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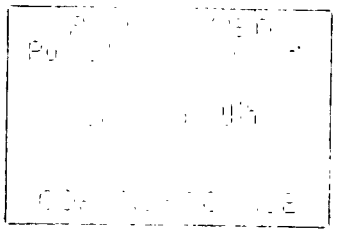

Before the
COPYRIGHT ROYALTY JUDGES
LIBRARY OF CONGRESS
Washington, D.C.

In re **DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)**	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

NATIONAL ASSOCIATION OF BROADCASTERS' REPLY FINDINGS OF FACT AND CONCLUSIONS OF LAW

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Counsel for the National Association of Broadcasters

July 10, 2015

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July 10, 2015

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THE NATIONAL ASSOCIATION OF BROADCASTERS' REPLY FINDINGS OF FACT AND CONCLUSIONS OF LAW

I. INTRODUCTION AND SUMMARY

1. The Proposed Findings of Fact and Conclusions of Law submitted by the National Association of Broadcasters ("NAB PFF") summarized the overwhelming evidence presented at trial showing that simulcasting differs in every material respect from both interactive services and other statutory services, and, as such, a substantially lower rate than currently exists is appropriate for simulcasting. The entire theory of SoundExchange's case—that interactive and statutory services allegedly are now "converging"—is inapplicable to simulcasting and in fact highlights the pervasive and unchanging differences between simulcasting and all of the other services for which rates will be set or that are asserted as benchmarks. As shown by the evidence, the unique attributes of simulcasting, including mixed music and non-music content and integration with the terrestrial radio business, also require a per performance royalty, not a royalty that includes a percentage-of-revenue metric.

2. The evidence is undisputed that simulcasting is local radio, not a music service. The value of simulcast programming is based on all of its many elements, including personalities, news, talk, weather, and sports programming, and localized content, not just constant streams of sound recordings as provided by other services. In addition to the stark programming differences, simulcasting also is a traditional one-to-many medium, as opposed to a customized one-to-one transmission. And all of the content is chosen by the broadcaster, not the user. As such, simulcasting is the least

substitutional, and most promotional, of the services. These facts strongly point toward a lower per performance rate for simulcasting.

3. In response to this showing by NAB, SoundExchange asserts three basic arguments with respect to simulcasting:

- It contends that the promotional effect of simulcasting has not been shown to be exactly the same as the now expressly conceded promotional effect of terrestrial radio;
- It contends that, even though simulcasting is totally non-interactive, the added functionality provided by certain aggregators shows that simulcasting could nonetheless be converging to some extent with other services; and
- It contends that establishing a separate rate for simulcasting would be legally improper, would encourage "gamesmanship," and would discourage innovation.

None of these arguments is supported by the evidence or is otherwise persuasive.

4. First, in order to justify a lower rate, the Judges are not required to find that the promotional effect of simulcasting is exactly the same as that of terrestrial broadcasting, the undisputed gold standard of sound recording promotion. Rather, the relevant question is whether simulcasting is more promotional or less substitutional in comparison to other services. On that score, the record is clear. The programming elements on simulcasting are the same as those on the broadcast, so the promotional effect should be the same or very similar. The curation provided by terrestrial radio, the repetition, the lack of listener control, and the trust relationship between listener and station [[ ]] are identical. There is no evidence that the labels ever seek to exclude simulcasts from their vast promotional efforts directed to radio; to the contrary, iHeartMedia presented evidence that [[

[redacted]

[redacted]]] Finally, Aaron Harrison of Universal not only testified unequivocally and without contradiction that simulcasting is less substitutional than custom radio or on-demand services, but he also confirmed that that fact would properly lead to a lower rate in a market negotiation. Thus, the promotion / substitution evidence points toward a lower rate for simulcasting.

5. It is undisputed that, in contrast to the various user control features employed by custom radio services and to an even greater degree by interactive services, the stream of a radio simulcast is programmed by the broadcaster and unchangeable by the user. Thus, the "convergence" that is the cornerstone of SoundExchange's case for higher rates is totally absent from simulcasting, again pointing towards a lower rate. The limited evidence regarding aggregators does not change this fact. The cross-examination of Dennis Kooker regarding his aggregator "experiment" demonstrated that, absent narrow and contrived circumstances, using simulcasting to search for particular songs is totally unworkable. SoundExchange provides no reason why listeners would be "patient" (Mr. Kooker's word) and wait to try to find part of a song on a radio simulcast station when they could listen to the entire song immediately and from the beginning using any number of available services. SoundExchange provided no evidence that listeners are actually using aggregator search functionality in such an inefficient way; common sense suggests that no such evidence exists. Nor is there any evidence as to how many people are using aggregators or even how many simulcast stations are available through aggregators. In sum, the limited evidence regarding aggregators does not contradict the overwhelming evidence that simulcasting is not converging with interactive services.

6. SoundExchange also argues that establishing a lower rate for simulcasting based on this accumulated evidence would somehow be *per se* improper. But section 114 obligates the Judges to "distinguish among the different types of eligible nonsubscription services then in operation." 17 U.S.C. § 114(f)(1)(A). And, as the Judges noted in their Notice commencing this proceeding, "[i]f the marketplace indeed would establish separate rates, the adoption of a rate structure consistent with that result might be more realistic than a single per-performance rate. . . . To impose a rate that is economically appropriate for one . . . willing buyer upon any or all other willing buyers might not necessarily satisfy the statutory requirement of replicating the marketplace." 79 Fed. Reg. 412, 413 (Jan. 3, 2014).

7. Indeed, when Congress created section 114, it recognized that radio programming was different – that it did not raise the concerns that animated the creation of the public performance right in sound recordings. The factors identified by Congress apply both to over-the-air broadcasts and radio simulcasts: radio programs (1) are available without subscription; (2) do not rely upon interactive delivery; (3) provide a mix of entertainment and non-entertainment programming and other public interest activities to local communities to fulfill FCC licensing conditions; (4) promote, rather than replace, record sales; and (5) do not constitute "multichannel offerings of various music formats."[1]

8. Nothing in the statute supports SoundExchange's claim that only a single rate may be set based on the greatest functionality possible under the statutory license. Here, the evidence is overwhelming that simulcasters, as a type of willing buyers, would

[1] S. Rep. No. 104-128, 15 (1995) (the "1995 Senate Report").

pay less, and also that the record companies, as willing sellers, would charge less for a service that is not converging and that is demonstrably less substitutional and more promotional.

9. Significantly, the evidence is also clear that a separate rate for simulcasting would be necessary if the Judges adopted any rate structure for other services that included a percentage of revenue component. The evidence demonstrates that, for the upcoming rate period at least, such a structure would be uniquely unworkable for simulcasters because it would raise a host of difficult and unresolved allocation issues related to, *inter alia*, broadcast revenues and non-music programming revenues. As the proponent of such a rate structure, which has never previously been implemented in the webcasting context, SoundExchange has failed to present a clear solution to this allocation morass, other than to say that any resolution should be "fair." Any percentage of revenue fee for simulcasting should be rejected, let alone the 55% of revenues demanded by SoundExchange.

10. SoundExchange speculates that a lower rate for simulcasting could incentivize gamesmanship and decrease the incentive to innovate. But it points to no evidence to support this conjecture. Moreover, NAB has clarified its proposed definition of "broadcast retransmission" to limit substitution of programming and to make clear that customized transmissions to particular users are not within the definition.

11. The statute calls upon the Judges to recognize the realities of the marketplace and set license fees for services that exist, not for services that SoundExchange may (or, given its complaints about innovation leading to convergence, may not) want to incentivize. In any event, any disincentive to innovate in the context of

simulcasting comes from rates that are too high, not from rates that SoundExchange thinks are too low. The record is clear that current rates are stifling the growth of simulcasting; broadcasters are limiting access to streams (Ben Downs), considering whether to continue streaming (John Dimick), streaming only a minority of stations (Steve Newberry), or not streaming music at all (Julie Koehn). Innovation cannot be expected when, as now, rates are so high as to cause broadcasters to stop simulcasting or to artificially limit its potential growth. In the context of simulcasting, therefore, a significant rate reset is the only way to allow innovation to occur.

12. The proof that a lower rate is appropriate for simulcasting leads to the question of what that rate should be, and on what basis it should be set. As NAB demonstrated, the evidence shows that the rate for simulcasting should be based primarily on the labels' behavior towards terrestrial radio, which itself is valuable marketplace evidence showing that radio has near zero, if not negative, opportunity costs to record companies and artists. SoundExchange argues that the lack of a radio performance right is legislated, so it is not a marketplace "benchmark." But that misses the point. NAB is not arguing that the zero rate, itself, is marketplace evidence. Rather, it is the <u>labels' behavior</u> in the face of that zero rate—namely, still actively seeking airplay—that is valuable marketplace evidence.

13. NAB's proposed rate of $0.0005 per performance is corroborated by other data points, including, among others discussed in NAB's Proposed Findings of Fact, Professor Katz's analysis correcting only some of the flaws of SoundExchange's interactive benchmark analysis, Professor Katz's analysis correcting some of the flaws of SoundExchange's analysis of the Apple iTunes Radio license agreements, and Professor

Katz's demonstration that the effective per performance rate being paid by the [[ ]]. For the reasons discussed below, SoundExchange's responses to Professor Katz's analyses miss the mark. SoundExchange does not respond to Professor Katz's discussion of [[ ]].

14. SoundExchange, of course, argues for dramatically higher rates, including the improper percentage of revenue fee discussed above. But the flaws in SoundExchange's case are not limited to its contentions with respect to simulcasting. Faced with compelling evidence, from the mouths of its own experts, witnesses, and representatives, that its chosen interactive service benchmark market is not competitive but instead reflects the supra-monopoly market power of sellers of must-have complements, SoundExchange reverses course and argues, for the first time, that the law does not require the Judges to set competitive prices.

