apply in this proceeding. Music Choice's reference to neo-classical economics (citing the testimony of non-lawyer witnesses, rather than legal authority) is inconsistent with that law. For example, interpreting the first Section 801(b)(1) objective (availability) in *SDARS I*, the Judges explained that "an effective market determines the maximum amount of product availability consistent with the efficient use of resources." *SDARS*

I, 73 FR at 4094. Similarly, the Judges agreed with Dr. Ordover in that same proceeding that "voluntary transactions between buyers and sellers as mediated by the market are the most effective way to implement efficient allocations of societal resources." *SDARS I*, 73 FR at 4094.

Similarly with respect to the second Section 801(b)(1) objective, the Judges in *SDARS I* explained that "a fair income is . . . consistent with reasonable market outcomes." *SDARS I*, 73 FR at 4095. In *SDARS II*, the Judges noted a presumption that a "marketplace-inspired" rate "already reflects a fair income and a fair return." *SDARS II*, 78 FR at 23067. Accordingly, neo-classical economics is highly relevant in applying the Section 801(b)(1) objectives.

Response to ¶ 26. While the Judges can and should consider all facts relevant to the Section 801(b)(1) objectives, the Judges "begin with a consideration and analysis of the benchmarks and testimony submitted by the parties," so as to ascertain a rate that would represent a hypothetical marketplace transaction between a willing buyer and seller. *SDARS I*, 73 FR at 4084. For an adjustment to a benchmark to be proper, it must be supported by evidence. *See SDARS I*, 73 FR at 4089, 4093. "The absence of solid empirical evidence that might suggest a difference between the benchmark and target markets cautions against the need for an adjustment." *SDARS II*, 78 FR at 23066.

There may be cases where the evidence establishes a directional result or a range of results with a sufficiently high degree of confidence that the Judges could act consistent with that evidence without being arbitrary, even if that result cannot be fixed with mathematical precision. However, the Judges must base their decision on evidence. For example, given the history of PSS rate-setting, it is clear that the current statutory royalty rate for PSS is well below market. SE FOF § XIII.B.3. SoundExchange believes that its proposed CABSAT benchmark provides a reasonable proxy for a market rate for the television-based services provided by the PSS. SE

FOF § XIII.B.2. However, even if the Judges were unconvinced of that, it would be contrary to the evidence for the Judges simply to assume that the current statutory rate is a reasonable proxy for a market rate and proceed to measure that against the Section 801(b)(1) objectives. It would be most appropriate for the Judges to make the best estimate they can of the market rate based on the available evidence before proceeding to weigh that estimate against the Section 801(b)(1) objectives.

As to the alleged promotional impact of Music Choice, it has provided only the same kinds of anecdotal evidence that the Judges have consistently rejected. That evidence does not even indicate a directional result. SE FOF at § XIII.D.2.iii.a.

2. Rates Set Pursuant To 801(b)(1) Are Based On The Best Available Benchmarks, Adjusted As Necessary To Fit The 801(b)(1) Objectives.

Response to ¶ 27. Of course, the Register held in *PSS I* that a rate set pursuant to Section 801(b)(1) does not necessarily need to be a market rate. *PSS I*, 63 FR at 25409. However, Music Choice incorrectly represents that the Section 801(b)(1) standard "need not bear any relationship to a marketplace rate." As discussed above, the Judges begin the Section 801(b)(1) analysis "with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach [their] decision." *SDARS I*, 73 FR at 4084. This approach was also the one employed by the Copyright Arbitration Royalty Panel ("CARP") in *PSS I*. The CARP explained:

> In prior royalty adjustment proceedings, the CRT and CARPs have utilized a consistent approach to rate-setting. They looked initially at specific "benchmarks" – rates negotiated in analogous market transactions. They then analyzed those benchmarks in light of the applicable statutory criteria and record evidence to determine a reasonable royalty rate.

PSS I CARP Report, Trial Ex. 979 at ¶ 123. The Register of Copyrights endorsed this approach. *PSS I*, 63 FR at 25400. While the benchmark rate may be adjusted if necessary to achieve the Section 801(b)(1) objectives, an adjustment is appropriate only when a "relative difference between the benchmark market and the hypothetical target market would necessitate an adjustment." *SDARS I*, 73 FR at 4094-95.

Music Choice also appears to suggest that the Section 801(b)(1) standard applies differently to the PSS than to SDARS. The words of Section 801(b)(1) mean the exact same thing whether applied to an SDARS service, a PSS, or under Section 115.

Response to ¶ 28. The Register's legal holding in *PSS I* is clear. Response to ¶ 27. However, her legal interpretation of Section 801(b)(1) is distinct from the rate set based on the particular facts in the record of that case. She did not hold, and it is not the law, that the PSS must always have a below-market rate. The particular rate decided, and the decision to set a low rate, were based on the factual record in that proceeding, which reflected the unique factual circumstances of the time. The arbitrators "expressly noted that a future Panel may reach an entirely different result based on the then-current economic state of the industry and new information on the Services' impact on the marketplace." *PSS I*, 63 FR at 25405. The Register likewise noted that "another Panel will have an opportunity to make adjustments to the rate, and may well find that the changed circumstances favor an upward adjustment." *PSS I*, 63 FR at 25409.

A rate set pursuant to Section 801(b)(1) could be above-market rate if that is what best achieved the Section 801(b)(1) objectives. In Section 801(b)(1) Congress merely provided that "[t]o make determinations and adjustments of reasonable terms and rates of royalty payments" the rates determined pursuant to it "shall be calculated to achieve the following objectives." 17

U.S.C. § 801(b)(1). Congress did not prescribe an adjustment in any particular direction. To the contrary, the Judges' discretion to adjust upward as well as downward if they see fit is underscored by the evenhandedness of the 801(b)(1) objectives. For example, the second factor requires the Judges to set a rate that will "afford the copyright owner a fair return for his or her creative work" while at the same time affording "the copyright user a fair income." 17 U.S.C. § 801(b)(1)(B). Likewise, the third factor requires consideration of "the relative roles of the copyright owner and the copyright user" in making the product available to the public. 17 U.S.C. § 801(b)(1)(C). As set out in the unambiguous statutory text of Section 801(b)(1), Congress gave the Judges discretion to adjust the marketplace benchmark rates *in whatever direction* is necessary to achieve the statutory objectives.

Response to ¶ 29. Although the D.C. Circuit did conclude that Section 801(b)(1) does not *require* the use of "market rates," it also did not hold more than that. Rather, the D.C. Circuit concluded only that the Librarian of Congress's determination on Section 801(b)(1) was "reasonable," making it permissible under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *See Recording Industry Ass'n of Am. v. Librarian of Congress*, 176 F.3d 528, 533 (D.C. Cir. 1999).

Response to ¶ 30. The D.C. Circuit's description of the DMCA is entirely consistent with SoundExchange's responses above.

3. Music Choice Improperly Seeks To Institute A Presumption That Market Rates Do Not Satisfy The Section 801(b)(1) Objectives

Response to ¶ 31. Music Choice seeks to transmogrify the plain text of Section 801(b)(1) and over 35 years of consistent interpretations of that text into a requirement that the Judges pull statutory rates out of the air based on what feels right without any regard to the important information that market rates provide about how best to achieve the statutory

objectives. At times Music Choice almost seems to be arguing that a rate that achieves the Section 801(b)(1) objectives should never be a market rate. That certainly is not what is held in the authority described above. In effect it is the same as RIAA's rejected position in *PSS I*, but running in the opposite direction. It must be rejected for the same reasons.

Under Section 801(b)(1), the Judges are to "begin with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach [their] decision." *SDARS I*, 73 FR at 4084. The Judges should make departures from the benchmark rates if, and only if, that is necessary to achieve the Section 801(b)(1) objectives. The Judges may well decide that, after making appropriate adjustments to account for differences between the benchmark and target markets to best reproduce a rate that would represent hypothetical marketplace transactions between a willing SDARS buyer and a willing record company seller, no further adjustment is necessary based on the Section 801(b)(1) objectives.

Response to ¶ 32. Music Choice seems to be referring to the Register's statement in *PSS I* that a statutory rate "rarely does" mirror a market rate. *PSS I*, 63 FR 25409. On its face that is plainly a factual observation and not law. After artists and copyright owners have for 20 years endured a statutory royalty rate for PSS that is clearly below-market, SE FOF at § XIII.B.3, it is probably a factual observation with which many would agree.

However, the Judges' duty in this proceeding is to apply the law as expressed in the text of Section 801(b)(1) and the authority identified in Section 803(a)(1), not a passing factual observation made by the Register 20 years ago. Contrary to Music Choice's assertions, the relevant legal precedent says nothing about whether the Section 801(b)(1) objectives are "typically" effectuated in benchmark negotiations. The applicable precedent makes clear that an

adjustment to the benchmark rate is appropriate only when necessary to effectuate Section 801(b)(1). It does not establish how often such an adjustment will be necessary. Response ¶ 25.

Response to ¶ 33. As discussed previously, the DMCA's legislative history says hardly anything about why Congress adopted the Section 801(b)(1) standard for Section 114 in the DPRA or bifurcated Section 114(f) into separate paths for the SDARS/PSS and other services. There was certainly nothing approaching a "specific intent" to protect the PSS at the expense of future market entrants or artists and record companies. Response to ¶¶ 12-16.

Response to ¶ 34. Section 801(b)(1) is far from "surplusage." The law is clear that it is the Judges' duty to apply Section 801(b)(1) in accordance with its text and the authority identified in Section 803(a)(1). Music Choice's convoluted arguments about the appropriateness of "presumptions" notwithstanding, the Judges' precedents on how 801(b)(1) should be implemented are clear. Response to ¶¶ 21, 25. Earlier in this case, before its recent desire to lead the Judges into a more rudderless application of Section 801(b)(1), Music Choice acknowledged as much. As Dr. Crawford explained:

> [T]here are two steps to this process. The first step is to determine what royalties would arise in the absence of regulatory intervention, i.e. what royalties would arise in a "hypothetical market" for PSS sound recording performance rights. The second step is to consider how the royalties that arose in such a hypothetical market should be adjusted, if at all, to account for the four statutory objectives outlined in Section 801(b) of the Act.

Trial Ex. 54 at ¶ 39 (Crawford WDT).

Response to ¶ 35. Music Choice mischaracterizes the Judges' precedent on when a benchmark rate may effectuate Section 801(b)(1). Music Choice suggests that the appropriate rate, by default, will be one that is not a benchmark rate and adoption of a benchmark rate must be based on a "specific evidentiary showing with respect to the policy objectives as applied to

that agreement." In other words, Music Choice seeks to do what it repeatedly cautions against: set up a blanket presumption – *against* adoption of an unadjusted benchmark rate under Section 801(b)(1). The Judges have discredited this theory. For an adjustment to be made to a benchmark under Section 801(b)(1), the adjustment must be supported by the evidence, and within the limits of reasonable estimation, account for key differences between the proposed benchmark market and the target market so as to resolve the lack of comparability. *See SDARS I*, 73 FR at 4089, 4093. "The absence of solid empirical evidence that might suggest a difference between the benchmark and target markets cautions against the need for an adjustment." *SDARS II*, 78 FR at 23066.

4. Nothing In The Text Of Section 801(b)(1) Or Relevant Precedents Suggests That Benchmark Rates Are Supposed To Set An "Upper Bound" On Reasonable Rates.

Response to ¶ 36. Music Choice seeks to read into Section 801(b)(1) something that appears nowhere in its plain text: a rule that a benchmark rate functions as a "ceiling" for the appropriate. The text of Section 801(b)(1) says nothing to that effect. It is certainly possible that an above-market rate might in some situations be consistent with the Section 801(b)(1) objectives. Response to ¶ 28.

Music Choice mischaracterizes the sole case that it has cited for this proposition, *Recording Industry Ass'n of Am. v. Copyright Royalty Trib.*, 662 F.2d 1 (D.C. Cir. 1981). In that case, the D.C. Circuit reached the narrow, fact-driven conclusion that a rate is not reasonable under Section 801(b)(1) when it is "deliberately fixed above the level that the market can bear so that a lower rate can be negotiated in the marketplace." *RIAA*, 662 F.2d at 12. That is very different from a conclusion that the Section 801(b)(1) objectives can never compel an above-market rate under the facts of a particular case.

Response to ¶ 37. Again, Music Choice seeks to engraft a presumption against the adoption of benchmark rates onto Section 801(b)(1). As discussed previously, in SoundExchange's Response to paragraph 31, nothing in Section 801(b)(1) establishes a higher evidentiary bar for use of a benchmark rate, as opposed to some other rate. To the contrary, a benchmark rate is appropriate if it satisfies the Section 801(b)(1) factors and should be adjusted based on those factors if it does not. Response to ¶ 25.

5. Rates May Be Adjusted In Future Proceedings Based Upon Changed Circumstances

Response to ¶ 38. SoundExchange agrees that rates are set for each ratemaking period based on circumstances related to the Section 801(b)(1) objectives as they exist at the time. *PSS I*, 63 FR at 25405 ("a future Panel may reach an entirely different result based on the then-current economic state of the industry and new information on the Services' impact on the marketplace"). To the extent that Music Choice suggests that the Judges can simply dispense with the well-established methodology of first trying to ascertain a market rate and then adjusting based on Section 801(b)(1), that is not the law. Response to ¶ 25. The Judges must reject Music Choice's invitation to pull a rate out of the air based on what feels right rather than taking into account the important information provided by consideration of benchmarks.

6. Congress Intended That The Section 801(b)(1) Objectives Apply To The PSS

Response to ¶ 39. Interpretation of Section 801(b)(1) must begin with the text of the Copyright Act, and unless that text is ambiguous, the interpretation must end there as well. *Exxon Mobil*, 545 U.S. at 568. What the text of the Act makes clear is that the Judges are to apply Section 801(b)(1) in setting a rate for the PSS – no more and no less. The Judges must refuse Music Choice's wish to find in the legislative history of the DMCA, which was enacted

20 years after Section 801(b)(1), a desire to set low rates for PSS that Congress neglected to include in the statutory text.

The text is clear that PSS are to be treated differently from services whose rates are set pursuant to Section 114(f)(2), so one does not need to consult legislative history to see that. What is wrong is reading into Congress's decision to treat the PSS differently a desire to set below-market rates for PSS. There is no reliable indication that Congress intended to do anything other than maintain the status quo for the PSS.

Response to ¶ 40. Music Choice argues at length that Congress' intent in treating the PSS differently than later market entrants was to "reward" the PSS for their early "pioneering" investment in digital music services. Tellingly, however, Music Choice, does not actually cite to anything in the statutory text (or the legislative history of the DMCA for that matter) that actually says that. The reason it cites no such authority is because *nothing* in the statute or legislative history says anything about special solicitude for the PSS as compared to the later market entrants, at least when it comes to rates. By contrast, as discussed previously, the legislative history describing the DMCA's bifurcation of Section 114(f) into separate parts of the SDARS/PSS and other services devotes minimal attention to the difference in rate standards. The differences in the two standards are noted only in passing. H.R. Conf. Rep. 105-796, at 85-86, *reprinted in* 1998 U.S.C.C.A.N. at 661-62. Congress specified no rationale for the different rate standards other than continuing the status quo, which is what the statutory text obviously did. *Id*. at 85, *reprinted in* 1998 U.S.C.C.A.N. at 661. Thus, in this proceeding, the Judges must interpret and apply Section 801(b)(1) as to the PSS consistent with the statutory text, the same way Section 801(b)(1) has always been interpreted and applied.

Response to ¶ 41. To avoid repetition, SoundExchange incorporates its Response to paragraph 40, *supra*.

IV. Interpretation Of The Section 801(b)(1) Objectives

Response to ¶ 42. Seeking to avoid the import of the Judges' previous application of the Section 801(b)(1) objectives, Music Choice offers that there has been only one "appellate" decision interpreting 801(b)(1) – the *PSS I* determination. Music Choice ignores the 20 years of subsequent precedent that have followed since *PSS I*, including the Judges' determinations in *SDARS I* and *SDARS II*, as well as 20 years of earlier precedent under the Copyright Royalty Tribunal. Collectively, it is all these determinations, not a myopic view of only *PSS I*, that govern the proper application of Section 801(b)(1) to the PSS. 17 U.S.C. § 803(a)(1).

Music Choice's discussion of the Section 801(b)(1) objectives omits the well-established methodology for their application. The Judges must apply that methodology. Response to ¶ 25. Music Choice seems to suggest that the Judges should simply review the objectives one by one, tally up the results, and then guess at a rate they like without the benefit of market information to inform their decision. However, the Judges have made clear that the objectives are not "a beauty pageant where each factor is a stage of competition to be evaluated individually to determine the stage winner and the results aggregated to determine an overall winner." SDARS I, 73 FR at 4094. The Judges are to first try to ascertain a market rate, and then adjust based on the objectives.

A. Objective One: Maximizing The Availability Of Creative Works To The Public

Response to ¶ 43. Music Choice's lengthy discussion of the Register's decision in *PSS I* obscures the simple point of the first Section 801(b)(1) objective. Put simply, the first Section 801(b)(1) factor directs that licensing rates should be high enough to foster the creation of new

works, but not so high as to prevent allocation of an efficient level of resources to distribution of those works. The Judges' decisions in *SDARS II* and *SDARS I* are each consistent with this understanding of the first 801(b)(1) factor. *See SDARS II*, 78 FR at 23066-67; *SDARS I*, 73 FR at 4094-95. As Dr. Wazzan explained, market rates satisfy these conditions. Trial Ex. 501 at ¶ 20 (Wazzan Corr. WDT); *see also* Trial Ex. 26 at ¶ 15 (Orszag Am. WDT).