15. SoundExchange's new-found position is contrary to section 114, section 114's legislative history, precedent, policy and common sense. There would be no reason to regulate rates—and no reason to have undertaken the extended and hugely costly process in which the parties have all just participated—if the outcome were rates set at a monopolistic or supra-monopolistic level. That is not what Congress intended or mandated – but it appears to be SoundExchange's unstated goal.

16. Notably, SoundExchange's newly stated position that the Judges are not required to set competitive prices also is contrary to the views of every economist to address the issue in this case, including SoundExchange's own economists, Professors Rubinfeld and Talley, who recognized that the statutory standard required competition. It

is also contrary to Mr. Pomerantz's opening statement, in which he recognized that the Judges "certainly have given us some indication of some factors that should be considered," including, whether the rates "approximate a monopoly" and "whether there are sufficient competitive factors in the marketplace." 4/27/15 Tr. 59:8-22 (Pomerantz). The Judges should recognize SoundExchange's about face for what it is – a post-trial maneuver to salvage its legally unsupported benchmark.

17. Rather than advocating competitive rates, the rates sought by SoundExchange are based on major label licenses in a market in which the major labels have [[ ]] PAN Ex. 5349 at 17 (emphasis added). Rates that extract [[ ]] leave services that are scraping by without profit, paying essentially everything to the recording industry – not quite dead, but not alive either.

18. Due largely to sound recording royalties, not a single interactive service is profiting despite substantial investments, including the world's largest service, Spotify, which has a dominant market share. And, because rates for statutory services have in the past been based on the vampiric rates charged by the labels to interactive services, not a single statutory service is profiting either. That is not a healthy state of affairs.

19. SoundExchange's response is that the Judges should assume once again that profitability is just around the corner. SoundExchange has consistently made this same argument in prior webcasting proceedings to justify its supracompetitive rates. But its predictions of happy days have never come to fruition. The Judges should adopt rates based on what is, not on speculation about what might be.

20. SoundExchange's position here conflicts with section 114 in other important ways as well. When Congress created the sound recording performance right coupled with the section 114 statutory license, it explicitly recognized that interactive services and statutory services were different, and were expected to have different effects on record company revenue streams. Copyright owners were granted an exclusive right (with no statutory license) with respect to performances by interactive services. Congress made clear that "such services were likely to have a significant impact on traditional record sales." In sharp contrast, copyright owners' rights with respect to noninteractive services were made subject to the section 114 statutory license. Congress recognized that such services posed less of a threat to record companies and artists. S. Rep. No. 104-128, 15 (1995).

21. SoundExchange's strategy of basing its proposed statutory rates on the rates that the record companies charge interactive services effectively subverts this key distinction. Congress contemplated different rates for interactive and non-interactive services that took account of the differential effect of the two types of services on traditional record company revenue streams. If Congress had intended statutory rates to be effectively the same as the rates charged to interactive services (with adjustments only for functionality), it again could have avoided the costly rate-setting mechanism it established. And, as noted above, Congress explicitly recognized the important differences between radio programming and the music services that animated the sound recording performance right.

22. SoundExchange offers no response to the direct testimony of record company witnesses that they do not compete with each other in licensing interactive

services. Nor does SoundExchange address Professor Rubinfeld's admissions in this proceeding that the major label repertoires are must-have complements for interactive services. And, while SoundExchange acknowledges the submissions made to the FTC by Universal Music Group and its representatives, SoundExchange's Proposed Findings of Fact have no answer for the extensive evidence and arguments demonstrating the lack of competition among the major labels in licensing interactive services.

23. Rather than address this evidence directly, SoundExchange argues that, even if competition is required by law, the licensing market is sufficiently competitive because "competitive forces in the downstream market have determined the prices charged in the upstream royalty market." SX PFF ¶ 444. SoundExchange presents no evidence that downstream competition has, in fact, pushed major label license fees to competitive levels, relying instead on theory and assertions that competition has had some effect on prices. NAB's Proposed Findings of Fact demonstrate the fallacy of SoundExchange's argument, that SoundExchange failed to support it with any evidence, and that the evidence in the record rebuts SoundExchange's theory. *See* NAB PFF ¶¶ 327-36; *infra* Part VI.A.

24. SoundExchange also argues that the major labels really do negotiate with interactive services, which it claims proves that the services have bargaining power. But the mere fact of negotiations proves nothing. As the economists agreed, monopolists negotiate, too, and do not always get everything they seek. The record is clear, however that the major labels' repertoires are "must have" complements and that they never price compete or negotiate lower rates in return for more performances.

25. SoundExchange repeatedly invokes the claim (parroting one of the Judges' Orders) that its interactive benchmark is a "thick market," as if the words had talismanic force. But an invalid thick benchmark market is no better than an invalid thin benchmark, and SoundExchange's interactive benchmark and Professor Rubinfeld's analysis of that benchmark are invalid. In any event, as demonstrated below, SoundExchange's benchmark is not as thick as SoundExchange claims. The "market" used by Professor Rubinfeld to develop his per-performance fee proposal comprises 4 (now 3) major labels licensing one large service and 8 smaller (mostly insignificant) services. That is not a thick market.

26. SoundExchange also fails to provide a meaningful response to other flaws in Professor Rubinfeld's interactive benchmark identified by the services, including, among others:

- The lack of support for Professor Rubinfeld's essential assumption that the ratio of license fees to subscription revenues would be the same for interactive and noninteractive services. SoundExchange has no response to Professor Rubinfeld's own testimony contradicting that assumption;

- The failure of Professor Rubinfeld to take account of the dominant ad-supported business model of noninteractive services in developing his interactivity adjustment. SoundExchange offers only conclusory assertions and fails to address Professor Katz's demonstration that it is essential to take account of per-performance revenues from both the ad-supported and subscription business models, including the different mix of those business models used by interactive and noninteractive services, in order to properly ascertain the relevant value of interactivity and the demand of the different types of services for sound recording licenses. SoundExchange's failure in this regard is particularly telling, as the same criticism was leveled by the Judges in the *Web III* Remand;

- Professor Rubinfeld's failure to account for differences in the numbers of performances per subscriber made by interactive and noninteractive services, an adjustment that is essential to determine a per-performance fee based on revenues. The Judges also recognized the importance of this adjustment in the

Web III Remand and criticized SoundExchange for failing to make it properly; and

- Professor Rubinfeld's failure to take account of non-license fee costs, despite the fact that he recognized the relevance of such costs to the services' demand for licenses. Although SoundExchange argues that Professor Katz allegedly used inaccurate cost data in an effort to correct Professor Rubinfeld's analysis, the burden is not on Professor Katz or NAB to fix SoundExchange's flawed benchmark analysis. The point is that this is an invalid benchmark.

These flaws render SoundExchange's interactive benchmark analysis unreliable and invalid.

27. SoundExchange's reliance on Professor Rubinfeld's analysis of two Apple iTunes Radio agreements is also misplaced. Those agreements [[ ]] Moreover, Professor Rubinfeld's retrospective analysis of the agreements asks the wrong question – the question is not how that deal worked out, but what the parties expected at the time the deals were done, which is just a proxy for what parties would agree to prospectively, today. SoundExchange's attempt to defend its use of these agreements falls short.

28. SoundExchange's position on terms depends in large measure on its interactive service benchmark agreements, which do not reflect the outcome of an effectively competitive market. Thus, they are not informative of what the participants in such a market would negotiate. The evidence demonstrates that SoundExchange's request to shorten the reporting period would cause hardship for little benefit. SoundExchange's request to abolish the requirement that audits be conducted by

Certified Public Accountants would eliminate objective standards and important safeguards that protect both licensees and the integrity of audit process for the benefit of all involved and the public. And, in response to NAB's proposed terms, SoundExchange's Proposed Findings of Fact rely almost exclusively on Mr. Bender's testimony, which NAB has already addressed in its Proposed Findings.

29. There is another theme that pervades SoundExchange's Proposed Findings of Fact. Having advanced a benchmark that (i) is demonstrably not competitive, (ii) demonstrably different from simulcasting in its promotional and substitutional effect; and (iii) demonstrably failed to take account of licensees' costs. SoundExchange argues that it was NAB's and the services' burden to quantify the flaws in SoundExchange's benchmark and the demonstrated differences between the target market and the flawed benchmark market. That is wrong. It is SoundExchange's burden to support its chosen benchmark, to account for demonstrable differences between the benchmark and statutory services, and to fix flaws in its analysis. The services have demonstrated that SoundExchange's chosen benchmark and its analysis of that benchmark are fatally flawed. If the evidence does not permit correction of the demonstrated problems, the correct result is to discard the flawed benchmark, not to ignore the flaws.

30. The remainder of NAB's Reply Proposed Findings of Fact and Conclusions of Law discuss these and other issues. Part II shows how SoundExchange's Proposed Findings of Fact confirms that its theories of the case are inapplicable to simulcasting. Part III demonstrates that SoundExchange's response to NAB's rate proposal lacks merit. Part IV responds to SoundExchange's arguments in support of its "greater of" fee structure. Part V demonstrates how SoundExchange's theories regarding

the profitability of simulcasting are inconsistent with the evidence and the statute. Part VI responds in detail to SoundExchange's arguments in support of its interactive service benchmark. Part VII rebuts SoundExchange's arguments that the iTunes Radio licenses and the licenses for certain other services corroborate its rate proposal. Part VIII shows that SoundExchange has failed to provide a basis to rely on the NAB or SiriusXM WSA agreements (or the *Web III* rates derived in large measure from those agreements) to set a rate. Part IX responds to SoundExchange's position on terms. Part X contains NAB's Reply Conclusions of Law.

II. SOUNDEXCHANGE'S PROPOSED FINDINGS CONFIRM THAT ITS THEORIES OF THE CASE DO NOT APPLY TO SIMULCASTING.

A. THERE IS NO EVIDENCE OF "CONVERGENCE" BETWEEN SIMULCASTING AND INTERACTIVE SERVICES.

31. Paragraphs 257-313 of SoundExchange's Proposed Findings purport to establish the factual cornerstone of SoundExchange's *Web IV* case – that "interactive and non-interactive services are rapidly converging." SX PFF Heading V.C. (capitalization omitted). As demonstrated below, however: (1) SoundExchange's convergence argument and supporting factual contentions are directed almost entirely at custom radio, not simulcasting; (2) to the extent simulcasting is briefly mentioned (principally in ¶¶ 290-91), SoundExchange's factual contentions are conclusory, misleading, and unsupported; and (3) SoundExchange ignores the overwhelming evidence—including the admissions of SoundExchange's own witnesses—showing that simulcasting does not have any of the "converged" characteristics that SoundExchange alleges would justify its

proposed rates. Simlucasting was and is a one-to-many online stream of terrestrial radio that cannot be controlled or influenced by the user.[2]

32. SoundExchange first argues that:

> Section 114 distinguishes between "non-interactive services," which are eligible for the statutory license, and "interactive" services, which are not. The line that the statute contemplates is between a service "that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient," and a service that does not.

SX PFF ¶ 257 (citations omitted). It is undisputed that simulcasting neither allows a recipient to receive a transmission of a program created especially for the recipient nor does it allow a recipient to request a particular sound recording. *See, e.g.,* Dimick WRT ¶¶ 1, 6-8; 5/26/15 Tr. 5800:22-5801:5 (Dimick); 5/4/15 Tr. 1689:11-1690:18 (Blackburn).

33. Dennis Kooker of Sony explained that "[o]ne of the original justifications for allowing statutory services to pay these lower rates [under the statutory license] was that the offering under the statutory license would provide a user experience similar to terrestrial radio." Kooker WDT at 15; *accord* 4/28/15 Tr. 416:20-418:2 (Kooker). The evidence at trial shows that simulcasting continues to "provide a user experience similar to terrestrial radio." Indeed, it is more than "similar" to terrestrial radio – it is essentially the same. The programming is in all material respects the same as on terrestrial radio and is controlled entirely by the broadcaster. NAB PFF ¶ 40.

34. SoundExchange claims that "[a]s a result of technological evolution, marketplace development, and changing consumer preferences, nominally 'interactive'

[2] The fact that simulcasting is not converging with interactive services is discussed in Paragraphs 66-81 of the NAB's Proposed Findings of Fact and Conclusions of Law.

and 'non-interactive' services like Spotify and Pandora exist side by side in the same market, on the same platforms, while offering similar listening experiences." SX PFF ¶ 257. As Pandora has demonstrated, SoundExchange's claim ignores numerous differences between Pandora and interactive services like Spotify. PAN PFF ¶¶ 301-09.[3] But, with respect to simulcasting, as SoundExchange's own witnesses admitted, there is no evidence that simulcasting is becoming more personalized. *See, e.g.*, 4/30/15 Tr. 1106:1-12 (Harrison). Simulcasting lacks the functionality of custom and is "literally terrestrial radio online." 5/1/15 Tr. 1283:20-1284:21 (Wheeler).

35. SoundExchange also claims that "[i]n today's streaming market, services defy easy categorization–they are not either 'on-demand' or 'non-interactive,' 'lean-forward' or 'lean-back,' 'free' or 'paid.' Increasingly, services tend to offer all of the above functionality." SX PFF ¶ 258. This claim—which, as with most of SoundExchange's argument, is asserted generically with respect to all "services"—is totally false when it comes to simulcasting. The record is clear that simulcasting is entirely non-interactive, is a lean-back, not a lean-forward service, and is entirely free (ad-supported). *See infra* Part II.A. In the words of SoundExchange, simulcasting is a "pure 'lean-back'" and "programmed radio" service. SX PFF ¶ 270. It does not resemble on demand services in any way.

36. SoundExchange notes that various interactive services purport to offer various services that are more lean-back or non-interactive. *See* SX PFF ¶¶ 259-68. But

[3] As a general matter, NAB will not respond in detail to SoundExchange's claims that custom radio and interactive services are converging, but will defer to the responses of Pandora and iHeart. Instead, NAB will focus on the fact that SoundExchange's arguments, even though most often framed in terms of "statutory services" generally, are plainly inapplicable to simulcasting.

none of these additional services is or purports to be a simulcast of a terrestrial radio broadcast. *Id.*

37. SoundExchange claims that "statutory services are increasingly offering functionality that comes close to replicating the on-demand listening experience within the confines of their ostensibly DMCA-compliant webcasting itself. These services employ sophisticated algorithms, user-interface controls, and other computer technology that allow users to communicate their preferences to the service, and the service to customize and curate programming tailored to the individual user." SX PFF ¶ 271 (citations and internal quotations omitted). As usual, SoundExchange explicitly makes this assertion on an undifferentiated basis as to all "statutory services." *Id.* As to simulcasting, however, SoundExchange's claim is false. As SoundExchange witnesses admitted, simulcasting does not include any of the described features or customizing functionality, or any of the custom functionality discussed at SX PFF ¶ 272 (seeding stations by artist or track, thumbs up/down), or any of the iHeart custom radio functionality discussed at SX PFF ¶¶ 274-75. *See* 4/30/15 Tr. 1102:22-1104:2 (Harrison); 5/1/15 Tr. 1283:20-1284:21 (Wheeler); 5/4/15 Tr. 1689:3-1690:18 (Blackburn); *see also* Dimick WRT ¶¶ 1, 6-8; 5/26/15 Tr. 5800:22-5801:5 (Dimick).

38. According to SoundExchange, "[t]his [custom] functionality [[ ]] SX PFF ¶ 273 (citations omitted). Simulcasting, in contrast, is the [[ ]] *Id.*

39. For the same reasons, SoundExchange's undifferentiated claim that "[u]sers of statutory services can also lean forward and influence what they hear" is inapplicable to simulcasting. SX PFF ¶ 278. Likewise, while SoundExchange makes reference to various "internal documents" concerning alleged competition between custom and interactive services (*e.g.*, SX PFF ¶¶ 279-86), these documents do not concern simulcasting.

40. SoundExchange's contentions with respect to the alleged convergence of simulcasting with on demand services are contained in SX PFF ¶ 290. Because it has nothing to say about actual individual simulcasters, SoundExchange first suggests that there has been a "proliferation of aggregator services like TuneIn." *Id.* But the only aggregators SoundExchange actually identifies are TuneIn and iHeart; there is no support for the alleged "proliferation" of aggregators. Moreover, SoundExchange offers no evidence of the extent to which such services are actually used.

41. SoundExchange next argues that, "[i]n practice, simulcast streaming services operate in such a way as to closely resemble the experience of on-demand streaming." *Id.* Notwithstanding the centrality of this contention to SoundExchange's argument, the <u>only</u> evidence cited for this statement is page 4 of Mr. Kooker's written rebuttal testimony (SX-27), which discusses his "experiment" searching for songs by a particular artist (Meghan Trainor) on iHeartRadio. First, as noted in NAB's Proposed Findings (¶ 74), there is no evidence (whether from surveys, internal analyses, or otherwise) that simulcast listeners actually use the iHeart simulcast service "in practice" the way that Mr. Kooker contends is possible in his "experiment." As he admitted, "I don't know whether they do or not." 5/29/15 Tr. 6639:14-21 (Kooker).

42. In addition to the lack of any real world application, the evidence at trial (and, in particular, the cross-examination of Mr. Kooker) demonstrated that there was virtually no real world utility to the "experiment" described in Mr. Kooker's rebuttal testimony and relied upon so heavily by SoundExchange with respect to the alleged convergence of simulcasting. First, Mr. Kooker contended that, after engaging in a search on iHeart, a listener "would be able to hear the song almost immediately." Kooker WRT at 6. In fact, however, as Mr. Kooker conceded, a song "starts where it's playing within the terrestrial feed." 5/29/15 Tr. 6559:21-6560:9 (Kooker). Thus, a listener does not hear "the song" but rather "whatever is left of the song." Moreover, while SoundExchange now claims that "aggregators like iHeartRadio and TuneIn will instantly display not only a list of stations, but also the songs that have just started playing on those stations," SX PFF ¶ 290, the screen shot provided in Mr. Kooker's WRT (at 5) confirms that the search results screen does not show how long ago the song started or how much or how little remains of the play; thus, the user would have no way of knowing. There is no evidence that the screen displays are limited to stations that have "just started playing" any particular song.[4]

[4] SoundExchange cites John Dimick's oral testimony for the contention that the lists would show stations that had "just started playing" a particular song. *See* SX PFF ¶ 290 (citing 5/26/15 Tr. 5841:11-14 (Dimick). But while the phrase "just started playing" was included in counsel's question, there is no suggestion in Mr. Dimick's testimony that <u>only</u> stations that "just started playing" the song would be included in the search results. Rather, as the testimony makes clear, there is no way to tell from the screen whether the song just started playing or is almost finished playing; the listener joins (after potentially hearing a pre-roll advertisement) wherever the song happens to be in the terrestrial feed. 5/29/15 Tr. 6559:21-6560:9 (Kooker); *id.* at 6561:5-12. Indeed, as Mr. Kooker conceded, the only way to try to get close to the beginning of a song would be to be "patient" and try to watch as the screen refreshed. *Id.* at 6560:6-9. There is no evidence that anyone in the real world would actually do this, particularly when it is undisputed that one could listen to the same song, immediately and from the beginning, on YouTube, among many other sources.