Response to ¶ 44. To avoid repetition, SoundExchange incorporates its Response to paragraph 43, *supra*.

Response to ¶ 45. The parties have submitted extensive findings of fact, so there is no need to rehash all their details under the rubric of conclusions of law. SoundExchange addresses Music Choice's supposed contributions to the availability of creative works in SE FOF § XIII.E.1 and SE MC RFOF § XII.B.

B. Objective Two: Affording The Copyright Owner A Fair Return And The Copyright User A Fair Income Under Existing Economic Conditions

Response to ¶ 46. The second Section 801(b)(1) objective counsels the Judges to consider whether the rate set will afford the copyright owner a fair return for his creative work and the copyright user a fair income under existing economic conditions. Affording copyright users a fair income "is not the same thing as guaranteeing them a profit." *SDARS I*, 73 FR at 4095. In general, a fair income is "consistent with reasonable market outcomes." *SDARS II*, 78 FR at 23067 (quoting *SDARS I*, 73 FR at 4095). "In the absence of substantial evidence in the record to the contrary, any marketplace benchmark rate that guides the selection of rates will encompass such a return because it represents the best evidence of reasonable market outcomes." *SDARS II*, 78 FR at 23067. A the market rate generally satisfies the second Section 801(b)(1) objective.

Response to ¶ 47. To avoid repetition, SoundExchange incorporates its Response to paragraph 46, *supra*.

Response to ¶ 48. To avoid repetition, SoundExchange incorporates its Response to paragraph 46, *supra*.

Response to ¶ 49. Notably, Music Choice provides no citations to legal authority for the propositions it states. And the portions of the *PSS I* CARP Report cited in the associated Music Choice findings are much more ambiguous than it suggests. To be sure, the arbitrators talked about the cable radio services, but that those were the services for which they were setting rates. It appears that Muzak was the only multi-platform provider at the time. *PSS I* CARP Report, Trial Ex. 979 at ¶¶ 22-27. The arbitrators addressed profitability only in very general terms without specific reference to Muzak. *Id*. ¶ 118. The *PSS I* decision did not conclude that profits from other lines of business are irrelevant to rate-setting. It appears that they were simply solicitous of the companies that were then stand-alone providers.

C. Objective Three: Reflecting The Relative Roles Of Copyright Owners And Copyright Users In The Product Made Available To The Public

Response to ¶ 50. The third Section 801(b)(1) objective addresses the relative roles of the copyright owners and the copyright user with respect to their relative creative and technological contributions, cost, risk, and contribution to the opening of new markets for creative expression.

Response to ¶ 51. To avoid repetition, SoundExchange incorporates its response to paragraph 50, *supra*.

D. Objective Four: Minimizing Any Disruptive Impact On The Structure Of The Industries Involved And On Generally Prevailing Industry Practices

Response to ¶ 52. The fourth Section 801(b)(1) objective is minimizing any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. As the Judges first explained in *SDARS I*, and confirmed in *SDARS II*, the test for determining disruption to an industry is "whether the selected rate directly produces an adverse impact that is substantial, immediate, and irreversible in the short-run." *SDARS II*, 78 FR at 23061; *SDARS I*, 73 FR at 4097. As noted in *SDARS* I, in instances of such direct, immediate adversity, there would be insufficient time for the impacted industry "to adequately adapt to the changed circumstances produced by the rate change," thereby "threaten[ing] the viability of the music delivery service." *SDARS I*, 73 FR at 4097.

Music Choice describes a contradictory mixture of legal conclusions and *PSS I* results that were based on the facts of that particular case. For example, Music Choice seizes on language from *PSS I* to suggest that the fourth Section 801(b)(1) objective requires the adoption of a rate from the low range of possibilities. In fact, what *PSS I* concluded was that adoption of a low rate under the fourth factor was found to be appropriate in that case "based on the evidence in the . . . record before the Panel." *PSS I*, 63 FR at 25409. The Judges are not bound by 20 year old factual determinations and results; their duty is to apply the law.

Response to ¶ 53. To avoid repetition, SoundExchange incorporates its response to paragraph 52, *supra*.

Response to ¶ 54. Music Choice is right about one thing: *PSS I* did not decide what is an industry for purposes of Section 801(b)(1)(D). That the Register considered all the digital music services then in operation, as opposed to some other ones that did not yet exist, does not imply any particular industry definition.

Consideration of Music Choice's entire business for purposes of determining a market rate (as opposed to adjusting the market rate under the Section 801(b) factors) is consistent with prior decisions of the CARP and Register. Nothing in those decisions would preclude the Judges from determining a market rate that takes into account circumstances outside the PSS business, as Dr. Crawford's own description of the Threat Points commands. SE FOF at ¶¶ 2033-2034.

Response to ¶ 55. As discussed previously, the express legislative purpose of Congress' creation of the PSS category was to preserve the status quo, not to provide a special hand-out to the PSS. Response ¶¶ 13-16. Nothing in the statutory text or legislative history supports the notion that Congress intended to confer a permanent advantage to the PSS services vis a vis their competitors, except to the extent that continuation of Section 801(b)(1) as enacted in 1976 constitutes such an advantage. Accordingly, Music Choice's argument regarding relevant industries under the fourth factor is misguided.

Response to ¶ 56. SoundExchange and Music Choice agree that the Judges have held that a rate is disruptive to an industry only if it "directly produces an adverse impact that is substantial, immediate, and irreversible on the short-run." *SDARS II*, 78 FR at 23061.

Response to ¶ 57. Notwithstanding its acknowledgment of the test the Judges laid out in *SDARS I* and confirmed in *SDARS II*, Music Choice urges the Judges to now abandon that test and adopt a new one. Its argument twists the plain text of Section 801(b)(1) beyond recognition, based on a result in *PSS I* and opposed to a legal conclusion in *PSS I*. According to Music Choice, the "substantial, immediate, and irreversible" test must be abandoned because Section 801(b)(1)(D) references "any disruptive impact," which according to Music Choice means that the Judges must account for *any* disruptive impact on industry whatsoever. This approach would lead to an absurdity because any change to the rates will have some disruptive effect, yet

Congress plainly did not intend to freeze the rates in place when it created a statute requiring they be determined anew every five years. At a minimum, the phrase "any disruptive impact" is ambiguous and the Judges' long-standing interpretation of the phrase is reasonable – and therefore binding. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

V. The Appropriate Method Of 801(B)(1) Analysis

Response to ¶ 58. Music Choice suggests that the Judges could choose to set a rate by evaluating application of the Section 801(b)(1) objectives with respect to any of three equally-good possible starting points – a benchmark, an economic model, and the existing rate. This ignores what the Judges have recognized as their "well laid out" "path" for deciding rates in a case subject to Section 801(b)(1). *SDARS I*, 73 FR at 4084. Insofar as it suggests that the Judges do not even need to try to identify a benchmark rate as their starting point, Music Choice's new fondness for the existing rate is even inconsistent with its own expert's testimony.

To be sure, in *SDARS II*, the Judges used the existing rate, rather than an estimated market rate, as the starting point for evaluating the Section 801(b)(1) objectives. However, that was only after evaluating the proffered benchmarks, failing to find what they perceived as any useful indication of a market rate, and being persuaded that the current rate was neither too low nor too high. *In re Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 78 FR 31842, 31843 (2013) (hereinafter "*SDARS II amend.*"); *SDARS II*, 78 FR at 23058; 78 FR at 23058. In this proceeding, the Judges must likewise first consider the evidence of market rates proffered by the participants and see if they can establish a range of reasonable market rates. Even if the Judges are not persuaded that a market rate would be at a particular level (although SoundExchange believes that level should be

the level of the CABSAT rates), there is in the record of this proceeding ample evidence that the current rate is significantly below market. SE FOF at ¶¶ 1889-1947. [ ] Any application of the factors in the absence of a specific marketplace rate level would have to take that into account.

A. The Best Available Benchmark Is The Appropriate Starting Point For The Section 801(b)(1) Analysis

Response to ¶ 59. SoundExchange agrees that benchmarking is the most commonly used method to generate a starting point for evaluating the Section 801(b)(1) objectives, but it is more than that. Benchmarking is a standard way for economists to estimate reasonable royalty rates. SE FOF ¶¶ 90, 1779. Trying to ascertain a market rate through some kind of benchmarking process should be the goal in every proceeding under Section 801(b)(1). As the Judges explained in *SDARS I*, after reviewing the history of rate-setting under Section 801(b)(1):

> The path for the Copyright Royalty Judges is well laid out. We shall adopt reasonable royalty rates that satisfy all of the objectives set forth in Section 801(b)(1)(A)-(D). In so doing, we begin with a consideration and analysis of the benchmarks and testimony submitted by the parties, and then measure the rate or rates yielded by that process against the statutory objectives to reach our decision. Section 114(f)(1)(B) also affords us the discretion to consider the relevance and probative value of any agreements for comparable types of digital audio transmission services . . . .

SDARS I, 73 FR at 4084; *see also* SE FOF ¶ 95, § XIII.B.1. The Judges have never relied on an economic model as the sole basis for assessing market value, and have dispensed with trying to ascertain a market rate only once, and then after concluding that there was insufficient evidence to do so and being persuaded that the current rate was neither too low nor too high. *SDARS II amend.*, 78 FR at 31843; *SDARS II*, 78 FR at 23058.

As discussed in extensive detail in its Proposed Findings of Fact, SoundExchange disagrees with Music Choice's conclusion that there are no sufficiently comparable services to serve as a benchmark. In any event, Dr. Crawford's opinion that there are no comparable digital music services, which Music Choice presents in ¶ 59, certainly is not a "conclusion of law."

1. The Judges Have Previously Rejected Marketplace Benchmarks For The PSS, But The CABSAT Benchmark Is An Appropriate Benchmark.

Response to ¶ 60. SoundExchange and Music Choice are broadly in agreement that a benchmark should be as comparable to the target market as practicable, and also as to considerations relevant to selection of a comparable benchmark. SE FOF at ¶¶ 96-99, 1782-1784. However, Music Choice at times seems to suggest that if an ideal benchmark cannot be found, the whole idea of trying to identify a range of marketplace rates should be discarded, and the Judges should as a "policy" matter just pull a rate out of the air without reference to the marketplace. MC FOF at ¶¶ 99-101; Trial Ex. 55 at 7 (Del Beccaro WDT). That is not the way the Judges or their predecessors have ever set rates under Section 801(b)(1). *E.g*., *SDARS I*, 73 FR at 4084; *PSS I*, 63 FR at 25410 (after making a policy decision to set a low rate, choosing a number with reference to the perceived market).

Response to ¶ 61. SoundExchange agrees that in *SDARS II* – the only fully-litigated proceeding in which the Judges considered PSS rates – the Judges rejected the benchmarks that Music Choice and SoundExchange proffered. *SDARS II*, 78 FR at 23058. However, that does not mean that they considered and rejected "all available potential benchmarks" that might ever be proposed. It is clear from the Judges' decision in *SDARS II* that they considered only the evidence they were presented. In fact, the Judges' rationale for rejecting SoundExchange's proffered marketplace benchmark for PSS in *SDARS II*, coupled with their *Web IV* determination

that a benchmark subject to some regulatory overhang is better than "the wholesale abandonment of benchmarking," *In re Determination of Royalty Rates and Terms for Ephemeral Recording and digital Performance of Sound Recordings (Web IV)*, 81 FR 26316, 26331 (2016) (hereinafter "*Web IV*"), leads directly to the conclusion that Dr. Wazzan's CABSAT benchmark should be employed here to determine a market rate for PSS.

Response to ¶ 62. SoundExchange and Music Choice agree that in *SDARS I* the Judges concluded that the PSS rate could not be used as a benchmark for setting the SDARS rate. Notably, however, all of the characteristics of Music Choice's service that were identified in the language quoted by Music Choice apply to an equivalent extent to the CABSAT services, suggesting that they are a very comparable benchmark for use in setting PSS rates. SE FOF at § XIII.B.2.ii-.iii.

Response to ¶ 63. SoundExchange agrees that at the time of *SDARS II*, its expert who testified concerning the PSS, Dr. Ford, was unable to identify any voluntary agreements for the licensing of sound recordings for a service having distribution comparable to the PSS. *See SDARS II*, 78 FR at 23057-58. That remains an issue today. The only such agreements Dr. Wazzan was able to identify were Sirius XM's direct licenses and a couple of Muzak licenses, all of which predominantly covered services other than residential cable radio services and had other significant problems. SE FOF ¶¶ 885-1212, 1789-1791.

The question is what to do about this relative lack of voluntary agreements covering comparable services when trying to estimate a market rate for PSS. In *SDARS II*, Dr. Ford thought the best approach would be to look at robust licensing markets for a wide range of different types of services that happened not to be distributed through MVPDs. *SDARS II*, 78 FR at 23057. The over 2,000 agreements he examined had the advantage of providing extensive

information about marketplace royalty rate levels for sound recordings without much taint of regulation, but the disadvantage of not reflecting the MVPD distribution of cable radio services like Music Choice. *SDARS II*, 78 FR at 23057-58.

As for some purported but unidentified admission made by SoundExchange concerning the non-existence of services comparable to the PSS, MC FOF ¶ 91, the CABSAT services existed at the time of *SDARS II*. SE FOF ¶ 1852-1853. However, as noted above, Dr. Ford thought the best approach would be to look at marketplace transactions rather than a regulated rate. The CABSAT services were also less material at the time of *SDARS II* than they are now, since Stingray only entered the U.S. market the year before *SDARS II* direct cases were filed, and did not begin making significant competitive inroads until later. SE FOF ¶ 1875-1879.

Response to ¶ 64. SoundExchange agrees that in *SDARS II*, the Judges rejected the benchmark proffered by Dr. Ford due to differences between cable radio services and the services studied by Dr. Ford. *SDARS II*, 78 FR at 23058.

Response ¶ 65. Dr. Wazzan was clear that in his search for suitable benchmarks to use in setting PSS rates, he identified no true marketplace benchmark that is sufficiently comparable to the PSS. *E.g.*, Trial Ex. 501 at ¶ 12 (Wazzan Corr. WDT). Instead, Dr. Wazzan characterized his CABSAT benchmark as "market-like." 5/3/17 Tr. 2318:2-5, 25 (Wazzan); see SE FOF ¶¶ 1847-1870.

Dr. Wazzan's proffered CABSAT benchmark is a direct response to the Judges' rejection of Dr. Ford's benchmark in *SDARS II*. Trial Ex. 501 at ¶¶ 48-50 (Wazzan Corr. WDT). Unlike Dr. Ford's *SDARS II* benchmark, the CABSAT benchmark is extremely comparable to the PSS, because the PSS and CABSAT services are all functionally equivalent cable radio services that share the same MVPD distribution channel and are provided by similar multi-platform providers.

SE FOF ¶¶ 1792-1846. However, it is subject to greater regulatory overhang than Dr. Ford's *SDARS II* benchmark. In view of the Judges' *SDARS II* determination that comparability as to MVPD distribution and downstream bundling is critical to a PSS benchmark, *SDARS II*, 78 FR at 23058, and the Judges' *Web IV* determination that a benchmark subject to some regulatory overhang is better than "the wholesale abandonment of benchmarking," *Web IV*, 81 FR at 26331, the CABSAT benchmark is the best available option for the PSS. SE FOF ¶¶ 1847-1870.

Response to ¶ 66. To avoid repetition, SoundExchange incorporates its responses to paragraphs 59-65, *supra*.

2. The Musical Works Benchmark Has Been Consistently Rejected Since *PSS I*

Response to ¶ 67. In *PSS I*, the Register set the PSS rate based largely on a benchmark derived from the rates the services paid for musical works. *See PSS I*, 63 FR at 25409. After taking account of those rates, the Register concluded that the arbitrators were not arbitrary in deciding that Section 801(b)(1) supported setting a "rate favoring the Services," *PSS I*, 63 FR at 25406, and set a rate close to the 5% level recommended by the arbitrators because that "did not draw an objection from the Services." *PSS I*, 63 FR at 25410.

The Register was left relying on musical works as a benchmark because there was no other evidence of the marketplace value of anything that seemed to her to be even remotely relevant. *SDARS II*, 78 FR at 23055. The Register was keenly aware of the limitations of that benchmark, at one point asking rhetorically "whether this reference point is determinative of the marketplace value of the performance right in sound recordings," and agreeing with the arbitrators that the answer to that question was "no." *PSS I*, 63 FR at 25404. That is why every subsequent decision-maker to consider the utility of a musical works benchmark for setting sound recording royalties has thoroughly rejected such a benchmark. *SDARS II*, 78 FR at 23055,

23058; *SDARS I*, 73 FR at 4089-90; *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 72 FR 24084, 24094-95 (2007) (hereinafter "*Web II*"); *In re Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, 67 FR 45240, 45246-47, 45258-59 (2002) (hereinafter "*Web I*").

It is illogical for Music Choice to suggest that present marketplace conditions are similar to those at the time of *PSS I*. Many more services are in operation today. *E.g.*, Trial Ex. 32 at ¶ 10 (Harrison WDT) ("[o]ver the last decade, numerous services that digitally stream music to consumers have launched and gained popularity"). Rates for such services provide potential benchmarks that were not available in 1998. For example, the CABSAT services are cable radio services functionally equivalent to the PSS that were not in operation at the time of *PSS I* (that is why they are not PSS). SX FOF at ¶¶ 1797-1846; 17 U.S.C. § 114(j)(11).