43. SoundExchange also contends based on Mr. Kooker's experiment that "[t]his search functionality gives users the ability to immediately identify and access specific tracks essentially on demand." SX PFF ¶ 290. In addition to the fact that the reference to "access to specific tracks" really means "whatever portion remains of a specific track," the cross-examination of Mr. Kooker at trial demonstrated that this claim is false except potentially for whatever handful of songs happen to be most popular at a particular moment. Thus, while Mr. Kooker was able to find a simulcast station playing Meghan Trainor's "All About That Bass" when his rebuttal testimony was prepared in February, *see* SX Ex. 27 at 4-6, there were no stations playing it when the same search for Meghan Trainor was conducted only three months later at trial. 5/29/15 Tr. 6635:10-6638:16 (Kooker). This was so even though, as Mr. Kooker suggested, counsel waited "patiently" for results to appear. *Id.* In contrast, it was possible to locate "All About That Bass" and other songs immediately on YouTube, as Mr. Kooker conceded. *Id.* at 6640:8-6644:1 (Kooker).

44. In response to his own counsel's questions on redirect, Mr. Kooker stated unequivocally: "I obviously understand the difference between an on-demand play and what people get through customized radio or the simulcast." *Id.* at 6645:12-15 (emphasis added). Mr. Harrison likewise was able to differentiate clearly among on-demand, custom, and simulcast services:

> Q. And, in fact, if you were to rank streaming services from least substitutional to most, the order would be simulcast, then custom, then on-demand, correct?
>
> A. Yes.

4/30/15 Tr. 1100:16-1102:12 (Harrison) (emphasis added). It is only SoundExchange, not its actual witnesses, that purports to be incapable of distinguishing among on-demand services, custom radio, and simulcasting.

45. SoundExchange's final contention regarding simulcasting is that "in sharp distinction to terrestrial radio, simulcast services are not geographically bound." SX PFF ¶ 291. Thus, according to SoundExchange, "[s]imulcast services . . . offer listeners the same wide range of listening options as other streaming services – an almost infinite number of choices." *Id.* (internal quotations and citation omitted). SoundExchange finally notes the hypothetical possibility—explicitly framed as such in the only evidence cited—that counsel for SoundExchange who is a resident of San Francisco could listen to the simulcast of an Indie rock station in Seattle. *Id.* (citing 5/14/15 Tr. 3906:11-3911:10 (Peterson)).

46. As with its contentions regarding aggregators and search functions for simulcast, SoundExchange's contentions in Paragraph 291 are over-stated and are refuted by both common sense and record testimony. While theoretically available outside of a local market, simulcasts are not designed for out-of-market listening. As discussed in detail in NAB's Proposed Findings, radio is targeted to a local market and includes program elements and an overall voice that are unique in each market. NAB PFF ¶¶ 41-61 (citing supporting evidence). Mr. Newberry explained why (i) there would be no reason for him as a station owner to seek a non-local audience, and (ii) it is unlikely that a random listener in a remote location would be interested in listening to his stations:

Q. Now, do you target out-of-market or non-local listeners?

A. We don't.

> Q. Why not?
>
> A. Two reasons. One is our advertisers. The advertisers that I'm dealing with [are] in Glasgow and Bowling Green and Elizabethtown, Kentucky, they're not interested in trying to reach potential customers for their businesses that are outside the local market area. So there is no value to me to try to have listeners that are in Los Angeles or Idaho or anywhere else.
>
> The second thing is to maintain that connection. We really want to make sure that our programing is unique to our local communities, and so I doubt very seriously someone that's in Los Angeles wants to hear about Western Kentucky University or what [is happening] at the Corvette plant[] or other local activities. We -- we really focus our programming and our connection to the local [community].

5/20/15 Tr. 5077:25-5078:19 (Newberry); *accord* Newberry WDT ¶ 15. Other broadcasters provided similar testimony. 5/26/15 Tr. 5803:1-17 (Dimick); Downs WDT ¶ 24; 5/21/15 Tr. 5218:13-5219:16 (Downs). SoundExchange has presented no contrary evidence whatsoever.

47. SoundExchange's hypothetical, which is premised on SoundExchange's San Francisco resident somehow becoming aware of and particularly dedicated to an Indie rock station in Seattle (SX PFF ¶ 291), demonstrates the absurdity of its position. First, it is premised on a big market station that can operate in a unique niche (and therefore is inapplicable to necessarily more mainstream stations such as those operated by all of the witnesses (John Dimick, Buzz Knight, Ben Downs, and Julie Koehn) who testified on behalf of NAB. Second, in listening to this station, SoundExchange's counsel is going to be required to listen to a host of commercials and other programming (Seattle car dealer sales, Seattle news and traffic, Seattle weather, the prospects of the Seahawks and the Mariners, etc.) that have no pertinence to him in San Francisco. Third, SoundExchange's counsel would have to listen to all of this irrelevant material even

though the indie rock he supposedly wants to listen to would be readily available from other sources (*e.g.,* Pandora) without all of the extraneous Seattle-based content. Finally, individuals like this single hypothetical listener would have to be sufficiently pervasive on a national basis so as to generally affect broadcasters' economics and their willingness to pay to stream sound recordings. There is no evidence whatsoever to support any of these facially implausible hypotheses.

48. SoundExchange also argues that "interactive and non-interactive services directly compete for listeners." SX PFF Heading V.C.2 (capitalization omitted). The cited documents from Pandora and iHeartMedia do not, however, concern simulcasting. SoundExchange has adduced no evidence that simulcasting actually competes with interactive services.

B. THE RECORD IS DEVOID OF ANY SHOWING THAT SIMULCASTING SUBSTITUTES FOR HIGHER ARPU SERVICES; RATHER, THE RECORD SHOWS THAT SIMULCASTING IS PROMOTIONAL.

1. There Is No Record Evidence that Indicates that Simulcasting Is Substitutional.

49. The second factual cornerstone of SoundExchange's case is that statutory services substitute for higher revenue directly licensed services. *See* SX PFF XIII.C. Like its convergence argument discussed *supra*, SoundExchange offers no evidence whatsoever that this is true of simulcasting; its argument is entirely focused on custom webcasting.

50. Moreover, even as to custom webcasting, and webcasting generally, SoundExchange misstates the evidence. As Professor Katz explained, "the advertising-supported and subscription models attract different customers. Specifically, customers

who choose to pay for subscription services are an unrepresentative minority of all consumers who stream music. . . . Non-interactive, ad-supported appears to be a high-volume, low-margin business, appealing to customers with a lower willingness to pay for access to music." NAB PFF ¶ 363 (citing Katz AWRT ¶ 55, iHM Ex. 3118 at 11); *see infra* ¶ 284 (citing evidence of low willingness to pay among users of noninteractive services).

51. SoundExchange argues that "statutory and non-statutory services are becoming closer and closer in their market offerings as they compete for the same consumers. This competition creates natural substitutes . . . . It is evident from numerous internal company documents that Pandora and iHeartRadio are seeking to compete for the same consumers and the same listening time as directly licensed services such as Spotify." SX PFF ¶ 1105 (footnote omitted).

52. As set out in Part II.A above, and as also detailed in Paragraphs 66-81 of NAB's Proposed Findings of Fact, SoundExchange's entire "convergence" argument (*i.e.,* that "statutory and non-statutory services are becoming closer and closer in their market offerings") is demonstrably false with respect to simulcasting. As such, the claimed existence of "natural substitutes" is likewise unsupported.

53. SoundExchange is unable to cite any documentary evidence showing that simulcasting competes with interactive services. SoundExchange primarily cites documents from Pandora, which necessarily concern custom radio rather than simulcasting. *See, e.g.,* SX PFF ¶ 1106 (citing SX Exs. 263, 266). Similarly, the quoted document from Mr. Pittman makes the point [[[redacted]

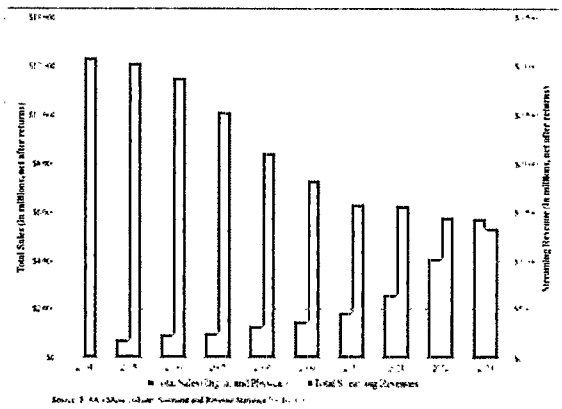
[redacted]]] SX PFF ¶ 1109 (quoting SX Ex. 373). This is the exact opposite of SoundExchange's position and confirms that radio – and simulcasting – are fundamentally different from custom radio or interactive services in terms of substitutional effects.

54. SoundExchange also argues that "the experience of copyright owners is that statutory webcasting is net substitutional." SX PFF Part XIII.C.3 (capitalization omitted). Rather than presenting any actual facts, this section of SoundExchange's Proposed Findings consists almost entirely of self-serving characterizations and unprovable suppositions culled from the written testimony of SoundExchange's label and other witnesses. *See* SX PFF ¶¶ 1120-24. Even as to this testimony, however, the focus on custom webcasting (to the exclusion of simulcasting) is clear. *See, e.g.,* SX PFF ¶ 1122 ("as statutory webcasters increasingly customize and curate programmed streams for individual users"). Notably, in the sole sentence in the section in which simulcasting is even mentioned ("Likewise, as statutory webcasters (whether customized, programmed, or simulcast) continue to converge with subscription services it makes it that much less likely that a consumer will pay for a subscription") (*id.*), no citation to <u>any</u> testimony or other evidence is provided. And Aaron Harrison of Universal specifically admitted that simulcasting is the least substitutional of the different types of services. 4/30/15 Tr. 1101:14-1102:12 (Harrison).

55. In addition to the fact that alleged "market evidence" is totally inapplicable to simulcasting, SoundExchange's attempt to blame the general growth of statutory webcasting for a decline in record industry revenue was revealed as a charade at

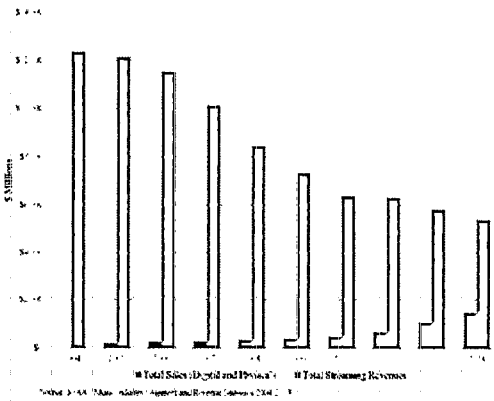
trial. *See* SX PFF Part XIII.C. Dr. Blackburn, for example, presented charts superimposing webcasting growth with record label revenue decline. *See, e.g.*, Blackburn WRDT ¶¶ 23-24, Figs. 4, 5. At trial these charts were shown to be inherently misleading. For example, Blackburn Figure 4 purports to compare the amount of revenues from streaming services in general with the amount of total recording industry sales for each year from 2004 to 2013. 5/27/15 Tr. 5998:22-5999:2 (Blackburn). At first glance, this figure appears to show streaming revenues soaring and overtaking rapidly plunging sales revenues in 2013. In fact, as NAB showed at trial, Dr. Blackburn used very different scales on the left and right sides of the chart to show these "trends" – the "Total Streaming Revenues" scale was in fact multiplied by a factor of <u>four</u>. *Id.* at 5999:11-20. Using the same scale, the misleading visual correlation between webcasting revenues and sales revenues (and the unstated inference of causality) dissolves:

Blackburn WRT Fig. 4



Corrected Blackburn WRT Fig. 4

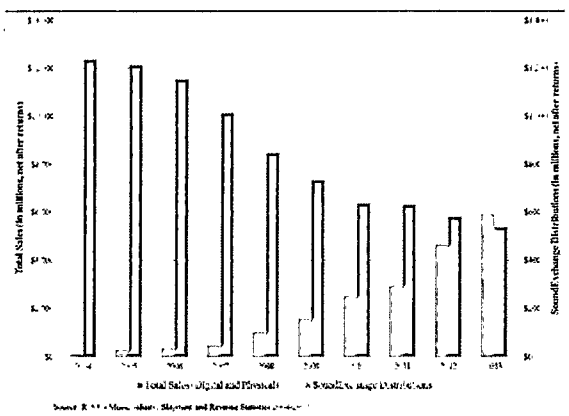
NAB Ex. 4236



56. This same deceptive tactic was used even more egregiously by Dr. Blackburn in Figure 5 of his Written Rebuttal Testimony, purporting to show a visual

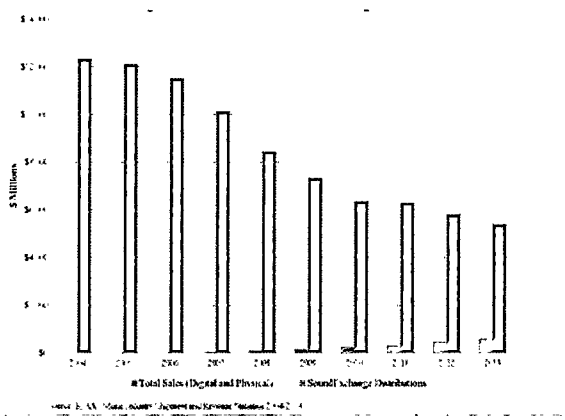
comparison of the amount of statutory royalties that SoundExchange distributed with the amount of total recording industry sales for each year from 2004 to 2013. *Id.* at 6004:14-19. This time, Dr. Blackburn chose to inflate the scale for SoundExchange's statutory royalty distributions, as compared with total recording industry sales amounts, by a factor of ten. *Id.* at 6004:14-6005:2. When properly graphed, again the implication of causality is shown to be a sham:

Blackburn WRT Fig. 5



Corrected Blackburn WRT Fig. 5

NAB Ex. 4237



57. Dr. Blackburn's charts imply a causality that does not exist. *See also* Blackburn WRT at 15, Fig. 2 (Pandora active users versus industry sales), *reprinted in* SX PFF ¶ 1112. And, when questioned directly on this point, SoundExchange's witnesses, including Dr. Blackburn, each conceded that they were aware of no evidence that statutory webcasting has caused a decline in the record industry revenues. *See, e.g.*, 5/4/15 Tr. 1613:11-19 (Blackburn); 5/27/15 Tr. 6004:7-8 (Blackburn); 4/28/15 Tr. 425:21-426:12 (Kooker); 4/30/15 Tr. 1115:17-1116:22 (Harrison); 5/7/15 Tr. 2471:5-17

(Wilcox). In sum, there is no market proof that statutory webcasting is substitutional with respect to interactive services, and no proof at all that simulcasting is in any way substitutional.

58. SoundExchange's demonstrated lack of proof for its contentions is not cured by the Sarah Butler survey that purports to show that consumers view directly licensed music streaming services as a substitute for Pandora and iHeartRadio. *See* SX PFF ¶¶ 1127-31. SoundExchange admits (albeit burying this fact at the bottom of a page near the end of its discussion) that "these results are not predictive of future behavior." *Id.* ¶ 1131. The survey, therefore, is completely devoid of any usefulness to show that any substitution actually would or does occur.

59. To the extent the Butler survey has any probative value at all, it plainly has none with respect to simulcasting. The Butler survey sought to determine only "what services and methods of listening to music consumers would use if they could not listen to iHeartRadio or Pandora. In other words, the survey addresses the following questions: for which form of listening (if any) are iHeartRadio and Pandora substituting?" Butler WRT ¶ 29 (emphases added). Ms. Butler admitted that she did not study what consumers evaluate as substitutes or possible alternatives to simulcasting. 5/29/15 Tr. 6837:7-17 (Butler). She also admitted that even the data she gathered regarding iHeartRadio cannot be disaggregated to show the results for iHeart's simulcast service. 5/29/15 Tr. 6836:5-6837:17 (Butler). Thus, no conclusions whatsoever can be reached from the Butler survey with respect to simulcasting.

60. In addition, according to SoundExchange's own contentions with respect to proper survey design, the Butler survey was inherently flawed and not reliable.

SoundExchange criticizes the survey conducted by Pandora expert Larry Rosin as "biased" and having "methodological flaws." For example, SoundExchange asserts that it was error for Mr. Rosin to include the term "free" in connection with terrestrial radio (SX PFF ¶¶ 1136-37) but simultaneously asserts that it was perfectly acceptable for Ms. Butler to have included "free/paid" only in connection with two substitute choices, Spotify and Pandora, and not next to the numerous other listed services that have free and paid service offerings. 5/29/15 Tr. 6794:25-6796:16 (Butler).

61. Moreover, Ms. Butler did not break out free and paid service options and did not provide any indication of cost, so there is no way of knowing the respondents' awareness of these offerings, whether they were thinking of the free or paid options, or whether they would pay for those services. 5/29/15 Tr. 6796:17-6798:12 (Butler). This error in the Butler survey is particularly telling in light of SoundExchange's criticism of Mr. Rosin's survey for failing to "ask any questions regarding whether Pandora users might otherwise use the ad-supported or other free versions of directly licensed services, such as Spotify's Shuffle or Spotify's Desktop service," complaining that, "[t]his crucial flaw evades the very question of substitution here – would consumers otherwise use the free *or* paid versions of the higher ARPU directly licensed services?" SX PFF ¶ 1138. This is exactly what Ms. Butler did.

62. Similarly, Ms. Butler did not separate out, and has no way of knowing, whether respondents were choosing "lean back" listening options or on demand listening options. Therefore, a "lean back" listener to iHeartRadio or Pandora might have chosen only another "lean back" option. 5/29/15 Tr. 6801:2-6802:12 (Butler).

63. Similarly, SoundExchange criticizes the Rosin survey for including only three sentences regarding the hypothetical service's features – whereas Ms. Butler included none. SX PFF ¶ 1135.

64. Other methodological flaws in the Butler survey show that it is inherently unreliable for any purpose:

- Ms. Butler did not conduct any pretest of the survey to determine how the survey was understood or if respondents were confused. 5/29/15 Tr. 6782:18-24, 6800:18-24 (Butler).

- Ms. Butler instructed the survey company, SSI, not to collect standard information about possible confusion about the survey questions (such as unclear instructions and errors in logic) from respondents and therefore has no way of knowing whether respondents understood the survey. *Id.* at 6783:25-6785:15.

- Ms. Butler did not conduct any validation of the survey, which is standard in the industry. *Id.* at 6785:16-18.

- Ms. Butler included all qualified responses in her data calculation without regard to length of time to complete, even though some respondents took only two minutes to complete the entire survey. *Id.* at 6782:25-6783:18.