Response to ¶ 68. The services in *PSS I* offered two benchmarks before the CARP. The first was fees payable by Music Choice to two affiliated record companies, Sony Music and Warner Music Group, based on their use of sound recordings within the context of the Music Choice (then DCR) partnership agreement, which was entered into before there was any statutory obligation to pay for the use of sound recordings. 5/17/17 Tr. 4518:14-4519:14 (Del Beccaro). The other proposed benchmark was the musical works benchmark discussed in ¶ 67. *PSS I*, 63 FR at 25396; *PSS I* CARP Report, Trial Ex. 979 at ¶124. The panel of arbitrators ultimately derived its rate from both of the services' benchmarks. *PSS I*, 63 FR at 25396-97; *PSS I* CARP Report, Trial Ex. 979 at ¶¶ 126-150.

Response to ¶ 69. No response.

Response to ¶ 70. No response.

Response to ¶ 71. No response.

Response to ¶ 72. SoundExchange and Music Choice agree that the Register found "that the Panel's adoption of the DCR negotiated license fee as the starting point for making its determination [was] arbitrary." *PSS I*, 63 FR at 25399. The Register found that Music Choice's payments to affiliated record companies based on its use of sound recordings "could not reflect accurately the marketplace value of the digital performance right since no such legal right existed at the time the rate was negotiated." *PSS I*, 63 FR at 25409-10. The Register also rejected the arbitrators' calculation of an appropriate rate based on the musical works benchmark. *PSS I*, 63 FR at 25410.

Response to ¶ 73. Music Choice's characterization of the Register and the Librarian's reasons for rejecting the benchmark based on the DCR negotiated license fee is largely accurate. In articulating the reasons why the Register rejected the panel's benchmark, the Librarian explained that the DCR agreement "cannot represent a license for a right to perform sound recordings, because no such legal right existed at the time of negotiations." *PSS I*, 63 FR at 25401. The Librarian explained that "the agreement concerning the performance right was merely one of eleven independent co-equal agreements which together constituted the partnership agreement between DCR and the record companies." *PSS I*, 63 FR at 25402. The Librarian noted that the DCR license fee was not an industry-wide agreement. *PSS I*, 63 FR at 25402. Finally, the Librarian pointed out testimony from a witness stating that "a successful negotiation may have required that Warner and Sony compensate Music Choice for including the performance rights payments as part of the partnership agreement. The effect of this compensation may have restrained Warner and Sony in their choice of a higher fee level." *PSS I*, 63 FR at 25403.

Response to ¶ 74. To avoid repetition, SoundExchange incorporates its response to paragraph 73, *supra*.

Response to ¶ 75. SoundExchange and Music Choice agree that the Register and Librarian rejected the arbitrators' "decision to set a lower limit" for the musical works benchmark. *PSS I*, 63 FR at 25404. The Librarian's opinion did not "affirm" the upper limit valuation for the musical works benchmark. Rather, it noted in passing that RIAA accepted the panel's determination as to the upper limit valuation and did not discuss the issue further. *See PSS I*, 63 FR at 25403.

Response to ¶ 76. SoundExchange and Music Choice agree that the Register set a new PSS rate after rejecting the proposed DCR license fee benchmark.

Response to ¶ 77. No response.

Response to ¶ 78. Music Choice suggests that the Register's *PSS I* decision had a mathematical precision that is absent from the decision itself. The number ultimately derived by the Register was based primarily on musical works rates and a desire to set a low rate favoring the services, SX FOF at ¶ 1900, but rested to some extent on an unspecified combination of factors. *SDARS II*, 78 FR at 23055.

Response to ¶ 79. SoundExchange agrees that the Librarian did adopt the Register's use of the musical works benchmark, and the D.C. Circuit affirmed the Librarian's decision. However, the fact that the *PSS I* proceeding adopted the musical works benchmark on one occasion, almost twenty years ago, does not compel its use today. In the nearly 20 years since *PSS I*, the music marketplace and the available information has changed. The *PSS I* proceeding began very shortly after enactment of the statute creating the digital performance right, so no market for licensing sound recording performance rights existed. With a more complete record,

the Judges in *SDARS II* thoroughly rejected use of the musical works benchmark. The Judges explained:

> [A] benchmark market should involve the same buyers and sellers for the same rights. However, the musical works market involves different sellers (performing rights societies versus record companies) selling different rights. The fact that a [PSS] needs performing rights to musical works and sound recordings to operate its service does not make the rights equivalent, nor does it say anything about the relative values of those rights.

SDARS II, 78 FR at 23058 (citations omitted). That conclusion was consistent with prior decisions that also rejected the use of musical works rates as a benchmark for sound recording royalties. *SDARS I*, 73 FR at 4089-90; *Web II*, 72 FR at 24094-95; *Web I*, 67 FR at 45246-47, 45258-59.

Response to ¶ 80. To avoid repetition, SoundExchange incorporates its response to paragraph 79, *supra*.

Response to ¶ 81. Music Choice's expert Dr. Crawford did not propose using musical works rates as a benchmark in this proceeding. 4/25/17 Tr. 848:6-8 (Crawford). To avoid repetition, SoundExchange incorporates its response to paragraph 79, *supra*.

3. The CABSAT Rates Are The Best Available Benchmark For The PSS

Response to ¶ 82. Given that the parties have submitted extensive findings of fact, it is not apparent why Music Choice believes it is necessary to engage in extensive fact-based advocacy in what purport to be conclusions of law. SoundExchange addresses its CABSAT benchmark in SE FOF § XIII.B.2 and SE MC RFOF § XI. Nonetheless, because Music Choice chose this forum to attack SoundExchange's principal benchmark in this forum SoundExchange feels constrained to respond.

SoundExchange agrees that the CABSAT benchmark is not a marketplace benchmark; it is a regulated rate. That said, it is the best available benchmark. In the case of PSS, it is simply

not possible to find a benchmark entirely free of the shadow of the statutory license. Music Choice continues to profess its fondness for the musical works benchmark, even though that benchmark has been thoroughly rejected. MC PCL ¶ 81; Response ¶ 79. Musical works rates are regulated rates. Trial Ex. 54 at ¶ 58 (Crawford WDT). Music Choice accordingly has no leg to stand on in complaining about the "non-marketplace" nature of the CABSAT benchmark.

The current CABSAT rates were established in a rate-making proceeding similar to this one. The participants in that proceeding were SoundExchange and Sirius XM, and they reached a settlement. After publication in the Federal Register, and in the absence of any negative comments, the Judges adopted the settlement. *See In re Digital Performance Right in Sound Recordings and Ephemeral Recordings for a New Subscription Service*, 72 FR 72253 (2007). SoundExchange relies on these adopted rates as a benchmark for the PSS.

It is true that the settlement agreement[1] between Sirius XM and SoundExchange included language that the "Agreement" and "[t]he royalty rates and terms set forth in the Proposed Regulations [attached to the Agreement] are intended to be nonprecedential," and that "[s]uch royalty rates and terms shall not be relied upon as precedent in any proceeding to set statutory royalty rates and terms." Trial Ex. 992 at 2 (SoundX_000477825).

However, SoundExchange does not use either the settlement agreement or the statutory CABSAT rates as a "precedent." A precedent is "an earlier occurrence of a similar character," or "something done or said that may serve as an example or rule to authorize of justify a subsequent act of the same or analogous kind." Webster's Third New International Dictionary 1783 (1986).

[1] SoundExchange incorporates by reference the pending Joint Artist/Copyright Owner Participants' Opposition to Music Choice's Motion *In Limine* to Exclude SoundExchange's Use of Testimony and Evidence Related to or Based on The CABSAT Rates and Terms (filed April 11, 2017).

SoundExchange proposes using the statutory CABSAT rates as a benchmark – an economic measure in valuation.

SoundExchange and its expert Dr. Wazzan relied on the rates adopted by the Judges, not the underlying agreement with Sirius XM or the proposed regulations attached thereto. *See, e.g.*, Trial Ex. 501 at ¶ 12 (Wazzan Corr. WDT) ("[T]he Judges are charged with setting regulated rates for other services that share similar characteristics with the PSS – that is, the television-based 'new subscription services' subject to the rates in 37 C.F.R. Part 383 (which SoundExchange refers to as 'CABSAT' services). I ultimately conclude that these regulated rates provide the best available proxy for a marketplace royalty for PSS."); Trial Ex. 501 at ¶ 60 (referring to "the rates in 37 C.F.R. Part 383"); Trial Ex. 502 at ¶ 4 (Wazzan Corr. WRT) (referring to "the rates in 37 C.F.R. Part 383"); Trial Ex. 502 at ¶ 15 (referring to "the statutory royalty rates paid by the CABSAT services").

The Judges have repeatedly distinguished adopted statutory rates from the settlements that led to them, and declined to say that the adopted statutory rates are without precedential effect. *See, e.g.*, *In re Noncommercial Educational Broadcasting Statutory License*, 72 FR 19138, 19139 (2007) (hereinafter "*Public Broadcasting I*") ("The Copyright Royalty Judges decline to include such a provision" stating that the rates reached by settlement agreement were without precedential effect because "[o]ur task, as set forth in section 118 and chapter 8 of the Copyright Act, is to adopt rates and terms for the noncommercial broadcasting license. It is not our task to offer evaluations, limitations or characterizations of the rates and terms, or make statements about their use or value in proceedings other than this one."); *In re Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding*, 73 FR 57033, 57034 (2008) (same); *In re Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 75 FR

16377, 16378 (2010) (similar); *CABSAT I*, 72 FR 72253 (publishing final rule without the non-precedential language from the proposed rule).

Interpreting language similar to that contained in the Sirius XM-SoundExchange CABSAT agreement, the Register likewise distinguished non-precedential WSA rates and terms agreements from rates and terms based thereon, and allowed reliance on the latter in subsequent proceedings. In *Web IV*, the Judges referred to the Register questions concerning their ability to consider agreements that "are substantively identical to, have been influenced by, or refer to" provisions of a WSA agreement. *In re Scope of the Copyright Royalty Judges' Continuing Jurisdiction*, 80 FR 58300, 58305 (2015). By statute the Judges are prohibited from considering "any provisions" of such an agreement, "including any rate structure [and] fees." 17 U.S.C. § 114(f)(5)(C). The Register interpreted that prohibition to extend only to the rates and terms in the WSA agreement itself, and not to the same or similar rates and terms if copied into a new agreement. *Id.* at 58,306. In view of the foregoing, the no-precedent language in the CABSAT agreement should be understood to refer only to the agreement itself, and the rates and terms set forth in the accompanying proposed regulations themselves, and not to the regulations adopted by the Judges. Accordingly, SoundExchange's reliance on the CABSAT rates does not contravene its obligations under the settlement agreement – and even if it did, Music Choice cannot enforce those obligations. *See* response to ¶ 88, *infra*.

Music Choice also complains that the rates mentioned in the settlement agreement are not "the product of a true marketplace transaction" because SoundExchange and Sirius XM had "vastly different incentives and bargaining power." Again, SoundExchange agrees that the rates are not marketplace rates. But rather than "the wholesale abandonment of benchmarking," *Web IV*, 81 FR at 26331, a benchmark based on a regulated rate may be the best available option

where no marketplace benchmark exists. That is the case here. No one has identified any suitable marketplace benchmark for the PSS that is not constrained by regulation. Instead, the statutory CABSAT rates are "a market-like rate." 5/3/17 Tr. 2318:25 (Wazzan); *see also* Trial Ex. 502 at ¶¶ 19-20 (Wazzan Corr. WRT).

The CABSAT rates are "market-like" because they were negotiated within the context of a proceeding subject to the willing buyer/willing seller standard under 17 U.S.C. § 114(f)(2). Trial Ex. 501 at ¶ 64 (Wazzan Corr. WDT). At least as important, the statutory CABSAT rates have been accepted over a sustained period by multiple providers of CABSAT services, including Stingray, which made a decision to enter the U.S. market knowing the magnitude of the statutory CABSAT rates. 5/3/17 Tr. 2307:18-24 (Wazzan).

Throughout the history of the statutory CABSAT rate, "Sirius XM negotiated with SoundExchange . . . in an arm's-length, willing buyer/willing seller transaction, and agreed on a rate." 5/3/17 Tr. 2307:6-9 (Wazzan). In doing so, they were constrained by the low PSS rate, which would probably bias the CABSAT rate downwards, but "ultimately as a willing buyer/willing seller they reached some settlement." 5/3/17 Tr. 2400:14-18 (Wazzan). Presumably they would have been mindful of the willing buyer/willing seller standard that would have applied if they had failed to reach an agreement. 17 U.S.C. § 114(f)(2)(B).

Music Choice's own expert, Dr. Crawford, endorsed the use of regulated musical works rates as a benchmark, noting that the rate standard applied in setting musical works royalty rates is "designed to approximate marketplace outcomes." Trial Ex. 54 at ¶ 58 (Crawford WDT). That standard is similar to the willing buyer/willing seller standard used in CABSAT proceedings. *See* 17 U.S.C. § 114(f)(2)(B). Dr. Crawford also readily found the negotiating stakes to be similar in the markets for musical works and sound recordings for a PSS. Trial Ex.

54 at ¶ 58 (Crawford WDT). Because the PSS and CABSAT services are so similar, their stakes in negotiating sound recording royalties are likewise similar. Trial Ex. 502 at ¶ 20 (Wazzan Corr. WRT). In short, the statutory royalty rate for CABSAT services has the characteristics of the best available benchmark, even though it is not an *ideal* benchmark.

Finally, Music Choice repeats its arguments that Dr. Wazzan's expert testimony should be excluded because it "is flawed, based on a false key premise, and unreliable." Although Dr. Wazzan's testimony did contain some errors, *he corrected them*. Dr. Wazzan's corrected testimony – the testimony that appears in the record of this proceeding – is accurate, and Music Choice fails to point to any inaccuracies in the corrected testimony as admitted into the record. Accordingly, it has made no argument that his opinions in the form in which they have been formally filed are "unreliable." By contrast, Dr. Crawford – Music Choice's expert – has yet to correct the substantial errors in his testimony. SE FOF at ¶ 2054.

a. Relying On The Adopted CABSAT Rates Is Consistent With The Settlement Agreement

Response to ¶ 83. No response.

Response to ¶ 84. The portion of the settlement agreement that Music Choice quotes states that "[t]he royalty rates and terms set forth in the Proposed Regulations are . . . based on the Parties' current understanding of *market* and legal conditions, among other things." Trial Ex. 922 at 2 (SoundX_000477825) (emphasis added). In other words, the rate was informed by market conditions – and it was also informed by legal conditions (which are part of the market).

Response to ¶ 85. The portion of the settlement agreement that Music Choice quotes also provides that "[t]he royalty rates and terms set forth in the Proposed Regulations [an attachment to the agreement] . . . shall not be relied upon as precedent in any proceeding to set statutory royalty rates and terms." But, again, SoundExchange's rate proposal in this proceeding

relies on the adopted CABSAT rates as an economic benchmark (not a precedent). It does not rely on the proposed regulations attached to the agreement *See* Response to ¶ 82, *supra*.

Response to ¶ 86. The email that Music Choice cites reflects Sirius XM's understanding of the CABSAT settlement agreement. It does not indicate SoundExchange's own interpretation of that language. Regardless of how the parties understood the agreement, the terms of the agreement do not bar reliance on the adopted rates themselves. The long line of decisions that set rates determined by a settlement agreement and that also declined to include non-precedential language regarding those rates proves as much. *See* Response to ¶ 82, *supra*. They certainly alerted the parties to the CABSAT settlement agreement that such an interpretation of the no-precedent language was more likely than not if the issue ever arose.

Response to ¶ 87. To avoid repetition, SoundExchange incorporates its response to paragraph 82, *supra*.

Response to ¶ 88. Contrary to Music Choice's assertions, nothing in contract law permits Music Choice to enforce the agreement between SoundExchange and Sirius XM. "Generally, a stranger to a contract may not bring a claim on the contract"; being allowed to do so is an "exceptional privilege." *Ford Lincoln Civic Ass'n v. Ford Lincoln New Town Corp*., 944 A.2d 1055, 1064 (D.C. 2008) (quoting German Alliance Ins. Co. v. Home Water Supply Co., 226 U.S. 220, 230 (1912)). As a result, "a third party beneficiary of a contract may bring an action against the principal parties to that contract only when the parties to the contract intended to create and did create enforceable contract rights in the third party." *Sealift Bulkers, Inc. v. Republic of Armenia*, No. 95-1293, 1996 WL 901091, at *4 (D.D.C. Nov. 22, 1996). The parties to the contract must have "had an express or implied intention to benefit directly the party claiming such status." *Ford Lincoln Civic Ass'n*, 944 A.2d at 1064 (quoting *Alpine Cty., Calif. v.*

United States, 417 F.3d 1366, 1368 (Fed. Cir. 2005)). In fact, "the parties to a contract must 'directly and unequivocally intend to benefit a third party.'" *Nortel Networks, Inc. v. Gold & Appel Transfer, S.A.*, 298 F. Supp. 2d 81, 90 (D.D.C. 2004) (quoting *Barnstead Broad. Corp. v. Offshore Broad. Corp.*, 886 F. Supp. 874, 879 (D.D.C. 1995)). Merely receiving an incidental benefit is not enough. See *Corporate Sys. Res. v. Wash. Metro. Area Transit Auth.*, 31 F. Supp. 3d 124, 132 (D.D.C. 2014); *Jahanbein v. The Ndidi Condominium Unit Owners Ass'n, Inc.*, 85 A.3d 824, 831 (D.C. 2014).