- After screening, respondents were asked if they could no longer listen to Pandora or iHeartRadio, they would be most likely to (1) find a substitute for the music I listen to on Pandora / iHeartRadio," (2) "stop listening to music," or (3) "don't know, unsure." Ms. Butler did not present an option to listen to less music or not find a substitute, simply believing that a person who still listens to music via other sources would choose to "stop listening to music." *Id.* at 6793:8-6794:13.

- In contrast, Ms. Butler <u>did</u> include "listen [] to less music" as a response choice to two other questions, "to be conservative and allow people to indicate that, you know, once they thought about their substitution possibilities, they really would just listen to less or stop listening." *Id.* at 6805:12-20 (Butler).

- Ms. Butler counted as a "higher value" option substituting listening to music that had <u>previously</u> been purchased by the respondent. *Id.* at 6802:13-6803:1 (Butler).

65. Ms. Butler also reported the results of her survey in a skewed manner. By far the greatest percentage of iHeartRadio respondents reported that they would substitute

Pandora for iHeartRadio, and the greatest percentage of Pandora respondents reported that they would substitute iHeartRadio for Pandora; however, Ms. Butler's Figure 5 erroneously omits Pandora as the largest substitute for iHeartRadio. 5/29/15 Tr. 68214:5-6814:21 (Butler). SoundExchange also glosses over this error, failing to report these results accurately. SX PFF ¶ 1130 (omitting the percentage of Pandora users that reported they consider iHeartRadio as a substitute in the absence of Pandora).

66. Ms. Butler's conclusions about which services/substitutions are "higher value" for the record labels were based entirely on what SoundExchange's counsel told her; this included music that the respondent had previously purchased. She did no independent evaluation, such as review contracts, and did not determine whether the record labels on balance would be better or worse off based on the results of her study, for example, by comparing actual hours listening. At most, as she admitted, the survey shows what consumers view as possible "marketplace alternatives." 5/29/15 Tr. 6815:7-6817:1 (Butler).

67. SoundExchange also argues that the rates contained in the Rubinfeld agreements "likely" implicitly factor in promotional / substitutional considerations. SX PFF Heading XIII.B & ¶ 1104. SoundExchange then attempts to extend this proposition by taking the position that it is the burden of the services to prove otherwise. SX PFF ¶ 1098 ("Accordingly, to the extent that no clear and quantifiable difference in the net promotion/substitution effect exists across services, no adjustment should be made."). There is no basis for SoundExchange's attempt to reassign the burden of proof.

68. NAB has demonstrated that there is "clear" difference between simulcasting and interactive services. There is no record evidence that simulcasting is

substitutional with respect to interactive services or, indeed, substitutional in any way at all. *See supra* ¶¶ 49-66. Aaron Harrison's testimony could not be more unequivocal that simulcasting is less substitutional than custom radio, which in turn is less substitutional than interactive services. NAB PFF ¶ 116 (citing 4/30/15 Tr. 1100:16-1102:12 (Harrison)). Furthermore, NAB has shown that simulcasting is, ear-for-ear, equally promotional to terrestrial radio. NAB PFF Part III.C. Thus, NAB has established a "clear" difference that must be accounted for by Professor Rubinfeld in applying his purported benchmark. It is SoundExchange's benchmark and, therefore, SoundExchange's obligation to marshal the evidence necessary to support the necessary adjustments to that benchmark to account for differences between the benchmark and target markets. SoundExchange has clearly failed to do so; its attempt to shift the burden to the services make that showing should fail.

2. SoundExchange's Attempts To Disprove the Promotional Effects of Simulcasting Are Unpersuasive.

69. As set out in NAB's Proposed Findings of Fact, it is undisputed—and SoundExchange's counsel specifically admitted in his opening statement—that terrestrial radio is highly promotional:

> "record companies try to get their music played on terrestrial radio, and that shows that terrestrial radio is promotional. They spent a lot of money to try to convince terrestrial radio to play new releases. They put a lot of effort behind it, but that -- and that's true. Other companies do try to get terrestrial radio stations to play their music. And many people at record companies believe that that helps to sell CDs and downloads. We're not here to claim otherwise."

NAB PFF ¶ 83 (citing 4/27/15 Tr. 82:2-13 (Pomerantz) (emphasis added)). NAB's Proposed Findings demonstrated the vast personnel and financial resources that the labels invest in promoting to radio. NAB PFF ¶¶ 82-106. Those Findings also presented evidence demonstrating that simulcasting had the same promotional effect as the same content going over the airwaves, including the same effect ear-for-ear. *Id.* ¶¶ 107-13.

70. SoundExchange claims that "promotion to terrestrial radio is irrelevant to determining promotional/substitutional effect of statutory services." SX PFF Heading XIII.E.2.d (capitalization omitted). SoundExchange's arguments in this regard, however, are entirely unpersuasive.

71. SoundExchange first notes what it terms the "anomaly" that labels do not receive royalties for plays on terrestrial radio and then claims (notably without citation) that "[a]s a result, the music industry uses its promotional staff to ensure that sound recordings played over the airwaves are those record label priorities." SX PFF ¶ 1177 (emphasis added). But as Professor Katz explained, the attempt to tie the lack of a terrestrial performance right to the labels' efforts to promote on radio is entirely nonsensical; the fact that the recording industry would go to such enormous efforts to obtain airplay even though there is no direct compensation for that airplay necessarily demonstrates that the labels believe they are obtaining other revenue (either sales or paid streams) as a result of that induced airplay. *See* NAB PFF ¶¶ 106, 202-03; Katz AWRT ¶¶ 95-97.

72. SoundExchange next attempts to dispute NAB's claim that the content on a simulcast is the same as on the terrestrial broadcast. *See* SX PFF ¶ 1179. In support of its argument, SoundExchange cites the testimony of iHeart's Jeffrey Littlejohn about

iHeart's ability to switch out songs overnight. *Id.* SoundExchange also complains about iHeart's proposed definitions, which allow 49% content replacement. *Id.* But the NAB witnesses uniformly testified that the content on their simulcasts (everything except the commercials) is the same as the broadcast. Dimick WDT ¶ 11; Dimick WRT ¶ 5; 5/26/15 Tr. 5798:15-5799:9 (Dimick); 5/20/15 Tr. 5104:1-12 (Newberry); Knight WDT ¶¶ 13, 29; Downs WDT ¶ 14; 5/21/15 Tr. 5217:24-5218:12 (Downs). Moreover, as discussed *infra* at Part III.C.3, the definition of "broadcast retransmission" proposed by NAB in order to qualify for the simulcast rate would not allow substitution of the type described by SoundExchange. *See* NAB Proposed Rates and Terms § 380.11 (June 19, 2015) (submitted with NAB's Proposed Findings of Fact and Conclusions of Law). In addition, NAB's definition makes clear that it does not apply to the individually customized streams that SoundExchange claims must be substitutional.

73. SoundExchange focuses on an alleged different "user experience" for simulcasts than terrestrial broadcasts. *See* SX PFF ¶¶ 1177-80. But SoundExchange fails to present any evidence, as opposed to sheer speculation, that any of these purported differences actually eliminate or even diminish the promotional effects of simulcasting. For example, in arguing that simulcasting must not be promotional (even though radio clearly is), SoundExchange reiterates its claims that simulcasts have a greater geographic reach than broadcasts, and that the presence of aggregators somehow affects the equation. As explained above, however (*see supra* ¶¶ 45-47), the geographic reach issue is entirely theoretical, because (i) broadcasters generally do not want to target out-of-market listeners, because their advertisers are uninterested in them, (ii) the pervasive localized content and advertising are unlikely to appeal to out-of-market listeners, (iii) the most

prevalent non-localized content – music – is nonexclusive and available from numerous other sources, and (iv) there is no record evidence proving or even suggesting that most simulcasters have significant out-of-market audiences. *See also* NAB PFF Part III.A.2. Moreover, SoundExchange presents no evidence at all that, to the extent there are out-of-market listeners, the promotional effect of the simulcast—which includes all of the promotional elements of a radio broadcast—would be any different.

74. Similarly, as discussed in detail above (*see supra* ¶¶ 40-44) and in NAB's Proposed Findings (¶¶ 74-81), there is no reason that any added functionality from aggregators would negate the otherwise promotional nature of radio and simulcasting as SoundExchange claims. *See* SX PFF ¶ 1179. While SoundExchange suggests that a user of TuneIn can record a simulcast stream, this is analogous to holding a tape recorder up to the radio and playing it back later. Moreover, any such recording would be no higher quality than the simulcast and would include all of the non-music elements included on the broadcast, including voice-overs and segues. SoundExchange has presented no evidence that demonstrates that these functions are actually used, or their significance in the marketplace. Indeed, SoundExchange's own expert, David Blackburn, was completely unaware of these capabilities prior to his engagement in this case and admitted that they had numerous disadvantages and distinctions compared to an on-demand service. *See* NAB PFF ¶¶ 80-81 (citing testimony). In sum, there is no showing that users of simulcast services actually have a different listening experience than listeners to terrestrial radio broadcasts – and no showing that, even if they do, that it makes any difference as to the promotional effect of simulcasting.

75. Notwithstanding SoundExchange's efforts to create differences, the evidence shows that the critical attributes that cause radio to be promotional are equally present in simulcasting. Aaron Harrison of Universal explained his view as to why radio is promotional:

> Terrestrial radio, I think, is seen more as a platform where we can break artists and get the DJs to, you know, pump up those artists, do interviews with those artists, and talk about new album release, so hopefully they migrate from terrestrial radio to actually purchasing the album on an a la carte -- based, you know, on individual one-by-one purchase basis.