Establishing that Sirius XM and SoundExchange intended to benefit Music Choice directly, and thereby to confer on Music Choice the right to enforce their contract against them, requires evidence of that intention. See *Mariano v. Gharai*, 999 F. Supp. 2d 167, 173 (D.D.C. 2013) (when putative beneficiary is not named in the contract, there must be evidence to support the conclusion it was an intended beneficiary); *Footbridge Ltd. Trust v. Zhang*, 584 F. Supp. 2d 150, 161 (D.D.C. 2008) (third party not an intended beneficiary when "[t]here [was] a dearth of evidence"), *aff'd*, 358 F. App'x 189 (D.C. Cir. 2009). Music Choice has failed to proffer evidence that the parties intended to confer a benefit on third parties, rather than on themselves – to the extent it has offered any evidence it certainly is not "unequivocal." SE Opposition to MIL at 13-14 (Apr. 11, 2017). By contrast, SoundExchange's representative has testified that he does not understand the agreement to have intended to confer a benefit to Music Choice. SE Opposition to Music Choice MIL at 14 (Apr. 11, 2017). Music Choice has not made a sufficient showing that it is entitled to enforce the Settlement Agreement.

Response to ¶ 89. SoundExchange and Music Choice agree that the Judges did not have authority to alter the terms of the CABSAT settlement unless they found it contrary to law.

Review of Copyright Royalty Judges Determination, 74 FR 4537, 4540 (2009). But that is irrelevant. The adopted CABSAT rates are nonetheless market-like. SE FOF at § XIII.B.2.v.

b. The CABSAT Rates Are The Best Available Approximation Of A Market Rate For The PSS

Response to ¶ 90. Dr. Wazzan acknowledged that litigation settlements must be approached with care, but did not rule out relying on them if necessary. Specifically, he said: "Rates contained in settlement agreements are *not necessarily* indicative of a market rate—*i.e.*, what a willing buyer and a willing seller would agree to." Trial Ex. 501 at ¶ 41 (Wazzan Corr. WDT) (emphasis added). This is not the same as testifying that "settlement rates are inherently unreliable."

Response to ¶ 91. That the rates were negotiated by Sirius XM, which is primarily an SDARS provider, does not affect the reliability of the statutory CABSAT rates as a benchmark. Music Choice says that Sirius XM had little incentive to vigorously negotiate for a fair market deal because it views its CABSAT service as promotion for its SDARS. But Dr. Wazzan explained that the possibility Sirius XM views its CABSAT as promotional should not have an effect on the CABSAT rates they agreed to. 5/3/17 Tr. 2420:9-15, 2314:4-11 (Wazzan). "There's no evidence that they would simply accept a bad deal." 5/3/17 Tr. 2314:9-10 (Wazzan). In addition, Mr. Del Beccaro [[redacted]]. 5/18/17 Tr. 4575:6-13 (Del Beccaro) ([" [redacted] "]).

Moreover, the existing CABSAT providers other than Sirius XM have had the opportunity to participate in a rate proceeding, which would have given them an opportunity to seek a lower rate and standing to object to any settlement to any settlement. 17 U.S.C.

§ 801(b)(7)(A); 5/3/17 Tr. 2307:10-16, 2400:19-22, 2406:5-19 (Wazzan). But DMX never participated in any of the CABSAT proceedings, despite providing a CABSAT service from before the first CABSAT proceeding until the middle of the third proceeding. *CABSAT III*, 80 FR at 36927 (*CABSAT III* commenced January 2014); Trial Ex. 29 at 17 (Bender WDT) (DMX transferred service to Muzak in May 2014).

[ ] 5/18/17 Tr. 4579:9-12 (Del Beccaro); Trial Ex. 54 at ¶ 147 (Crawford WDT). That was roughly the time of *CABSAT II*. Stingray is a large and sophisticated company with the resources to litigate rates if it wanted to. Trial Ex. 57 at 9 (Del Beccaro WRT); Trial Ex. 973. And Stingray could not have been unmindful of the statutory CABSAT rates in its thinking about entering the U.S. market. If it thought that the statutory CABSAT rates were many times fair market value, it would have had strong incentives to do something about that, as Dr. Crawford suggests. Trial Ex. 59 at ¶ 124 (Crawford WRT) ("they would have a good case"). As Dr. Wazzan put it, "if they are willingly paying the CABSAT rate and they didn't participate, they must not be terribly troubled by it." 5/3/17 Tr. 2407:7-9 (Wazzan).

Response to ¶ 92. The roster of CABSAT services is quite "stable." DMX and Sirius XM started providing CABSAT services in approximately 2006. SE FOF ¶¶ 1850-1851. Sirius XM remains a CABSAT provider. SE FOF at ¶ 1810. The legacy DMX service is still in operation, although it is now operated by DMX's corporate affiliate Muzak. SE FOF at ¶ 1811. Stingray entered the U.S. market in 2010 and remains in operation. *See* Trial Ex. 54 at ¶ 147 (Crawford WDT). Absent evidence comparing churn among CABSAT services with other kinds of businesses, rather than mere speculation, it certainly should not be assumed that any group of

services in which 100% have been in operation for more than seven years (and some more than ten) is unstable.

Response to ¶ 93. The thought exercise that Music Choice asks the Judges to engage in here, contemplating what would happen if Music Choice exited the market and Stingray had to step into its shoes, is not only irrelevant but also incorrect. The only evidence that Music Choice offers for the proposition that Stingray would be unprofitable if it had *more* MVPD partners is unsubstantiated speculation of its witness, David Del Beccaro. For its part, Stingray is competing aggressively to obtain more MVPD partners. It is highly unlikely that a profit-maximizing firm would pursue those opportunities if they would cause it to become unprofitable.

Response to ¶ 94. SoundExchange's proposal to rely on the adopted CABSAT rates as a benchmark for the PSS is reasonable in light of the economic evidence. In *SDARS II*, the Judges indicated that a benchmark for PSS rates would have to reflect the "distinctive features that distinguish [the PSS] from other types of music services." *SDARS II*, 78 FR at 23061. Cable radio services other than the PSS pay CABSAT rates. Thus, the CABSAT benchmark is the benchmark the Judges asked for. This benchmark does not require any adjustments under Section 801(b)(1). Arguing that the rates should be adjusted to account for the value of settling rather than litigating the prior CABSAT proceeding (a factor that would have affected both parties) without accounting for other factors that are likely to drag the CABSAT rate down – including the existence of the PSS, which have historically operated functionally the same service as the CABSAT while paying a lower royalty rate – is simply incomplete.

c. Dr. Wazzan's Testimony Is Reliable

Response to ¶ 95. Music Choice's characterization of Dr. Wazzan's testimony is both hyperbolic and incorrect. His testimony is neither "inequitable" nor "unreliable." Moreover,

Music Choice has already presented these arguments in a motion *in limine* to exclude Dr. Wazzan's testimony. There is no need to rehash the same arguments here.

Response to ¶ 96. To be sure, Dr. Wazzan was confused at his deposition about when he knew about the settlement agreement. He initially stated unequivocally that he *was* aware, at the time he wrote his written testimony, that the CABSAT rates in Part 383 were the product of a settlement. 3/28/17 Depo. Tr. 129:9-130:6 (Wazzan). Then after multiple tries, Mr. Fakler eventually convinced Dr. Wazzan of the contrary. 5/3/17 Tr. 2397:20-2398:9 (Wazzan). But he quickly recognized that he was "not sure when I became aware of that." 3/28/17 Depo. Tr. 130:1121 (Wazzan).

Music Choice also makes much of the fact that Dr. Wazzan had not seen the agreement when he prepared his written testimony. But that is a red herring because Dr. Wazzan's proposal is *not* based on the settlement agreement, but rather on the rates set forth in the final regulations.

Additionally, Music Choice claims that Dr. Wazzan admitted at trial that he "did not even review the Judges' notice in the Federal Register adopting and implementing the settlement prior to submitting his testimony." But in the portion of the trial transcript that Music Choice cites, all Dr. Wazzan admitted to was (1) not recalling what Federal Register notice he reviewed, and (2) omitting the Federal Register notice setting the most recent CABSAT rates from his list of documents relied on. *See* 5/3/17 Tr. 2402:8-2404:7 (Wazzan). This attempted "gotcha" gets Music Choice nowhere.

Response to ¶ 97. It is true that Dr. Wazzan did not file an errata sheet to clarify the degree of his testimony about his awareness about the CABSAT settlement at the time he filed his written testimony. That is because it would have been inappropriate to do so. Federal Rule of Civil Procedure 30(e) cannot be interpreted to "allow one to alter what was said under oath. If

that were the case, one could merely answer the question with no thought at all[], then return home and plan artful responses. . . . A deposition is not a take home examination." *Trout v. First Energy Generation Corp.*, 339 F. App'x 560, 565 (6th Cir. 2009) (quotation marks omitted) (bracket in original). Music Choice's allegation that Dr. Wazzan somehow did something wrong by not filing an errata sheet after his deposition is a non sequitur. For the complete record of questions and answers concerning this matter at Dr. Wazzan's deposition see Response ¶ 96. (And, given that Music Choice is crying wolf over Dr. Wazzan's efforts to correct his deposition record, one can only assume they would do the same had he filed an errata sheet, too.)

Although Dr. Wazzan's testimony did contain some errors, *he corrected them* before his testimony was admitted into evidence. Dr. Wazzan's corrected testimony is accurate, and Music Choice fails to point to any inaccuracies in the corrected testimony as admitted into the record. Accordingly, it has made no argument that his opinions in the form in which they have been formally filed are "unreliable," much less that they are "useless." By contrast, the written testimony of Dr. Crawford (Music Choice's expert), as admitted into the record, contains major errors, as Dr. Crawford himself conceded. SE FOF at ¶¶ 2054-55.

Response to ¶ 98. Music Choice misrepresents Dr. Wazzan's testimony. SoundExchange has explained at length why the CABSAT rates provide the best available basis for setting PSS rates. *See generally* SE FOF at Section XIII.B.

As to Music Choice's argument regarding Dr. Wazzan's failure to mention the correct Federal Register notice in the list of "documents relied upon" in his written testimony, see the response to paragraph 96, *supra*.

Response to ¶ 99. To avoid repetition, SoundExchange incorporates its response to paragraph 98, *supra*.

Response to ¶ 100. To avoid repetition, SoundExchange incorporates its response to paragraph 90, *supra*.

B. Economic Models

1. Economic Modeling Is Appropriate Only In Tandem With Benchmark Analysis

Response to ¶ 101. It is true that the Judges have previously considered economic modeling as part of determinations under Section 801(b)(1). However, the Judges have not used economic modeling "as an alternative" to benchmark analysis. To the contrary, the Judges have repeatedly and consistently emphasized that the proper way to conduct ratemaking under Section 801(b)(1) is to select a benchmark, and then adjust that benchmark. *See SDARS I*, 73 FR at 4084. The proceeding cited by Music Choice as an example of the Judges sanctioning economic modeling as an "alternative" to benchmark analysis was not a proceeding conducted under 801(b)(1), *see In re Distribution of 1998 and 1999 Cable Royalty* Funds, 80 FR 13423, 13427-28 (2015), and is therefore of minimal value.

2. Dr. Crawford's Nash Bargaining Model Is Not A Reliable Way To Determine Royalty Rates For PSS

Response to ¶ 102. Dr. Crawford's Nash Bargaining Model is not a reliable way to set the statutory royalty rate for PSS in this proceeding. The Judges rejected essentially the same model in *SDARS II*, finding it "unworthy of further consideration" because there was no "real-world data" to support its "theoretical approximations" and "predictive capacity." *SDARS II*, 78 FR at 23058 & n.17. The Judges also found that use of the Nash Model was improper for the specific task of setting PSS rates, because the role of a PSS as intermediary between record labels and cable operators "disrupts and complicates the Nash analysis . . . and requires that all three bargains be considered jointly." *SDARS II*, 78 FR at 23083 (Roberts, J. dissenting); *see*

also 78 FR at 23058 n.17 (agreeing with Judge Roberts' "more spirited rejection of the probative value of the Nash Framework as proffered in this context"). Dr. Crawford's rejected model has not improved with age. It is still unsuitable for the purposes to which Dr. Crawford has put it. SE FOF at ¶¶ 2017-2028.

Response to ¶ 103. While it is true that record companies and Music Choice each have a certain degree of market power, Dr. Crawford adopted an arbitrary bargaining power range. SE FOF at ¶¶ 2107-2111.

Response to ¶ 104. No response.

Response to ¶ 105. No response.

Response to ¶ 106. Dr. Crawford's allocations are unreliable. As Music Choice admits, it is an integrated business that offers a portfolio of services, bundles its services in the downstream market because of synergies among them, enjoys efficiencies from sharing expenses across lines of business, and in the ordinary course of business maintains its books on a consolidated basis. MC FOF at ¶ 121; SE FOF at ¶¶ 1840-1844. Any allocation of Music Choice's revenues and expenses is necessarily artificial. *SDARS II amend.*, 78 FR at 31844 (describing testimony by Mr. Del Beccaro that Music Choice's consolidated financials "cannot be disaggregated").

Response to ¶ 107. As Music Choice indicates, Crawford's Joint Agreement Surplus analysis contained a significant error. SE FOF at ¶¶ 2054-2055. Dr. Crawford incorrectly included CRB litigation costs in his Joint Agreement Surplus analysis. SE FOF at ¶¶ 2054-2055. Music Choice provides no citation to the record to support its assertion about the effect of this error on Music Choice's proposed rates. Moreover, Dr. Crawford's error casts doubt on his

entire analysis, as it highlights the inherent problem of his attempt to allocate costs and revenues to a hypothetical standalone PSS service.

Music Choice's assertion that the CRB litigation costs "would be replaced with the costs" of a direct licensing initiative is utterly false. In Dr. Crawford's hypothetical, there would be no "direct licensing initiative," because Music Choice would be negotiating with "a single record label." MC FOF at ¶ 109. Presumably both the label and Music Choice would incur some costs in that negotiation, and Music Choice provides no reason to think those costs would be unbalanced. Moreover, that single record label would be a major record label. Trial Ex. 54 at ¶ 78 & nn.62-63 (Crawford WDT). Talking about negotiations with 7,000 indie labels, MC FOF at ¶ 147, makes no sense in the context of a model involving a negotiation with one major record label.

Response to ¶ 108. Dr. Crawford incorrectly assumed that Music Choice's Threat Point should be zero. As explained in SoundExchange's Findings of Fact, Dr. Crawford's own testimony showed that Music Choice's Threat Point should actually be negative. Calculating its proper Threat Point is possible, and yields a much higher royalty rate than Music Choice is proposing. SE FOF at ¶¶ 2032-2046.

Response to ¶ 109. There is no credible evidence of promotion. *See* Response to ¶ 184.

Response to ¶ 110. While Dr. Crawford excluded promotional benefits from his calculation of threat points, he also improperly ignored opportunity cost to the record company. SE FOF at ¶ 2098-2106.

Response to ¶ 111. Dr. Crawford set the bargaining power at three arbitrary levels with little attempt at justification, and certainly "no data to support the theoretical approximations." *SDARS II*, 78 FR at 23058. His model thus leads to three arbitrary results and leaves it to the

Judges to guess at the appropriate parameters. SE FOF at ¶ 2108. The evidence suggests that the bargaining power should be set close to one, to reflect a record company's relative bargaining power. SE FOF at ¶ 2109-10. As Dr. Wazzan testified, assigning the record company a bargaining power of 80% or more, after correcting for Music Choice's Threat Point, would yield a royalty rate in the range of [ ] or more. SE FOF at ¶ 2111.

Response to ¶ 112. As explained in SoundExchange's Findings of Fact, Dr. Crawford's calculation of a 3.5% royalty rate is simply not plausible. *See* SE FOF ¶¶ 1943-1947. The 3.5% rate is only 41% of the current 8.5% statutory rate. If the statutory PSS rate were above market by as much as Music Choice claims, one would expect to see direct licenses. But at no time since the enactment of the digital performance right has Music Choice ever obtained a direct license. SE FOF ¶ 1946. That is because the current 8.5% statutory rate is *below* (not above, as Dr. Crawford's Nash bargaining analysis suggests) what would otherwise be the prevailing market rate.

3. Dr. Wazzan Demonstrated That Dr. Crawford's Nash Bargaining Model Should Be Disregarded

Response to ¶ 113. Music Choice offers misguided and procedurally inappropriate criticisms of Dr. Wazzan. Music Choice had ample opportunity to oppose Dr. Wazzan's qualification as an expert witness and to move to exclude his testimony. It did not object to Dr. Wazzan's qualifications, and it did not file any motion to exclude Dr. Wazzan's testimony related to Nash bargaining. *See* 5/3/17 Tr. 2293:20-25 (Wazzan). Music Choice cannot now launch an assault on Dr. Wazzan's qualifications after declining to raise any such argument during Dr. Wazzan's testimony. Nothing in the cases Music Choice cites suggest anything different. Rather, those cases involve motions to exclude expert testimony under Rule 702 of the Federal Rules of Evidence, and are inapplicable in this circumstance. *See Restivo v. Hessemann*,

846 F.3d 547, 578 (2d Cir. 2017); *Sparta Comm. Servs., Inc. v. DZ Bank*, __F. App'x__, 2017 WL 710131, at *2 (2d Cir. Feb. 22, 2017).

At any rate, the argument makes little sense. Dr. Wazzan was qualified as an expert in economics. 5/3/17 Tr. 2293:20-22 (Wazzan). As Music Choice's own witness admits, "the Asymmetric Nash Bargaining Framework is among the most widely applied tools within economics to analyze negotiations between firms." Trial Ex. 54 at ¶ 65 (Crawford WDT). The notion that Dr. Wazzan, an esteemed economist, would be unfamiliar with Nash bargaining is inconceivable.

Response to ¶ 114. For the reasons set forth below, Dr. Wazzan's criticisms are well-founded.

Response to ¶ 115. Dr. Crawford erred in assigning a Threat Point of zero to Music Choice, as explained in SoundExchange's Findings of Fact. SE FOF at ¶¶ 2032-2046. Music Choice contends that Dr. Crawford could not accurately calculate Music Choice's Threat Point, but that is simply an admission that Dr. Crawford's application of the Nash model to the PSS was incomplete and unreliable. If Dr. Crawford was not able to complete the calculations he determined that his model required in the time available, then Dr. Crawford should not have proposed the model, and should have used a different approach to rate-setting instead.

Moreover, this new argument about quantifying the revenue Music Choice would lose without the catalog of one major record company is inconsistent with Dr. Crawford's testimony about his model. Dr. Crawford could not have been clearer that "that Music Choice could not offer a viable cable radio service without the catalog of even a single major record label." Trial Ex. 54 at ¶ 93 n.73 (Crawford WDT); *see also* SE FOF ¶ 2036.

Response to ¶ 116. Dr. Crawford ignored the possibility that the hypothetical PSS provider (Music Choice) would lose profits from its non-PSS lines of business in the absence of an agreement with the hypothetical record company. SE FOF at ¶ 2034. Doing so was inconsistent with Dr. Crawford's own explanation of how Threat Points work. It is Dr. Crawford who explained that "*[e]ach firm* in a negotiation must allow for the possibility that no agreement will be reached." Trial Ex. 54 at ¶ 81 (Crawford WDT) (emphasis added) (explaining that "[t]he profit each receives when no agreement is reached is called their . . . 'Threat Point'"); *see also* SE FOF at ¶¶ 2033-2034. While Dr. Crawford considered a record company's potential profits and lost profits from other lines of business (*e.g.*, downloads) in analyzing its Threat Point, he chose not to do the same for Music Choice. This manipulation of the model highlights Dr. Crawford's results-drive approach, plainly designed to artificially lower the resulting royalty rate.

In *SDARS II*, the Judges criticized Dr. Crawford for improperly or insufficiently disaggregating Music Choice's costs and revenues for purposes of analyzing whether any adjustment to the rates was necessary to achieve the second Section 801(b)(1) objective. *SDARS II amend.*, 78 FR at 31844. However, the fact that in *SDARS II* Dr. Crawford mishandled the data about Music Choice's other lines of business for purposes of the Section 801(b)(1) analysis (which of course relates to adjusting the market rate) does not mean that the Judges should not hold Dr. Crawford to his own description of a Threat Point for purposes of his Nash analysis (which relates to identifying the market rate). Indeed, as discussed above, Dr. Crawford himself considers the effects of the negotiation on the record company's other lines of business, such as its download sales.

Response to ¶ 117. At trial, Mr. Del Beccaro confirmed that in the real world, negotiators would not blind themselves to the overall economics of their relationship, and would take other lines of business into account in a negotiation. 5/18/17 Tr. 4608:19-24 (Del Beccaro). In addition, Dr. Crawford considered the effects of Music Choice's PSS service on a record company's other lines of business; there is no reason to treat the hypothetical PSS differently from the hypothetical record company. SE FOF at ¶¶ 2033-2034.

Music Choice's effort to exclude from Dr. Crawford's Nash model lost profits from Music Choice's other lines of business is a transparent attempt to reengineer the model to achieve a lower royalty than would apply if the model was used as originally described. It is Dr. Crawford, not SoundExchange or Dr. Wazzan, who decided to use a Nash model with Threat Points to model a negotiation between Music Choice and a major record company, provided a reciprocal definition of the concept of a Threat Point, and reached beyond the scope of the PSS license to consider the record company's other lines of business. Music Choice might now regret those decisions, but it cannot escape their natural consequences.

Response to ¶ 118. Music Choice confuses Dr. Crawford's own design of his Nash model with application of the Section 801(b)(1) objectives. Consideration of Music Choice's entire business for purposes of determining a market rate (as opposed to adjusting the market rate under the Section 801(b) factors) is consistent with prior decisions of the CARP and Register. Nothing in those decisions would preclude the Judges from determining a market rate that takes into account circumstances outside the PSS business, as Dr. Crawford's own description of the Threat Points commands. SE FOF at ¶¶ 2033-2034. Moreover, the *PSS I* decision does not seem to have considered Muzak's profitability at all (either on an enterprise or PSS basis), and instead focused on the smaller start-ups in the case. Response ¶ 49.

Response to ¶ 119. Music Choice contends that Dr. Wazzan's argument about opportunity costs is based on "speculation." That criticism is meaningless. Dr. Wazzan testified about Dr. Crawford's Nash Framework analysis – which is entirely speculation. That is, it is a theoretical model about what Dr. Crawford believes (speculates) would happen in a hypothetical negotiation. All testimony about the model – whether by Dr. Crawford or Dr. Wazzan – is necessarily speculative. In light of the objective facts about the annual per-subscriber revenue that record companies earn from interactive and non-interactive services ([ ]), as compared to revenue from Music Choice ([ )], it is entirely reasonable to expect that record companies incur significant opportunity costs when they license their recordings to the PSS. SE FOF at ¶ 2099. Music Choice's claim that Dr. Wazzan lacks empirical evidence to support his testimony is thus plainly false, and Dr. Wazzan explained how even a small migration of users from Music Choice to other services could easily replace Music Choice revenues earned by the record companies. SE FOF at ¶¶ 2100-2106.

Response to ¶ 120. The fact that Dr. Crawford used three different arbitrary bargaining power numbers does not make them any less arbitrary. Unlike Dr. Crawford's arbitrary assignment of bargaining power, Dr. Wazzan's conclusion that the record company's bargaining power should be closer to one is supported by the evidence. SE FOF at ¶¶ 2109-2111.

Response to ¶ 121. Music Choice mischaracterizes Dr. Wazzan's testimony. It is well established that the Nash Framework assumes that the analyzed negotiation (here, the negotiation between Music Choice and a record company) is independent of any other negotiation or strategic consideration. SE FOF at ¶ 2021 (citing academic literature). What Dr. Wazzan actually testified was this condition for proper application of the Nash Framework was not satisfied because of Music Choice's relationships with MVPD providers. SE FOF at ¶¶ 2021-

2026. At trial, Dr. Wazzan explained that he did *not* contemplate that there would actually be a three-way negotiation. 5/3/17 Tr. 2474:20-2475:21 (Wazzan).

In *SDARS II*, Judge Roberts faulted Dr. Crawford for exactly this reason, SE FOF at ¶ 2025, and the other Judges joined Judge Roberts in his "spirited rejection" of Dr. Crawford's model. SE FOF at ¶ 2025. In this proceeding, Dr. Crawford again ignored other negotiations and strategic considerations, such as the bargaining dynamics introduced by Music Choice's affiliation agreements with cable companies, even though he recognized their importance to the bargaining dynamics he purported to model. SE FOF at ¶¶ 2022-2024.

4. Music Choice's Criticisms Of Dr. Ford And Mr. Walker Are Meritless

Response to ¶ 122. Music Choice again repeats arguments that it already has made regarding Dr. Ford, and which already are pending before the Judges. As SoundExchange has previously explained, Dr. Ford's testimony is perfectly permissible. True, Dr. Ford relied to an extent on conversations with relevant members of the music industry, but such evidence is expressly permitted under the Federal Rules of Evidence. *See, e.g.*, *Carson Harbor Village, Ltd. v. Unocal Corp.*, 270 F.3d 863, 873 (9th Cir. 2001) ("[E]xperts are entitled to rely on hearsay in forming their opinions."); *Brennan v. Reinhart Institutional Foods*, 211 F.3d 449, 451 (8th Cir. 2000) (allowing "expert to testify about facts and data outside of the record"); *Arkwright Mutual Ins. Co. v. Gwinner Oil, Inc.*, 125 F.3d 1176, 1182 (8th Cir. 1997) ("[E]xpert may rely on otherwise inadmissible hearsay evidence."); *United States v. Bonds*, 12 F.3d 540, 566 (6th Cir. 1993); *MSC Software Corp. v. Altair Eng'g, Inc.*, 217 F. Supp. 3d 1122, 1132-33 (E.D. Mich. Feb. 3, 2017) (permitting expert to rely on conversations with employees); *Frost v. BNSF Ry. Co.*, 218 F. Supp. 3d. 1122, 1132-33 (D. Mont. Oct. 31, 2016) (permitting expert to rely on hearsay evidence); *Allen v. Hylands Inc.*, CV 12-1150, 2015 WL 12720304, at *5 (C.D. Cal.

Aug. 20, 2015) (expert may rely on consumers' statements); *Pickel v. Union Pac. R.R. Co.*, No. EDCV04-1319FMCRZX, 2006 WL 4941836, at *1 (C.D. Cal. July 18, 2006) (medical expert may rely on hearsay statements of patient).

Music Choice also suggests that Dr. Ford's testimony regarding the promotional and substitutional effects of Music Choice is outside his area of expertise. This argument also falls flat. Dr. Ford is a respected economist who has repeatedly been qualified as expert in matters related to the music industry. He has testified in multiple proceedings before this tribunal, as well as before the Copyright Judges in Canada. In this proceeding, as in those, his testimony sets forth certain background facts related to the economics of the music industry—a subject in which he is certainly qualified.

Dr. Ford did provide factual context for his conclusions regarding promotion and substitution, but that is not only permissible under the Federal Rules of Evidence, it is required. Rule 702 requires that expert testimony be "based on sufficient facts or data" and that the principles discussed be "applied to . . . the facts of the case." Fed. R. Evid. 702; *see also* Fed. R. Evid. 702, notes to 2000 amendments (specifically providing that trial court must consider whether principles and methods used by the expert have been properly applied to the facts of the case); *Damon v. Sun Co.*, 87 F.3d 1467, 1474 (1st Cir. 1996) ("It is fundamental that expert testimony must be *predicated on facts* legally sufficient to provide a basis for the expert's opinion" (internal quotation marks omitted) (emphasis added)); *Pulse Med. Instruments, Inc. v. Drug Impairment Detection Servs., LLC*, 858 F. Supp. 2d 505, 512 (D. Md. 2012) (argument that background facts and contextual information must be excluded "is easily dismissed"); *In re Graphic Processing Units Antitrust Litig.*, 253 F.R.D. 478, 492 (N.D. Cal. 2008) (courts "are increasingly skeptical of plaintiffs' experts who offer only generalized and theoretical opinions

. . . without also submitting a functioning model that is tailored to the market facts in the case at hand") (quotation marks omitted); *see also United States ex rel. Ruscher v. Omnicare, Inc.*, No. 4:08-CV-3396, 2015 WL 5178074, at *7 (S.D. Tex. Sept. 3, 2015) (rejecting objection to sections of expert reports in which the experts provide general background information and finding such testimony "particularly helpful where, as here, the case concerns a complex industry governed by a number of federal statutory and regulatory schemes"), *aff'd* 663 F. App'x 368 (5th Cir. 2016).

Response to ¶ 123. Music Choice similarly contends that Mr. Walker's rebuttal testimony regarding Music Choice should be disregarded because Mr. Walker did not read testimony from Music Choice's witnesses. Again, this repackaged evidentiary objection has no merit. Mr. Walker stated in his written rebuttal testimony that he had "never heard anyone at Sony express the view that Music Choice is an important promotional platform," and that Sony would "much rather have users use the basic tier of a free, ad-supported digital radio service, rather than a PSS, because such services are more effective at monetizing our recordings and pay royalties at a much higher rate." Trial Ex. 50 at ¶¶ 16, 18 (Walker WRT). Mr. Walker was testifying from his personal knowledge as an executive at Sony regarding how Sony views Music Choice. The extent to which Mr. Walker reviewed the written testimony of Music Choice's witnesses has no bearing on the accuracy or reliability of that testimony.

Response to ¶ 124. Music Choice had ample opportunity to cross-examine SoundExchange's witnesses and to move to strike their testimony at trial. Music Choice's non-specific, conclusory argument in ¶ 124 that "any" testimony from SoundExchange witnesses regarding Music Choice is unreliable should be disregarded.

C. Existing Rate

Response to ¶ 125. Music Choice's description of *SDARS II* is inaccurate. In *SDARS II*, the Judges did not "begin their analysis" with the current rate. MC FOF at ¶ 188. The Judges did eventually apply the Section 801(b)(1) objectives to the then-current statutory royalty rate, as well as a modestly-increased rate. However, they did so only after evaluating the proffered benchmarks, failing to find what they perceived as any useful indication of a market rate, and being persuaded that the current rate was neither too low nor too high. *SDARS II amend.*, 78 FR at 31843; *SDARS II*, 78 FR at 23058. The Judges believed that was the only option available to them based on the record before them in SDARS II.

On the record of this proceeding, it is clear that the current statutory royalty rate for PSS is well below market. SE FOF at § XIII.B.3. [ ] The Judges should begin their analysis in this proceeding as they always do, by seeking to determine a marketplace royalty rate for PSS, and only then turning to consideration of whether the Section 801(b)(1) objectives compel an adjustment in the rate. Even if the Judges ultimately conclude that they are not able to determine a market rate with precision (although SoundExchange believes that a market rate is indicated by the CABSAT rates), any application of the factors cannot ignore the evidence that the current statutory royalty rate is well below market. Response ¶¶ 77-78, 100.

Response to ¶ 126. Music Choice mischaracterizes the Judges' rationale. The Judges found that it was likely that Music Choice expected that "subscribers or advertisers would be more attracted to the expanded offerings." *SDARS II amend.*, 78 FR at 31845. Thus, the rate

increase was predicated on the Judges' perceptions of fairness based on an expectation of modestly increased listenership, not some other vague concept of usage. Additionally, the Judges cited Music Choice's planned channel expansion *not* as the rationale for raising the 7.5% rate to 8.5%, but rather, as the rationale for *choosing between* the 7.5% and 8.5% rates, which in other respects they found would both satisfactorily achieve the Section 801(b)(1) objectives. *SDARS II amend.*, 78 FR at 31844-45.

Response to ¶ 127. While Music Choice's planned channel expansion was not a major focus of the participants' arguments, it was certainly part of the case. *E.g.*, Proposed Findings of Fact of SoundExchange, Inc. in Docket No. 2011-1 ¶ 64, 681 (Sept. 26, 2012).

Response to ¶ 128. To avoid repetition, SoundExchange incorporates its response to paragraph 126, *supra*.

Response to ¶ 129. Whether and to what extent additional performances occurred as a result of Music Choice's channel expansion is irrelevant. Music Choice does not need to be "made whole" for any overpayment in the previous rate period. Music Choice has been enjoying below-market rates for the last 20 years [[redacted]]. Response ¶¶ 201, 203; SE FOF at § XIII.B.3. Because the PSS have been paying a below-market rate for 20 years, it would be most consistent with a fair return to copyright owners to set an above-market rate pursuant to Section 801(b)(1). *See* 17 U.S.C. § 801(b)(1)(B).

Response to ¶ 130. To avoid repetition, SoundExchange incorporates its response to paragraphs 124-129, *supra*.

VI. Application Of The Section 801(b)(1) Objectives

A. Music Choice's Proposed Approaches

1. It Is The Judges' Duty To Begin By Estimating A Market Rate With As Much Precision As Practicable

Response to ¶ 131. Music Choice's framing of the Section 801(b)(1) inquiry is incorrect. Music Choice suggests that the Judges have approved a menu of different ways to implement 801(b)(1), which they may toggle between as they wish. That is wrong. Response ¶ 58. The Judges have consistently followed a single consistent approach in setting royalties pursuant to Section 801(b)(1). This approach, which the Judges approved in *SDARS I* and *SDARS II*, requires the determination of benchmark rates, and then a determination of whether the Section 801(b)(1) policy objectives weigh in favor of modifying the results indicated by the benchmark. *SDARS I*, 73 FR at 4094; *SDARS II*, 78 FR at 23056, 23066. The analysis is sequential; first the Judges determine the applicable benchmark rate or rates, then they adjust them as necessary to account for the 801(b)(1) factors. That approach contemplates the possibility of multiple benchmarks, so there could potentially be some range of estimated market rates identified in the first stage of the Section 801(b)(1) analysis. In any event, the second stage is to evaluate the best available estimate(s) of the market against the Section 801(b)(1) objectives. Response ¶ 25.

Response to ¶ 132. To avoid repetition, SoundExchange incorporates its response to paragraph 131, *supra*.

Response to ¶ 133. To avoid repetition, SoundExchange incorporates its response to paragraph 131, *supra*.

2. The Judges Cannot Dispense With Seeking To Ascertain A Market Rate

Response to ¶ 134. In *SDARS II*, the Judges used the existing rate, rather than an estimated market rate, as the starting point for evaluating the Section 801(b)(1) objectives. However, that was only after evaluating the proffered benchmarks, failing to find what they perceived as any useful indication of a market rate, and being persuaded that the current rate was neither too low nor too high. *SDARS II*, 78 FR at 31843; 78 FR at 23058. In this proceeding, the Judges must likewise first consider the evidence of market rates proffered by the participants and see if they can establish a range of reasonable market rates. Response ¶ 58.