4/30/15 Tr. 966:16-23 (Harrison) (emphasis added). SoundExchange provides no reason why this would be any different on the simulcast; by definition, if the DJ is "pump[ing] up the artists" on the broadcast, the same will be happening on the simulcast. Mr. Harrison's Universal colleague, Charlie Walk, similarly testified [[

IHM Ex. 3242 at 33 (citing Walk Dep. Tr. 127:11-128:6). As with Mr. Harrison's testimony, none of these attributes is different on the simulcast, notwithstanding SoundExchange's efforts to create a distinction. Accordingly, the record strongly supports the conclusion that simulcasting, like radio, is not substitutional and is highly promotional.

76. SoundExchange argues based on Dr. Blackburn's testimony that only what SoundExchange terms "expansionary" promotion is relevant for statutory purposes. SX PFF ¶¶ 1086-89. These arguments are misguided for the reasons discussed in NAB PFF ¶¶ 396-98. As an initial matter, SoundExchange suggests that "it is important to be clear on certain definitional points" (SX PFF ¶ 1087), as if SoundExchange's arguments were premised on standard economic definitions. In fact, however, as Dr. Blackburn admitted on cross-examination, the concepts of "expansionary" and "diversionary" promotion were created by him and do not appear in any recognized textbook or economic literature. 5/26/15 Tr. 5926:20-5927:4 (Blackburn).

77. Dr. Blackburn's"industry expansion" view is also unsupported by the clear statutory language, which by its express terms requires the Judges to consider the extent to which statutory webcasting services "may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings" 17 U.S.C. §114(f)(2)(B)(i)(emphasis added). The statute refers to a single owner and its copyrighted sound recordings – not to the entire market or industry, as SoundExchange contends. *See* 5/26/15 Tr. 5665:9-5668:4 (Katz). SoundExchange's citation to *Web II* (SX PFF ¶ 1088) does not purport to alter this.

78. Finally, as Dr. Blackburn conceded (*see* NAB PFF ¶ 397 (citing 5/26/15 Tr. 5927:12-5928:5 (Blackburn)), and as Professor Katz confirmed (*see* NAB PFF ¶ 398 (citing 5/26/15 Tr. 5665:9-5666:4 (Katz)), Dr. Blackburn's construct works only in the context of a monopoly seller; sellers in a competitive market would be concerned with both types of promotion theorized by Dr. Blackburn.

III. SOUNDEXCHANGE'S RESPONSE TO NAB'S RATE PROPOSAL IS MERITLESS.

79. SoundExchange responds to NAB's rate proposal by asserting that "Prof. Katz does not offer any marketplace evidence" to support it. SX PFF ¶ 880. But Professor Katz, and NAB, provided substantial marketplace evidence in support of NAB's fee proposal, including compelling evidence demonstrating that the opportunity costs of simulcasting to the record companies are near zero or negative. *See* NAB PFF ¶¶ 191-225. SoundExchange is simply wrong to equate "marketplace evidence" with "license agreements." SoundExchange's arguments about this evidence are addressed in Part A, below.

80. SoundExchange also attacks Professor Katz's use of the *SDARS II* results as guidance. As discussed in Part B, below, SoundExchange's attacks are misguided. The Judges' decision in *SDARS II* makes clear that the rate used by Professor Katz as a guidepost was precisely analogous to the rate setting standard applicable to this case.

81. Finally, SoundExchange argues, despite the overwhelming evidence in the record demonstrating that simulcasting is different from both interactive and other statutory services and that SoundExchange's case did not relate to simulcasting, that simulcasting should not receive a rate that recognizes the essential differences – what it rhetorically and incorrectly describes as a "discounted" rate. NAB addressed the

evidence supporting a separate rate for simulcasting in its Proposed Findings of Fact. NAB PFF ¶¶ 230-42. Part C below responds to SoundExchange's arguments. Part C also demonstrates that contrary to SoundExchange's arguments, prior precedent does not in any way preclude setting a separate rate for simulcasting.

A. CONTRARY TO SOUNDEXCHANGE'S ARGUMENTS, THE LABELS' BEHAVIOR TOWARDS TERRESTRIAL RADIO PROVIDES COMPELLING REAL MARKET EVIDENCE OF A REASONABLE RATE FOR SIMULCASTERS.

82. SoundExchange does not deny that record companies spend [[ ]] each year and employ hundreds of employees to induce and cajole radio broadcasters to play their recordings. *See* NAB PFF Part III.C. Nor does SoundExchange deny that record companies would not expend this money and effort if they did not benefit from the airplay. *See* NAB PFF ¶ 106.

83. Instead, SoundExchange argues that "terrestrial radio is not a proper reference point" because "no market exists for performance rights in sound recordings on terrestrial radio." SX PFF ¶¶ 872, 879 & Heading X.A; SX PCL Part IV.B. It is true that there is no sound recording performance right, but SoundExchange misses the point. It is not the zero royalty rate *per* se that makes terrestrial radio's sound recording performance royalty a relevant rate benchmark – it is the record labels' marketplace behavior in the face of that zero royalty that renders the price of zero highly relevant.

84. NAB has demonstrated that record company conduct toward terrestrial radio in the face of the lack of a performance right provides essential and abundant marketplace evidence from which conclusions can be drawn that are relevant to setting a rate for simulcasting. NAB PFF ¶¶ 107-13. That evidence demonstrates that the opportunity costs to record companies from radio airplay are often negative—in other

words, record companies benefit from airplay—and that, in an open, competitive market, if they could, record companies would pay broadcasters to play their recordings. NAB PFF ¶¶ 197-206. As Professor Katz testified:

> the fact that record companies are willing to spend [[ ]] per year on radio promotion to get their songs played on terrestrial radio suggests that, if not for legal prohibitions, the license fee for terrestrial broadcasting of a musical recording could be negative in many cases.

Katz AWRT ¶ 97.

85. SoundExchange resists its own members' marketplace behavior, quoting Messrs. Harleston's and Burruss' views that the lack of a terrestrial performance right is "unfortunate" and "unfair" and calling the lack of a sound recording performance right an "anomaly." SX PFF ¶¶ 879, 882-84. As discussed below, the lack of a terrestrial performance right is neither unfortunate, unfair, nor an anomaly.

86. But more fundamentally, the fairness or unfairness of the current lack of a terrestrial performance right is beside the point and not at issue here. Rather, the record companies' marketplace behavior as willing sellers is the point. The simple fact is that record companies would not encourage radio broadcasters to play their recordings, let alone expend the money and effort that they do, if airplay from those broadcasters imposed costs on them. If each play were a net negative, record companies would be going out of their way to discourage airplay. But that is not what they do – rather, they seek out that airplay in droves. NAB PFF ¶¶ 202-03.

87. As Professor Katz testified:

> If the record company thinks that every play hurts it, when we balance things out, it shouldn't be promoting incremental plays. That would be irrational for them to do that. So the fact that they want additional plays and they spend money to get additional plays, says the record company has concluded that on balance, it's

> good for that record company to get more plays. If it is good for them to get more plays, that means they have a negative opportunity cost and that is something that is then going to push -- if they were bargaining over price, it's going to tend to push price downward, so I think it is telling us that they perceive there is a benefit of the margin.
>
> So that is the part I take away from it is given that the price they are getting is zero and given they want to push to have it happen, it is they perceive a negative opportunity cost, at the individual firm level.

5/26/15 Tr. 5677:18-5678:12 (Katz) (emphasis added); *see also* NAB PFF Part VI.B.2. SoundExchange has no response to this economically undeniable principle.

88. Ironically, SoundExchange relies heavily on a passage from Mr. Harleston's testimony expressing his view that it is unfortunate that the copyright law does not provide a performance right. But in that same passage, Mr. Harleston admitted that [[ ]] 5/1/15 Tr. 1371:20-1372:13 (Harleston). Apparently, Mr. Harleston's complaint was that the benefit to Universal was [[ ]] *Id.* at 1372:6-13 (emphasis added). Mr. Harleston did not explain why Universal sought terrestrial airplay if that were not sufficient benefit.

89. Similarly, immediately after Mr. Burruss described the lack of a performance right as "unfair," he testified that "the goal of putting music on terrestrial radio [is] to expose listeners to artists that they may not have heard before," that "the exposure that terrestrial radio provides stokes awareness and interest in music," and that that, in turn, "leads to music sales." 6/1/15 Tr. 7059:2-14 (Burruss).

90. Although the fairness or unfairness of the lack of a terrestrial performance right is not before the Judges, SoundExchange has raised the issue and it deserves a response. As discussed in NAB's Proposed Findings of Fact, the extensive promotional value provided by radio broadcasting is undisputed and undeniable. *See* NAB PFF ¶¶ 94-113. In light of that value, the lack of a terrestrial performance right is neither unfair nor unfortunate. Nor is it an anomaly. As demonstrated in NAB's Proposed Conclusions of Law, the sound recording performance right is relatively new to U.S. copyright law; it exists only for certain performances by digital transmission; it does not exist for the great majority of types of public performances, including performances at nightclubs, restaurants, retail stores, bars, airports, zoos, fetivals, theme parks or anywhere else music is played, as well as performances on terrestrial radio. NAB PCL ¶¶ 665-84. In other words, the anomaly in U.S. law is the limited, narrow sound recording performance right in digital transmissions.

91. Moreover, Congress has repeatedly recognized the benefits provided to record companies and artists by radio airplay, for which broadcasters are not compensated. NAB PCL ¶¶ 665-61. When Congress enacted the sound recording performance right, it expressly recognized that radio programming did not create the risks that the new performance right was intended to address – the risk that digital services might displace record sales – because radio programs (1) are available without subscription; (2) do not rely upon interactive delivery; (3) provide a mix of entertainment and non-entertainment programming and other public interest activities to local communities to fulfill FCC licensing conditions; (4) promote, rather than replace, record

sales; and (5) do not constitute "multichannel offerings of various music formats." S. Rep. No. 104-128, 15 (1995). Each of these features is also true of a station's simulcast.