3. SoundExchange Has Offered Extensive Evidence In Favor Of The CABSAT Benchmark

Response to ¶ 135. As an initial matter, adjustment of the estimated market rate based on Section 801(b)(1) is the exception, not the rule. Of course, adjustments may be necessary in any particular case. However, when a benchmark rate adequately addresses the Section 801(b)(1) objectives, no adjustment is necessary. Response ¶ 25.

SoundExchange submitted extensive testimony explaining why the CABSAT benchmark effectuates the Section 801(b)(1) objectives. SE FOF at § XIII.E. Therefore, Music Choice's argument that SoundExchange somehow defaulted by not proposing alterations to its benchmark is misguided.

B. Objective One: Maximizing The Availability Of Creative Works To The Public

1. Music Choice's Approach To This Objective Is Inconsistent With The Standards Articulated By The Judges

Response to ¶ 136. It does not. SE RFOF at § XII.B.

Response to ¶ 137. Music Choice vastly overstates the amount of "original creative content" it creates and distributes. *See* SE RFOF ¶¶ 335-341. In fact, precedent has recognized that "the record companies and the performers make the greater contribution in maximizing the availability of the creative works to the public." *PSS I*, 63 FR at 25407. The Judges have embraced a neoclassical economics interpretation that "an effective market determines the maximum amount of product availability consistent with the efficient use of resources." *SDARS I*, 73 FR at 4094. There is no interpretation of the law concerning availability that suggests that it is best served by below-market rates for PSS. And Music Choice provides no strong evidence it is different from the CABSAT services or other services in a way that would warrant a departure from a market rate.

Against that background, Music Choice's proposal will not promote the objective of maximizing the availability of creative works to the public. It is SoundExchange's proposal that will do so. If the PSS were paying higher royalties, such as at the CABSAT royalty rates, more funding would be available to artists and record labels for the creation of recordings, thus maximizing the availability of creative works to the public. *See* SE FOF at ¶ 2121. Conversely, low PSS rates have a negative effect on availability, because of opportunity costs to copyright owners, and greater competition for other services including CABSAT services. Adopting the CABSAT rates for PSS is fully consistent with the first objective; lower rates would be inconsistent with that objective. Trial Ex. 501 at ¶ 77 (Wazzan Corr. WDT).

Response to ¶ 138. Music Choice also overstates the uniqueness and importance of its on-screen displays. The CABSAT services are required by statute to have screen displays that display text data identifying the title of each sound recording they play, along with the album title and the featured recording artist's name, as each recording is being played. 17 U.S.C.

§ 114(d)(2)(C)(ix). [ ]. 5/18/17 Tr. 4576:1-14 (Del Beccaro); 5/18/17 Tr. 4738:16-4739:7 (Williams).

Response to ¶ 139. Music Choice has also failed to show that it "confers significant promotional benefits on artists and labels." Specifically, Music Choice has provided *no* direct evidence that its service currently produces sales that would not have occurred in the absence of its service, *see* SE FOF ¶¶ 2060-2078, much less that plays on its service allow artists "to create new, additional works." And while Music Choice makes much of its hand-curation of playlists, it fails to explain how its curation is different from the hand-curation practiced by CABSAT services. *See* Trial Ex. 985 at 2 (explaining that Stingray offers "1000s of channels hand-curated by a team of 100 music programmers").

Response to ¶ 140. Precedent has recognized that "the record companies and the performers make the greater contribution in maximizing the availability of the creative works to the public." *PSS I*, 63 FR at 25407.

Response to ¶ 141. Music Choice blames the PSS royalty rates for the fact that it has made spending cuts. That is simply not plausible. Music Choice is profitable. *See* SE FOF ¶ 2134. Its profits are projected to grow over the coming rate term. *See* Trial Ex. 406 at P&L tab. And it has chosen to focus on a residential audio business, rather than its more profitable commercial audio business. SE FOF ¶ 1845. That is not a decision the Judges are tasked with correcting.

Response to ¶ 142. Because Music Choice is incorrect about all of its points supporting the conclusion that "the first factor weighs in favor of a lower rate," *see* responses to ¶¶ 136-141, it is also incorrect that about this conclusion.

2. The First Objective Would Best Be Served By Adopting The CABSAT Rates

Response to ¶ 143. The first objective would best be served by adopting the CABSAT rates, so that additional dollars would flow to artists and record companies to support their creative endeavors. Music Choice's assertion that SoundExchange's rate proposal would put it out of business is not credible. SE FOF at § XIII.E.5.ii. Adopting the CABSAT rates for PSS would also allow Stingray to compete on a level playing field by continuing to compete with Music Choice in the downstream market, thereby increasing consumer welfare. SE FOF at § XIII.E.5.i; 5/18/17 Tr. 4646:4-4647:6 (Del Beccaro) (Stingray pays SoundExchange at a higher per-subscriber rate even as Stingray is charging lower per-subscriber rates to cable companies). In other words, the record companies and artists would be induced to create more recordings at the same time as customers and MVPDs pay a lower price – under this scenario, the availability of works to the public would be maximized.

Response to ¶ 144. *See* Response to ¶ 143.

C. Objective Two: Affording The Copyright Owner A Fair Return And The Copyright User A Fair Income Under Existing Economic Conditions

Response to ¶ 145. The second statutory objective requires the Judges to adopt a rate that results in a fair return for the copyright owner and a fair income for the copyright user. The Judges and their predecessors have consistently held that fairness to both parties under this provision is generally best accomplished by replicating to the greatest extent possible the returns that would exist in workably competitive markets, where producers and distributors are rewarded for their risks and for the value of what they bring to the market. *See, e.g., SDARS II,* 78 FR at 23067 (noting the presumption that a "marketplace-inspired" rate "already reflects a fair income and a fair return"); *SDARS I,* 73 FR at 4095 ("a fair income is more consistent with reasonable

market outcomes"); *PSS I*, 63 FR at 25409 (recommended rate based on consideration of "proposed marketplace benchmarks" achieves second objective).

Response to ¶ 146. Music Choice makes assertions about how fairness is to be judged that do not reflect any interpretation of law ever adopted by the Judges or their predecessors. Its long quote from the *PSS I* decision simply embodies a result based on the record of that case, not any sweeping legal pronouncements. Music Choice also wants to have its cake and eat it too. It wants to look only at some artificial construct of stand-alone PSS operations in order to plead poverty, but to record label revenues in general to argue that the labels are receiving enough money from other sources even with a PSS rate at well below market. The Judges should reject this gambit.

Response to ¶ 147. SoundExchange does not dispute that, *in theory*, it could be relevant to the PSS rate-setting exercise to consider PSS-only revenues. The problem – in the words of Music Choice's own expert, David Del Beccaro – is that Music Choice's PSS and non-PSS revenues "cannot be disaggregated," as all of its products are sold as a bundle. *See SDARS II*, 78 FR at 31844; *see also* SE FOF ¶¶ 2052-2054. Dr. Crawford's Nash bargaining analysis erroneously attributes to Music Choice's PSS business costs that were borne by the enterprise as a whole for precisely this reason. *See* SE FOF ¶ 2054. Music Choice also misdescribes the treatment of Muzak in *PSS I*. The *PSS I* decision does not seem to have considered Muzak's profitability at all (either on an enterprise or PSS basis), and instead focused on the smaller start-ups in the case. Response ¶ 49.

Response to ¶ 148. Music Choice again seeks to use its interpretations of legislative history, rather than the statutory text, to interpret Section 801(b)(1). This is cannot do. Response ¶¶ 13-16, 21-25.

Response to ¶ 149. *See* Response to ¶ 148, *supra*.

1. Music Choice's Proposed Rate Does Not Satisfy The Second Objective

Response to ¶ 150. As discussed in detail in SoundExchange's Findings of Fact and Conclusions of Law, *see* SE FOF at ¶¶ 2134, 2152-2157, Music Choice is currently profitable. 5/18/17 Tr. 4623:21-23 (Del Beccaro). Music Choice has continued to offer its PSS service for thirty years, as part of its profit-maximizing effort. 5/18/17 Tr. 4624:6-20 (Del Beccaro). Furthermore, the evidence shows that Music Choice would have been even more profitable if it charged its partners [redacted] Trial Ex. 502 at ¶ 87 (Wazzan Corr. WRT). For example, Music Choice [redacted] Trial Ex. 502 at ¶ 87 (Wazzan Corr. WRT). In addition, as Dr. Wazzan explained, "Music Choice also has the power to mitigate the effects of a rate increase, at least to a significant extent, because [redacted] Trial Ex. 502 at ¶ 88 (Wazzan Corr. WRT). Further, as Music Choice's expert Dr. Crawford testified, Section 801(b) does not guarantee a copyright user a certain level of profitability. 4/25/17 Tr. 901:6-18 (Crawford).

Response to ¶ 151. There is no evidence in the record indicating that Music Choice's financial difficulties are real. SE FOF at § XIII.E.5.ii. To avoid repetition, SoundExchange incorporates its Response to ¶¶ 150, 156 & 171.

Response to ¶ 152. To avoid repetition, SoundExchange incorporates its Response ¶ 151, as well as its responses to ¶¶ 206-219 of Music Choice's Proposed Findings of Fact.

Response to ¶ 153. Music Choice's argument seems to be that because it *currently* pays rates that are well below market and make up a small amount of the labels' overall revenue it should be allowed to *continue* paying these low rates indefinitely. Notably, it cites no precedent that supports this preposterous argument.

Moreover, as set forth in SoundExchange's Findings of Fact, record companies are increasingly reliant on statutory royalties. SE FOF at ¶¶ 1465, 1474, 1481-87. To be sure, PSS royalties are less than SDARS royalties, but the same point holds true: record companies must rely on an array of royalty streams to earn a fair return on their investments, and that includes royalties from the PSS. The PSS revenue to record companies is small because the statutory PSS royalty rate is low. That is not a fact that supports maintaining the PSS rate at such low levels. To the contrary, that is a reason to raise the rate.

There is nothing misleading about SoundExchange's testimony regarding the state of the record industry. SoundExchange has detailed the financial condition of the record industry. *See generally* SE FOF at X. Music Choice does not dispute that, as Jason Gallien testified, since 2000, music sales in the United States have declined by approximately 50%, falling from a high of $14.3 billion to $7 billion in 2015. Trial E. 30 at 3 (Gallien WDT). This testimony *recognizes* that 2000 was the peak of the industry.

Response to ¶ 154. Contrary to Music Choice's assertions, the record labels incur significant costs and risks to their overall profitability related to their significant outlay of capital, followed by possible recoupment. Record companies tend to absorb all the risk associated with creating a recording by fronting the costs and then sharing the rewards with the artist only if the artist finds commercial success. *See generally* SE FOF at Section X; *see also* SE FOF at ¶¶ 1447, 2138. For example, for a new artist, Atlantic's advance would typically

range from [ ], depending on competition. For an established artist with a track record of success, Atlantic may pay advances of many millions of dollars. The record company also typically pays all of the costs of producing the artist's recordings, including costs such as producer fees, studio fees, engineering costs, wages of session musicians, and costs of producing accompanying videos. For example, in the case of a first album from a new artist, Atlantic's recording costs typically range from [ ]. For an established artists, Atlantic sometimes pays recording costs for an album [ ].

Response to ¶ 155. There is nothing fair about Music Choice being allowed to use the copyright owners' property at a rate well below market just because the record industry outlook has improved over the past couple of years. [ ] SE FOF § XIII.E.5.ii.

Response to ¶ 156. There is nothing fair about allowing Music Choice to use the copyright owners' property at a rate well below market just because it would be less profitable if it had to pay a market rate. Indeed, Music Choice has [ ]

The Judges have held that no service is assured of a statutory royalty rate that will allow it to operate profitably. *SDARS I*, 73 FR at 4095; *SDARS II*, 78 FR at 23067. Indeed, even Music Choice's expert witness Dr. Crawford testified that "there's no requirement for the Judges to set rates to guarantee that the PSS survive." 4/25/17 Tr. 862:20-22 (Crawford). Dr. Crawford

likewise agreed that there is nothing in Section 801(b)(1) that guarantees a copyright user a certain level of profitability, or that requires the Judges to set rates to ensure that an inefficiently operated service can remain in business. 4/25/17 Tr. 901:6-18 (Crawford). "To allow inefficient market participants to continue to use as much music as they want 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." *Web II*, 72 FR 24088 n.8.

Response to ¶ 157. For all the reasons set forth in SoundExchange's Findings of Fact, there is every reason to raise the PSS rate, and no reason to lower it.

Music Choice refers to the possibility that the Judges could use the existing rate as their starting point. That would not be proper. The Judges must first consider the evidence of market rates proffered by the participants and see if they can establish a range of reasonable market rates. Response ¶ 58.

2. SoundExchange's Proposed Rates Satisfy The Second Objective

Response to ¶ 158. Music Choice's assertions are belied by the objective evidence in the record. Music Choice would remain profitable if required to pay the CABSAT rates. SE Response to MC FOF ¶ 206; SE FOF at § XIII.E.5.ii.

Response to ¶ 159. Music Choice has continued to offer its PSS service for thirty years, as part of its profit-maximizing effort. 5/18/17 Tr. 4624:6-20 (Del Beccaro). As a result, the Judges were skeptical of the similar claims of poverty Music Choice made in *SDARS II*. *SDARS II amend*., 78 FR at 31844 n.5 ("[i]t is improbable that Music Choice would continue to operate for over 15 years with the considerable losses that it claims").

Music Choice myopically focuses on its PSS business, and relies for that myopia on the unreliable allocations generated under Dr. Crawford's supervision. SE FOF at § XIII.D.2.ii.

Those allocations are no more appropriately relied upon in a Section 801(b)(1) context than a Nash model context. Moreover, financial forecasts for Music Choice's real business – the way it views its business for operational purposes rather than purposes of litigation – are strong. SE FOF at § XIII.E.5.ii.

Furthermore, the evidence shows that Music Choice would have been even more profitable if it charged its partners [ ] Trial Ex. 502 at ¶ 87 (Wazzan Corr. WRT). For example, Music Choice [.] Trial Ex. 502 at ¶ 87 (Wazzan Corr. WRT). In addition, as Dr. Wazzan explained, "Music Choice also has the power to mitigate the effects of a rate increase, at least to a significant extent, because [ ] Trial Ex. 502 at ¶ 88 (Wazzan Corr. WRT).

Response to ¶ 160. As discussed in detail in SoundExchange's Findings of Fact, *see* SE FOF at ¶¶ 2152-2159, the evidence shows that [ ]

Response to ¶ 161. There is substantial justification for SoundExchange's proposed per-subscriber rate structure. SE FOF at § XIII.B.4. SoundExchange has provided ample justification for a 3% annual rate increase. SE FOF ¶ 1770.

Music Choice's expert, Dr. Crawford, asserts that the pattern of pricing observed by Dr. Wazzan "is perfectly consistent with the widespread practice of providing quantity discounts to the largest cable companies by owners of content distributed on cable systems." The facts –

explained in greater detail in SoundExchange's findings of fact, *see* SE FOF ¶¶ 1960-1999 – simply do not support this view of the world.

A per-subscriber rate is easy to apply, so minimizes disputes concerning the proper accounting of revenues. *See* SE FOF at ¶¶ 1647.

SoundExchange has provided ample justification for a 3% annual rate increase. SE FOF ¶ 1770.

Response to ¶ 162. To avoid duplication, SoundExchange incorporates its responses to paragraphs 158 through 161, *supra*, and Sections XIII.B. & E.3 of its Findings of Fact and Conclusions of Law.

D. Objective Three: Reflecting The Relative Role Of The Copyright And Copyright Users In The Product Made Available To The Public

Response to ¶ 163. No response.

Response to ¶ 164. No response.

1. Music Choice's Proposed Rate Is Inconsistent With The Third Objective

Response to ¶ 165. Music Choice invites the Judges to conduct a "beauty contest" by examining a long litany of contributions in the abstract. That is not how this objective is to be applied. *SDARS I*, 73 FR at 4094. Instead, the question is whether some "unique" contribution compels divergence from a marketplace rate. *SDARS II*, 78 FR at 23069.

Response to ¶ 166. These factual determinations are irrelevant here. The Judges must make their decision in this proceeding based on its record, not the record of a different proceeding 20 years ago.

Response to ¶ 167. Music Choice's claimed technological contributions must be viewed with skepticism. SE RFF at ¶ 52. Music Choice blames the PSS royalty rates for the fact that it

"has had to make significant cuts to its [ ] activities" and "is [ ]." That is simply incorrect. Music Choice is significantly profitable. SE FOF at § XIII.E.5.ii.

Response to ¶ 168. The record labels make significant technological investments in creating the sound recordings themselves, without which Music Choice could not survive. As detailed in SoundExchange's Proposed Findings of Fact, ¶¶ 1559-60, 1562, the labels expend significant sums on recording costs, mastering costs, and producer and sampling fees, as well as costs associated with the manufacturing and distribution of recordings, both in physical and digital form. They also provide infrastructure for Music Choice and other services to download promotional copies. SE FOF at ¶ 2087. SoundExchange also has invested the money of artists and record companies in sophisticated systems to collect and distribute statutory royalties. SE FOF at ¶ 2344. Without these technological investments, sound recordings would not be made or distributed to the public by Music Choice under the statutory license.

Response to ¶ 169. *See* Response to ¶ 168, *supra*.

Response to ¶ 170. *See* Response to ¶ 171, *infra*.

Response to ¶ 171. All of the investments its partners have made in Music Choice were made a long time ago – in the first twelve years of Music Choice. There has been no investment by them in the last eighteen years, and the investors have realized returns on their investments. Moreover, these investments have helped fuel Music Choice's non-statutory video service line of business. 5/18/17 Tr. 4630:23-4631:21 (Del Beccaro). Music Choice has provided no evidence of the need for additional capital expenditures, including what these expenditures might be, when they are projected to be made, and how much they would cost. Thus, its claim that it cannot attract "new capital from investors" to fund any additional capital expenditures is a non sequitur.

As to Music Choice's ongoing costs, its wholesale distribution model seems to be relatively inexpensive to operate. Between 2013 and 2016, it spent less than [ ] of revenue on property and equipment. Trial Ex. 501 at ¶ 79 (Wazzan Corr. WDT). By way of comparison, Sirius XM's capital expenditures were 3% of its total revenues in 2015, and Pandora spent 2.8% of its total revenues on capital expenditures during the same period. Trial Ex. 501 at ¶ 80 (Wazzan Corr. WDT).

Response to ¶ 172. The record labels' and artists' investments in creating sound recordings are the *reason* that Music Choice exists. The record companies make large investments, at significant risk, to sign artists, create recordings, release them to the market, help them find an audience, and build a fan base. SE FOF at ¶ XIII.E.4.

Response to ¶ 173. Consequently, the "capital investment" subfactor supports making no adjustment, or an upward adjustment, to the benchmark rate.

Response to ¶ 174. Music Choice mischaracterizes the treatment of the "cost and risk" subfactor in the *PSS I* proceeding. In *PSS I*, the CARP did conclude that the relative costs and risks incurred by the parties was greater for the services than for the record companies and artists, and the Register and Librarian did not take issue with that conclusion. *PSS I*, 63 FR 25394-01 at 25407. But the CARP's conclusion regarding relative costs and risks was based heavily on the fact that the services, at the time, were making substantial investments "associated with bringing the creative product to market in a new and novel way." *PSS I*, 63 FR at 25407. As the *PSS I* opinion explained, "the Services have invested significant start-up costs and are currently undergoing a shift in how they market their services." *PSS I*, 63 FR 25394-01 at 25407. While these findings may have been accurate in 1999, when digital music services were

in their infancy, Music Choice is no longer pioneering a new and vulnerable technology. Accordingly, the conclusion from *PSS I* on the "cost and risk" subfactor is out of date.

Response to ¶ 175. What matters under the third objective is current, or at least recent, "ongoing" costs and risks, not ancient history. *SDARS II*, 78 FR at 23069. Nothing in Section 801(b)(1) suggests that the PSS should be forever rewarded for things they did 30 years ago.

Response to ¶ 176. Music Choice refers to a factual finding based on the *PSS I* record, not a principle of law. On the record of this proceeding, it is clear that there is no meaningful evidence of a positive promotional effect, and significant evidence that continued operation of the PSS at below-market rates imposes significant opportunity costs on artists and labels. SE FOF at ¶ XIII.D.2.iii.a.

Response to ¶ 177. Music Choice overstates the evidence. All of the evidence it points to for the proposition that "record companies have remained consistently profitable" as sales have declined relates to UMG. And the sources that Music Choice cites in the second sentence simply do not support the proposition that record company revenues "are projected to continue increasing for the foreseeable future." *See* SE RFOF at ¶ 419-420.

Response to ¶ 178. As explained in SoundExchange's proposed findings of fact, Music Choice's dismissal of the possibility that a PSS might cannibalize other forms of music consumption is unconvincing. *See* MC FOF ¶¶ 2068-2074.

Response to ¶ 179. Music Choice has continued to offer its PSS service for thirty years, as part of its profit-maximizing effort. 5/18/17 Tr. 4624:6-20 (Del Beccaro). As a result, the Judges were skeptical of the similar claims of poverty Music Choice made in *SDARS II*. *SDARS II amend*., 78 FR at 31844 n.5 ("[i]t is improbable that Music Choice would continue to operate

for over 15 years with the considerable losses that it claims"). Today, Music Choice is profitable. SE FOF at § XIII.E.5.ii.

Response to ¶ 180. *See* Response to ¶ 178, *supra*.

Response to ¶ 181. Music Choice continues to insist that it has produced "a great deal of evidence demonstrating the significant promotional effects it confers on the labels and artists, at Music Choice's own expense." That is simply not the case. *See* SE FOF ¶¶ 2060-2071. The anecdotal evidence it has provided is irrelevant, outdated, and insufficient to prove causation.

Response to ¶ 182. *See* response to ¶ 181, *supra.*

Response to ¶ 183. *See* response to ¶ 167, *supra*.

Response to ¶ 184. Music Choice's misunderstanding of the "cost and risk" subfactor lead it to an erroneous conclusion. Music Choice is no longer pioneering a new technology; it is using a now-established service that does not bear costs or risks distinguishable from those borne by any other music distribution service. There is no basis for a downward adjustment of a market rate based on this objective.

Response to ¶ 185. Music Choice again cites 20 year old factual findings that are no longer relevant. This factor no longer favors Music Choice.

Response to ¶ 186. *See* response to ¶185, *supra*.

Response to ¶ 187. *See* response to ¶¶ 166, 170, 174-175, 185, *supra*.

Response to ¶ 188. For the reasons explained above, the third policy factor does not warrant a downward adjustment of a market rate.

2. SoundExchange's Proposed Rates Promote The Third Objective

Response to ¶ 189. As Music Choice acknowledges, the third factor – consideration of the relative roles in making the product made available to the public – includes sound recordings.

See MC FOF at ¶ 245. The record labels' and artists' creative contributions to making those sound recordings are *the reason* that Music Choice exists. The record labels incur significant costs and risks to their overall profitability related to their significant outlay of capital, followed by possible recoupment. Record companies tend to absorb all the risk associated with creating a recording by fronting the costs and then sharing the rewards with the artist only if the artist finds commercial success. *See* SE RFOF to MC ¶ 466. The third factor is accordingly best served by a market rate that properly compensates the record companies and artists for their roles in creating the product that Music Choice disseminates.

E. Objective Four: Minimizing Any Disruptive Impact On The Structure of The Industries Involved And On Generally Prevailing Industry Practices

Response to ¶ 190. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 52-57, *supra*.

Response to ¶ 191. The fourth Section 801(b)(1) factor concerns disruption to the industries. It does not require that the Judges ensure the long-term survival of the PSS. As the *PSS I* decision explained in blunt terms, "[t]he law requires the Panel, and ultimately the Librarian, to set a reasonable rate that minimizes the disruptive impact on the industry. *It does not require that the rate insure the survival of every company.*" *PSS I*, 63 FR at 25408 (emphasis added).

1. Music Choice's Proposed Rate Does Not Promote The Fourth Objective

Response to ¶ 192. The *PSS I* decision did conclude that the fourth Section 801(b)(1) factor weighed in favor of a lower rate, but its conclusions were self-consciously fact-bound and limited. The decision explained clearly that, in the circumstances at hand, "[t]he evidence clearly show[ed] that the Services have been facing an uphill battle in their struggle to achieve

profitability," and it "recommend[ed] a rate that will not harm the industry at this critical point in its development." *PSS I*, 63 FR at 25410. However, the Register made abundantly clear that this decision was based on the factual situation at the time. The decision explains: "[A]s the market conditions change and the industry shows significant growth and profitability, another panel will have an opportunity to make adjustments to the rate, and may well find that the changed circumstances favor an upward adjustment. *PSS I*, 63 FR at 25409. That is exactly what has happened, and so the *PSS I* decision's treatment of the fourth factor does not control the Judges' analysis today.

Response to ¶ 193. Music Choice incorrectly characterizes the *PSS I* decision. The Register did not itself reach the conclusions quoted by Music Choice; rather, the CARP did, and the Register simply recounted them. *See PSS I*, 63 FR at 25408 ("The Panel determined that a rate set too high could cause one or all of the Services to abandon the business."); *id.* ("The Panel also calculated that the record companies would receive substantially less than a 1% increase in their gross revenues if the rate were set at the highest proposed level (41.5% of gross revenues), underscoring the lesser impact of the license fees on the record industry."). The Register's own analysis did evidence a general concern about setting rates that would harm the industry, but it said nothing about those specific conclusions from the CARP. *See PSS I*, 63 FR at 254108-10.

Response to ¶ 194. As discussed in detail in SoundExchange's Findings of Fact, *see* SE FOF at ¶¶ 2152-59, the evidence shows that [ ] 5/3/17 Tr. 2328:17-22 (Wazzan). According to Music Choice's forecasts that provided the basis for Dr. Crawford's and Dr. Wazzan's calculations,

Music Choice would be profitable as an enterprise at CABSAT rates in 2018 and for the remainder of the coming rate period. SE FOF at ¶ 2153.

Even if it were true that SoundExchange's proposed rates would drive Music Choice from the market – and there is no reason to believe that is true – that would not have much of an effect on the cable radio industry, and even less on some broader digital music services industry. SE FOF at § XIII.E.5.ii. At any rate, as Dr. Crawford testified, "there's no requirement for the Judges to set rates to guarantee that the PSS survive." 4/25/17 Tr. 862:20-22 (Crawford). If the PSS cannot, by some combination of lower profits, higher prices, reduced expenses, or subsidy from other lines of business operate their services while paying marketplace prices for the inputs used in their services, the economically-appropriate result is that other providers who can do so (such as the CABSAT services) should be allowed to do so. In fact, as discussed in SoundExchange's Findings of Fact at ¶¶ 1798-1820, 1871-1880, there are a number of substitutes for Music Choice's PSS, including Stingray, and it is likely that these sources would fill any void created by Music Choice's absence. Trial Ex. 502 at ¶¶ 83, 86 (Wazzan Corr. WRT).

Similarly, the fact that revenues from the PSS performance license currently make up only a small percentage of the record labels' revenues is not a sufficient reason to keep the current below-market rates. Music Choice has [

] Trial Ex. 418 at MC0002939. If the PSS were

paying higher royalties, the record companies and artists would be induced to create more recordings, this maximizing the availability of works to the public.

In addition, as Dr. Wazzan explained, if it really were the case that the royalties paid by Music Choice ([ ] in 2015) were too little to matter, and that its royalties should therefore be reduced (making its royalties even less significant), that logic would eventually lead to the conclusion that only the handful of statutory licensees paying more statutory royalties than Music Choice should pay royalties, and everyone else should have their statutory royalties reduced to zero. That is not consistent with how markets work or how the Judges have described the Section 801(b)(1) objectives. Trial Ex. 502 at ¶ 81 (Wazzan Corr. WRT).

Response to ¶ 195. To avoid repetition, SoundExchange incorporates its Response to ¶ 194, *supra*.

Response to ¶ 196. As discussed in SoundExchange's Findings of Fact and Replies to Music Choice's Findings of Fact, Music Choice is currently profitable. 5/18/17 Tr. 4623:21-23 (Del Beccaro). Music Choice has continued to offer its PSS service for thirty years, as part of its profit-maximizing effort. 5/18/17 Tr. 4624:6-20 (Del Beccaro). Further, as discussed in detail in SoundExchange's Findings of Fact, *see* SE FOF at ¶¶ 2152-59, the evidence shows that [ ] 5/3/17 Tr. 2328:17-22 (Wazzan) (SoundExchange's rate proposal would not put Music Choice out of business).

Response to ¶ 197. To avoid repetition, SoundExchange incorporates its Response to ¶ 194, *supra*.

Response to ¶ 198. To avoid repetition, SoundExchange incorporates its Response to ¶ 194, *supra*.

2. SoundExchange's Proposed Rate Does Not Require An Adjustment Under The Fourth Objective

Response to ¶ 199. SoundExchange does not seek to write the fourth 801(b)(1) factor "out of existence." To the contrary, Dr. Wazzan conducted detailed analysis of the factor and concluded that an adjustment under the fourth 801(b)(1) factor would be inappropriate. *See* Trial Ex. 501 at ¶¶ 82-86 (Wazzan Corr. WDT). As Dr. Wazzan explains, the artificially low PSS rate is disruptive because it provides Music Choice an insurmountable competitive advantage. Music Choice enjoys a distinct and unfair advantage over Stingray, Sirius XM, and potential new entrants to the market – the artificially low rates. Trial Ex. 502 at ¶ 81 n.112 (Wazzan Corr. WRT) (noting that Music Choice internal documents [[redacted]]). As set out in further detail in SoundExchange's Findings of Fact, SE FOF at ¶¶ 2146-2151, [[redacted].] *See* 5/18/17 Tr. 4532:25-4533:6 (Del Beccaro) ([" [redacted] "]). It would be patently unfair to require copyright owners and artists to continue subsidizing Music Choice with below-market rates to compensate Music Choice for changes in the cable industry or new competition. Such a subsidy fosters Music Choice's inefficient operation and risks disrupting the market for residential audio services. Trial Ex. 501 at ¶ 84 (Wazzan Corr. WDT).

Response to ¶ 200. It is not necessary for the Judges to adjust SoundExchange's benchmark rate based on the fourth Section 801(b)(1) objective. However, if the Judges adopt Music Choice's rate proposal, push forward the current statutory rate, or adopt a similarly low rate, then an upward adjustment would be necessary to minimize the disruptive impact in the market for residential cable audio services.

F. Conclusion On Section 801(b)(1) Objectives

Response to ¶ 201. The Section 801(b)(1) objectives do not require a downward adjustment of the PSS rate. As Dr. Wazzan testified, the first three objectives can be summarized as seeking to derive a free market rate, and then considering whether policy objectives might warrant any deviation. Trial Ex. 501 at ¶ 18 (Wazzan Corr. WDT). The fourth factor does not require any adjustment given the current state of the industry. If the PSS cannot continue to operate while paying market rates, then other providers (such as the CABSAT services), which already do pay market rates, would fill the void. There would be no threat to the "viability of the music delivery service currently offered to consumers under this license," which is all that the fourth factor requires. Accordingly, a market rate satisfies all four Section 801(b)(1) factors.

Response to ¶ 202. Music Choice is correct that Sirius XM's financial success supports SoundExchange's SDARS rate increase proposal. *See* SE FOF at ¶¶ 17, 1242. But it is wrong that Music Choice is in such dire financial straits that it cannot pay the rates paid by its CABSAT competitors. To begin, Music Choice is profitable. *See* SE FOF at ¶ 2134. [ ] *See* Trial Ex. 406 at P&L tab. Moreover, Stingray is a thriving enterprise, despite paying CABSAT rates for its residential audio service. *See* SE FOF at 1839, 1866-1868. To the extent Music Choice's profits are limited by its

own decision to focus on its residential audio business rather than its more remunerative commercial audio business, that is not a problem for the Judges to fix. *See* SE FOF at ¶ 1845. In short, SoundExchange's positions that Sirius XM's profitability should be considered and that Music Choice's hyperbolic financial story should be ignored are entirely consistent with one another.

Response to ¶ 203. Music Choice's proposed rate should be rejected.

VII. Music Choice Should Pay Webcasting Rates For Its Webcasting

Response to ¶ 204. Contrary to Music Choice's assertion, in its Proposed Findings of Fact, SoundExchange explained that *Section 114 itself* provides the authority for the Judges to require the PSS to pay for its webcasting activities. *See* SE COL at ¶ 40 (pp.806-07). The Judges were directed by Congress "to determine reasonable rates and terms of royalty payments for subscription transmissions" by a PSS. 17 U.S.C. § 114(f)(1)(A). In doing so, the Judges are to "distinguish among the different types of digital audio transmission services then in operation." 17 U.S.C. § 114(f)(1)(A). The Judges have also made plain that when setting rates under Section 801(b)(1), they seek "to unambiguously relate the [royalty] fee charged for a service . . . to the value of the sound recording performance rights covered by the statutory license." *SDARS II*, 78 FR 23072. Here, an Internet-based PSS distributed from a website or to mobile apps over the Internet is sufficiently different from the core PSS television-based service that the Judges must consider whether the value of the sound recording usage involved is sufficiently reflected in a rate set with a television-based service in mind, now that Music Choice's webcasting has increased to a significant level. SE FOF at ¶¶ 2003-2010.

SoundExchange's proposal to set a rate for webcasting by a PSS is complementary with its proposed CABSAT benchmark for the television-based services provided by a PSS. The PSS

television based services are functionally equivalent to the CABSAT services, making the CABSAT benchmark the best available benchmark for valuing the use of sound recordings in the PSS television-based services. SE FOF at § XIII.B.2. Because the CABSAT services separately pay for their webcasting at the statutory webcasting rates, asking the PSS to do the same is natural if the Judges rely on the CABSAT benchmark. SE COL at ¶¶ 41-42. However, if the Judges use some other methodology to determine a market royalty rate for the PSS, and that methodology does not clearly incorporate the value of the PSS webcasting, then Section 114(f)(1)(A) still requires the Judges to set a rate for the PSS that appropriately reflects the value of their webcasting in accordance with Section 801(b)(1).

Response to ¶ 205. The scope of the CABSAT rate category is not specifically a result of SoundExchange's settlements of CABSAT rates. As described in SoundExchange's Findings of Fact, in 2005, Sirius XM commenced a proceeding to set a rates for a "new type of service" that was a television-based cable radio service not qualifying a PSS. SE FOF at ¶ 1850. After a determination by the Register that Sirius XM did not qualify as a PSS, the Judges proceeded with the proceeding for which Sirius XM petitioned, and the first CABSAT rates were set in that proceeding. SE FOF at ¶ 1851-1852. Thus, the scope of that proceeding was determined by Sirius XM's petition and the Judges' commencing the proceeding. Because the proceeding was a commenced to set rates for the television-based services now referred to as CABSAT services, it would have been inappropriate for the parties to have proposed a webcasting settlement. *See* 17 U.S.C. § 801(b)(7)(A) (addressing settlements among participants in a proceeding of the rates and terms to be determined in the proceeding).

Response to ¶ 206. Music Choice claims to have been webcasting since 1996. Trial Ex. 57 at 25 (Del Beccaro WRT). But it has [redacted]

[redacted]. 5/18/17 Tr. 4658:16-4659:1 (Del Beccaro); SE FOF at ¶¶ 2007-2010. Because of Music Choice's low level of webcasting five years ago at the time of *SDARS II*, SoundExchange chose not to ask the Judges to seek to value webcasting by a PSS in *SDARS II*. The purpose of this rate proceeding is to set rates for the 2018-2022 period. Such rates must be determined anew for the coming period. SE FOF at § IX.A. Nothing in the Judges' rules of procedure suggests that SoundExchange's rate request in this proceeding must be circumscribed by its rate request in any predecessor proceeding. 37 C.F.R. § 351.4(b)(3).

Response to ¶ 207. This claim is not a relevant constraint on an otherwise permissible rate request, 37 C.F.R. § 351.4(b)(3), or a relevant consideration under 17 U.S.C. §§ 114(f)(1), 801(b)(1). To avoid repetition, SoundExchange incorporates its Response to ¶ 206, *supra*.

Response to ¶ 208. While some Internet activities may fall within the scope of a PSS, SoundExchange does not believe it is necessary to decide in this proceeding whether or not some or all of Music Choice's webcasts qualify as part of its PSS under the relevant standard, because the purpose of this proceeding is to set rates for the activities that a PSS is permitted to undertake. Trial Ex. 29 at 30 (Bender WDT); Trial Ex. 48 at 30-31 (Bender WRT). Accordingly, SoundExchange believes the Judges should set rates that properly reflect the value of Music Choice's webcasting. *See* Responses to ¶¶ 204-205.

Response to ¶ 209. Mr. Bender *did* conduct an investigation. He testified that he went to the website where Music Choice offers its video services. 5/10/17 Tr. 3306:2-4 (Bender). To avoid repetition, SoundExchange incorporates its Response to ¶ 208, *supra*. The Judges should credit Mr. Bender's testimony.

Response to ¶ 210. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]]. Trial Ex. 48 at 31 & n.14 (Bender WRT); Trial Ex. 454. [redacted]

[redacted]

[redacted]]

In early 2017, Stingray notified SoundExchange that it wished to resume webcasting under the statutory license as of January 2017. Trial Ex. 455. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]]

Trial Ex. 48 at 31 & n.14 (Bender WRT).

Response to ¶ 211. As a benchmark, the webcasting rates are similar to the CABSAT rates. The Part 380 streaming rates are not a *marketplace* benchmark, because they are regulated rates. However, Dr. Wazzan concluded that reproducing the economic analysis from *Web IV* was unwarranted for an ancillary activity of the PSS, and the Part 380 rates were recently determined by the Judges under the willing buyer/willing seller standard and thus purport to be fair market rates. In the absence of any apparent marketplace benchmark for the value of the use of sound recordings ancillary to a PSS, if one accepts that the CABSAT rates in Part 383 provide the best available approximation of a market based royalty for the core PSS television-based service, it follows that the Part 380 rates that would be paid for Internet streaming ancillary to

such a service must provide a reasonable approximation of a market royalty for Internet streaming ancillary to the core PSS television-based service. Trial Ex. 501 at ¶ 73 (Wazzan Corr. WDT).

Obviously, benchmarking is only the first step of the analysis under Section 801(b)(1). One must go on to consider whether any deviations from a market rate are necessary to achieve the Section 801(b)(1) objectives. Dr. Wazzan concluded not, as part of an integrated analysis of both the PSS television-based services and webcasting. Trial Ex. 501 at ¶ 75 (Wazzan Corr. WDT) ("the relevant inquiry is whether the target market (PSS) is different from the benchmark market (CABSAT and webcasting) in ways that require an adjustment"). For the reasons set forth in Section XIII.E of SoundExchange's Findings of Fact, no adjustment is required.

Response to ¶ 212. Music Choice claims that it, alone among webcasters (including broadcasters who simulcast), does not have the reporting tools to track individual performances. Trial Ex. 57 at 22-23 n.4, 31 (Del Beccaro WRT); 5/18/17 Tr. 4605:23-4606:14 (Del Beccaro). The grounds for that assertion are dubious. SE FOF at ¶ 1773. However, as an accommodation to Music Choice, SoundExchange submitted a modified rate request addressing Music Choice's concerns. SE FOF at ¶ 1774.

VIII. Section 112 Ephemeral License

Response to ¶ 213. The PSS "must have both the ephemeral copy right as well as the performance right in order to operate their services." Trial Ex. 51 at 10 (Des. WDT of Ford, *Web III*). SoundExchange has designated the prior testimony of Dr. Ford to support its proposal for ephemerals. This is the same testimony that the Judges have relied on in adopting the same proposal in the prior proceeding. There is no basis to reach a different conclusion here.

Music Choice agrees that "the Section 112 ephemeral license fee be included within the performance royalty rate." Music Choice Amended Rates and Terms at 2 (filed February 17, 2017). And it takes no position on SoundExchange's specific proposal.

But the record in this proceeding unanimously supports SoundExchange's proposal of a bundled rate for both the Section 112(e) and 114 rights, 5% of which shall be allocated as the Section 114 performance royalty. SoundExchange's proposal is consistent with marketplace agreements between record companies and music services for non-statutory forms of licenses, under which royalty rates 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. Trial Ex. 51 at 9-10 (Des. WDT of Ford, *Web III*).

The current 95% / 5% split was the agreement the participants reached – and the Judges approved – in *SDARS II*. *See SDARS II*, 78 FR at 23055-56. Likewise, in *Web IV*, the "Judges accept[ed] SoundExchange's proposal to continue the current bundling of Section 112 and 114 rates." *Web IV*, 81 FR at 26398. As set out more fully in SoundExchange's Findings of Fact, the record in this proceeding provides every reason to follow the same approach here and no reason to deviate from it. *See* SE FOF at ¶¶ 2369-80.

Response to ¶ 214. To avoid repetition, SoundExchange incorporates its response to paragraph 213, *supra*.

Response to ¶ 215. SoundExchange has presented evidence showing that the ephemeral copying right does have value. The PSS "must have both the ephemeral copy right as well as the performance right in order to operate their services." Trial Ex. 51 at 10 (Des. WDT of Ford, *Web III*). Accordingly, Dr. Ford concluded in his testimony that is designated in this proceeding that "ephemeral copies have economic value to services that publicly perform sound recordings

because these services cannot as a practical matter properly function without those copies." Trial Ex. 51 at 9 (Des. WDT of Ford, *Web III*). *See also* Response to ¶ 213.

Response to ¶ 216. To avoid repetition, SoundExchange incorporates its Responses to ¶¶ 213-215, *supra*.

IX. Regulations

A. SoundExchange's Proposed Regulations Should Be Adopted

Response to ¶ 217. SoundExchange refers to Section XIV.C of its Proposed Findings of Fact and Section XV.B of its Reply Findings of Fact. As discussed in those Sections, Music Choice's assertion that the PSS regulations have remained unchanged since the *PSS I* CARP proceeding is demonstrably false. SE FOF at ¶ 565-67, 599; SE FOF at 2180-81, 2301. Appendix A to SoundExchange's Proposed Findings of Fact is a redline comparing the terms following *PSS I* versus the current PSS terms.

Response to ¶ 218. SoundExchange adopted the *Web IV* regulations as the starting point for developing its proposed terms, and then incorporated various provisions that are specific to PSS. SE FOF at ¶¶ 561-64; SE FOF at ¶¶ 2160-64, 2167; *see also Web IV*, 81 FR at 26316 n.1, 26400 (revisions were intended to "reduc[e] the amount of repetition in the regulations," and state the regulations in "plain language," and address various drafting issues in the old regulations). Whatever difficulty Music Choice has in understanding these proposed revisions, it is not due to SoundExchange. *See* RFOF at ¶ 562 (describing steps SoundExchange took to clearly identify its proposed revisions).

Response to ¶ 219. SoundExchange repeats its Response to ¶ 218 and incorporates that response herein.

Response to ¶ 220. SoundExchange does not dispute the obvious proposition that different statutory license categories are governed by somewhat different rates and terms. Rather, in the interest of promoting consistency and efficiency, SoundExchange adopted the revised *Web IV* regulations as the starting point for developing its proposed regulations in this proceeding, and incorporated various provisions that are specific to PSS. SE FOF at ¶ 572; SE COL at ¶¶ 45-47; SE FOF at ¶¶ 2160-64, 2167. This approach is consistent with the Judges' efforts to "seek, where possible, consistency across licenses to promote efficiency and minimize costs in administering the licenses." *SDARS II*, 78 FR at 23073-74; *see also SDARS I*, 73 FR at 4098-99 ("[W]e 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."); *Web III*, 76 FR at 13042. 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 I*, 73 FR at 4099. SE COL at ¶¶ 45-45. The advantages of consistency among regulations is discussed in SoundExchange's Proposed Findings of Fact at ¶¶ 2160-7. *See also* SE FOF at ¶¶ 2168-93 (discussing justification for its proposals more broadly); SE RFOF at ¶¶ 552-601. Evidence regarding the need for operational efficiency, which Music Choice dismisses as an "alleged inconvenience," is discussed in SE RFOF at ¶¶ 567-71.

Response to ¶ 221. SoundExchange repeats it Responses to ¶¶ 217-18 and 220 *supra* and incorporates those responses herein.

Response to ¶ 222. The purpose of this proceeding is to set rates and terms, not to adjust them. Both parties are required to support their proposals. As set out in detail in Section XIV of SoundExchange's Proposed Findings of Fact, ample record evidence supports SoundExchange's proposed regulations. But even in the absence of such evidence, the D.C. Circuit in *RIAA v.*

Librarian of Congress acknowledged that terms can be based not on record evidence, but "principally on sound judgment" so long as the tribunal "has the benefit of the parties' views before reaching a judgment." 176 F.3d 528, 535-36 (D.C. Cir. 1999). Thus, even if the record did not support SoundExchange's proposal (and it does), the Judges could, in an exercise of their judgment, impose the proposed terms because the parties have had ample opportunity to debate the issues, as this briefing demonstrates.

Response to ¶ 223. Music Choice's attack of Mr. Bender are to no avail. Music Choice has no rationale for its opposition to the editorial changes the Judges made in *Web IV* aside from Music Choice's adherence to the status quo. So, in a bit of legal hand-waving, Music Choice asks the Judges to pay no attention to this fact, and instead invents a rule to hide behind. For the sake of brevity, SoundExchange incorporates its Response to ¶ 222, *supra*.

Response to ¶ 224. Despite trying to minimize SoundExchange's role as encompassing "only" five different statutory license types and "only" two companies, Music Choice offers no evidence to support its mischaracterization of SoundExchange's administrative burdens as "insignificant." SE FOF at ¶¶ 567-71.

Response to ¶ 225. Music Choice's false assertion that SoundExchange has failed to identify any "actual problem" caused by the existing regulations since their inception is in contradiction with the record. *See, e.g.*, SE FOF at ¶¶ 2179-2182 (PSS regulations have fallen out of step with improvements made to regulations governing other services); *id.* at ¶ 2301 (current regulations are insufficient to stop many licensees from underpaying); SE FOF at ¶ 567; *see also* SE FOF at Appendix A (redline of changes since *PSS I*, which the Judges found were justified).

Response to ¶ 226. SoundExchange repeats it Responses to ¶¶ 217-18, 220, and 225 *supra* and incorporates those responses herein.

B. SoundExchange's Proposed Regulatory Changes Are Reasonable

Response to ¶ 227. This is a summary paragraph. SoundExchange refers to its Responses to ¶¶ 228-38 *infra* with regard to Music Choice's specific objections to SoundExchange's proposed changes. With regard to the claim that Music Choice may be unable to discern the regulatory changes that SoundExchange proposes, SoundExchange refers to its Response to ¶ 218 *supra*.

Response to ¶ 228. SoundExchange's proposed definitions do not violate congressional intent. SoundExchange's Proposed Findings of Fact explain why Music Choice should pay royalties that reflect the value of both its television-based service and its webcasting. SE FOF at Section XIII.C. SoundExchange's proposed definitions are consistent with these principles.

Response to ¶ 229. SoundExchange refers to ¶ 2185 of its Proposed Findings of Fact.

Response to ¶ 230. SoundExchange refers to ¶ 2186 of its Proposed Findings of Fact.

Response to ¶ 231. SoundExchange refers to ¶ 2187 of its Proposed Findings of Fact.

Response to ¶ 232. SoundExchange refers to ¶ 2188 of its Proposed Findings of Fact.

Response to ¶ 233. SoundExchange refers to Section XIV.D of its Proposed Findings of Fact, and ¶¶ 575-90 of its Reply Findings of Fact. As discussed therein, SoundExchange's proposed confidentiality provisions track the provisions adopted by the Judges in *Web IV* (37 C.F.R. § 380.5) in all material respects. SoundExchange Amended Proposed Rates and Terms, App. A § 382.5 (filed June 14, 2017); Trial Ex. 29 at 38 (Bender WDT); *see also* SE COL at ¶¶ 45-47 (p.860) and SE FOF at ¶¶ 2160-93 (discussing goal of consistency). SoundExchange

believes that the current reference in the PSS regulations to a confidentiality agreement is unnecessary and confusing. SE FOF at ¶ 2313.

SoundExchange's proposed terms in the *SDARS II* proceeding are irrelevant here. SE RFOF at ¶ 596 (noting that *SDARS II* predated the *Web IV* revisions and that the proposed changes would not have advanced the goal of consistency and efficiency if adopted at that time).

Response to ¶ 234. SoundExchange refers to Section XIV.C of its Proposed Findings of Fact, and ¶¶ 591-602 of its Reply Findings of Fact. *See also* Response to ¶ 233 *supra*.

Response to ¶ 235. SoundExchange refers to Section XIII of its Proposed Findings of Fact, SE FOF at ¶¶ 1948-2002.

Response to ¶ 236. SoundExchange refers to ¶¶ 2189-90 of its Proposed Findings of Fact. To the extent that Music Choice's unspecified reference to "troubling recordkeeping" requirements refers to the proposed revision to the retention of records requirement in § 382.4(c), SoundExchange refers to ¶ 2191 of its Proposed Findings of Fact.

Response to ¶ 237. SoundExchange refers to ¶ 2192 of its Proposed Findings of Fact. *See also* SE FOF at ¶ 2169 (discussing value of consistency and noting that even a "difference so nonsubstantive as having definitions at the beginning of the subparts of Part 382 and the end of Subpart A of Part 380" created administrative challenges for SoundExchange staff).

Response to ¶ 238. SoundExchange refers to ¶ 2193 of its Proposed Findings of Fact.

C. Music Choice's Requested Changes

Response to ¶ 239. No response.

Response to ¶ 240. The *SDARS II* stipulation is irrelevant in this proceeding because the parties have not reached any comparable agreement here. As discussed in Section XVI.C of its Findings of Fact, SoundExchange proposes no substantive change to the current minimum fee

provision, which tracks the minimum fee provision for SDARS and has a basis in the Copyright Act. SE FOF at ¶¶ 85, 2385-2388; SoundExchange Amended Proposed Rates and Terms, App. A at § 382.11(b) (filed June 14, 2017).

Response to ¶ 241. No response.

Response to ¶ 242. SoundExchange repeats its Response to ¶ 240 and incorporates that response herein.

Response to ¶ 243. SoundExchange repeats its Response to ¶ 240 and incorporates that response herein.

Response to ¶ 244. SoundExchange proposes no substantive change to the current minimum fee provision, which tracks the minimum fee provision for SDARS and has a basis in the Copyright Act. SE FOF at ¶¶ 85, 2385-2388. That provision has been in the Judges' regulations for the last five years, and Music Choice has recouped the minimum fee. For example, its 2015 PSS royalty payment was [ ]. Trial Ex. 29 at 16 (Bender WDT). Five percent of that is [ ], which is well in excess of the minimum fee. At the CABSAT rates, Music Choice would recoup the minimum even more quickly.

Response to ¶ 245. As discussed in Section XIV.C.3 of SoundExchange's Findings of Fact, both PSS and SDARS should be required to pay audit costs in the event an audit reveals an underpayment in excess of 5%. SE FOF at ¶¶ 2258-2272; SE RFOF ¶ 559. This proposal requires a revision of the SDARS fee-shifting provision, but not the analogous PSS provision.

X. GEO Group's Proposal

Response to ¶ 246. No response.

Respectfully submitted,

By /s/ Jared O. Freedman

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July 7, 2017

CERTIFICATE OF SERVICE

I, Jared O. Freedman, do hereby certify that, on July 7, 2017, copies of the foregoing are being filed via eCRB, sent via electronic mail to all parties at the email addresses listed below, and sent in hard copy by first class mail.

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Dated: July 7, 2017

/s/ Jared O. Freedman
_____
Jared O. Freedman

Certificate of Service

I hereby certify that on Friday, July 07, 2017 I provided a true and correct copy of the SoundExchange, Inc. and Copyright Owner and Artist Participants' Replies to Music Choice's Proposed Conclusions of Law to the following:

Sirius XM, represented by Bruce Rich served via Electronic Service at bruce.rich@weil.com

Music Choice, represented by Paul M Fakler served via Electronic Service at paul.fakler@arentfox.com

Signed: /s/ Jared O. Freedman