92. In sum, the lack of a sound recording performance right on terrestrial radio is neither an anomaly nor unfair. More to the point, however, is the marketplace evidence provided by the record companies' behavior as willing sellers toward terrestrial radio in aggressively pursuing that airplay even in the face of receiving no royalties from it. That behavior leaves no doubt that record companies view radio airplay as promotional, and having a negative opportunity cost.

B. SOUNDEXCHANGE MISCHARACTERIZES THE SIGNIFICANCE OF THE *SDARS II* RATES.

93. SoundExchange argues that Professor Katz's use of a rate from *SDARS II* as a guidepost is improper because, among other things, it resulted from a regulatory proceeding and not a marketplace agreement. SX PFF Part X.B & ¶ 873. But that argument misapprehends both how the Judges arrived at *SDARS II* rates and what Professor Katz did. SoundExchange's additional criticisms of Professor Katz in this regard are similarly ill-founded.

1. Professor Katz Properly Relied on a Marketplace Rate from *SDARS II*, Before that Rate Was Adjusted To Account for the Section 801(b)(1)(B) Policy Factors.

94. In both *SDARS* I and *SDARS II*, the Judges held that the correct process for determining rates under the section 801(b)(1) policy factors is first to determine a range of reasonable rates based on marketplace evidence and then to assess that range against the four section 801(b)(1) policy factors to determine an appropriate reasonable rate that satisfies these four factors:

> To determine rates, the Judges begin with an analysis of proposed market benchmarks, if any, and voluntary license agreements as described in Section 114(f)(1)(B), and the participants' supporting testimony. The Judges then measure the rate or range of rates that process yields against the statutory policy objectives to reach a determination of rates and terms.

Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services: Final Rule and Order, 78 Fed. Reg. 23054, 23055 (Apr. 17, 2013); *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services: Final Rule and Order*, 73 Fed. Reg. 4080, 4084 (Jan. 24, 2008) ("[W]e 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."); *id.* at 4088 ("Both the copyright owners and the SDARS agree that a good starting point for the determination of what constitutes a reasonable rate encompassing the four policy factors is to focus on comparable marketplace royalty rates as 'benchmarks,' indicative of the prices that prevail for services purchasing similar music inputs for use in digital programming ultimately made available to consumers.").

95. In *SDARS II*, the Judges found that "the zone of reasonable rates" based on marketplace evidence alone – <u>before</u> consideration of any of the section 801(b)(1) policy objectives – "has 7% as its floor and 12%-13% as its most likely ceiling." 78 Fed. Reg. at 23071. After analyzing this zone in light of the section 801(b)(1) policy factors, "the Judges f[ou]nd that the most appropriate rate for SDARS for the 2013 to 2017 licensing period is 11% of <u>Gross Revenues</u>." *Id.* Notably, the benchmark agreements used to derive the 13% rate are the same types of proposed benchmark agreements upon which SoundExchange primarily relies in this case – interactive service agreements. *Id.* at

23068 ("The Judges also are informed by the presumed reasonableness of the 12% rate that SoundExchange proposed for 2013 and by the 13% benchmark rate that served as a benchmark in *SDARS–I*."); 73 Fed. Reg. at 4093-94 (relying upon interactive service agreements to derive 13% upper zone of reasonableness number).

96. Professor Katz did not rely on the 11%-of-revenue rate that the Judges found was the appropriate reasonable SDARS rate based on consideration of the four 17 U.S.C. § 801(b)(1) policy factors. Rather, he relied on the 13% upper bound of the zone of reasonable rates, which was a number derived from the very type of interactive service marketplace agreements on which SoundExchange relies here, before the Judges applied any of the section 801(b)(1) policy factors. Professor Katz's reliance on the 13% number was therefore entirely appropriate, as that number was a marketplace number and was not influenced by any of the section 801(b)(1) policy factors, as SoundExchange incorrectly suggests.

97. SoundExchange's misunderstanding of *SDARS II* also infects its argument that Professor Katz's "reliance on a satellite benchmark does not account for the fact that the cost structure of a satellite service like SiriusXM is dramatically different from the cost structure of webcasters like those at issue here." SX PFF ¶ 890. SoundExchange's decision to advance this argument is highly ironic. SoundExchange argued in both *SDARS I* and *SDARS II* that the Judges should rely on major label licenses to interactive webcasting services – the very services that SoundExchange now claims have different cost structures. *SDARS I*, 73 Fed. Reg. at 4092-94; *SDARS II*, 78 Fed. Reg. at 23058. SoundExchange argued in both SDARS cases that the cost differences should not affect the fee. *See, e.g.*, Proposed Reply Findings of Fact of SoundExchange, Inc., Docket No.

2006-1 CRB DSTRA, 66, 78-85 (Oct. 11, 2007); Proposed Findings of Fact of SoundExchange, Inc., Docket No. 2011-1 CRB PSS/Satellite II, 189-196, 212-14 (Sep. 26, 2012).

98. In any event, Professor Katz was, in fact, careful to account for those differences in cost structure. The difference in cost structure was one of the issues that the Judges relied upon to adjust the rate downward when they applied the section 801(b) policy factors after they determined the market-based rate. *SDARS I*, 73 Fed. Reg. at 7096; *SDARS II*, 78 Fed. Reg. at 23069. By using the market-based rate from before the adjustment for cost differences, Professor Katz used a rate that was not affected by the difference in cost structures. Indeed, as mentioned before, *SDARS I* relied on the licenses negotiated by the major record labels with interactive webcasting services – precisely the benchmark that SoundExchange relied upon here. That was also the benchmark advanced by SoundExchange in *SDARS II*.

99. For this same reason, SoundExchange's reliance on the Judges' *SDARS II* discussion of SiriusXM's costs is misplaced. SX PFF ¶¶ 892. The cited discussion occurred in the context of adjustments to the previously-determined market-based rates. *SDARS II Final Order*, 78 Fed. Reg. 23069 (discussing downward adjustment to the market-based rate that was necessary to effectuate the section 801(b) factors). Again, Professor Katz relied on the market-based rate identified in *SDARS II* before it was adjusted downward to account for SiriusXM's costs.

2. SoundExchange's Other Criticisms of Professor Katz's Use of the *SDARS II* Marketplace Rate Are Meritless.

100. SoundExchange's other attempts to undermine Professor Katz's use of the SDARS II marketplace rate are similarly off-base. To begin with, SoundExchange's

argument that rates "that are set by the Judges in a regulatory proceeding" are *per se* inappropriate benchmarks (SX PFF ¶ 886) not only ignores that the rate Professor Katz used was derived from voluntary agreements but also is inconsistent with SoundExchange's own position that the Judges should consider the *Web III* rates in this proceeding. For example, SoundExchange repeatedly references the reduction in current rates represented by the Services' proposals, *see, e.g.*, SX PFF ¶¶ 17, 20, 675-77, 1766-67, and it argues that, although the NAB and SiriusXM WSA agreements are not presented by any party as benchmarks, they were "probative, arms-length deals that the Judges properly considered in *Web III*." SX PFF ¶ 1034. The validity of the WSA agreements in *Web III* would be irrelevant if SoundExchange were not arguing that the *Web III* rates should be considered by the Judges. *See* SX PFF ¶ 20.

101. The contrast between *Web III* and *SDARS II* is stark, but not for the reasons presented by SoundExchange. Only one small commercial webcaster participated in *Web III* representing less than 3% of the webcasting market. *Web III*, 76 Fed. Reg. at 13026-27. The rest of the industry had settled under the Webcaster Settlement Acts and were barred from participating in any way in *Web III*. *See, e.g.*, *id.*; SX-121 at 9, 74 Fed. Reg. at 9301 (barring entities electing to pay under the settlement to withdraw from participating in any way in *Web III*). Thus, *Web III* was not a proceeding in which the service side was able to bring substantial resources to bear. And, by the time of the *Web III* remand, there was no commercial service left as a participant. *IBS v. CRB*, 684 F.3d 1332, 1335 (D.C. Cir. 2012).

102. *SDARS II*, on the other hand, involved a service paying [[ ]] a year to SoundExchange – it was fully contested by a service with substantial resources and an enormous interest in the case.

103. SoundExchange also argues that the *SDARS II* rates were based on stale market evidence – the interactive service benchmark of *SDARS I*, which was "based on agreements negotiated more than seven years ago." SX PFF ¶ 896. But this argument also undermines SoundExchange's implicit reliance on *Web III*. The interactive service benchmark, relied upon in part in *Web III*, was based on market data from 2007 to 2009, approximately six years ago. *Web III Remand*, 79 Fed. Reg. at 23118. In any event, the *SDARS II* proceeding occurred more recently than *Web III* and the Judges found the *SDARS I* data relevant in *SDARS II*.

104. Finally, SoundExchange objects that Professor Katz failed to take account of differences in the willingness of consumers to pay for satellite radio and noninteractive webcasting, because differences in consumer demand "would translate to a different willingness to pay upstream." SX PFF ¶ 895. But that argument does not help SoundExchange. The record makes clear that consumers have a much greater willingness to pay for satellite radio (for which they pay $9.99 to $14.99 per month) than they do for nonsubscription simulcasting. Frear CWDT ¶ 24. If that demand translates upstream as SoundExchange posits, SiriusXM would have a much greater willingness to pay for sound recording licenses for its satellite radio business than simulcasters would. In other words, SoundExchange's complaint means that the *SDARS II* rate overstates the rate for simulcasting.

105. In sum, for the reasons advanced by Professor Katz, the *SDARS II* rate, before it was adjusted to account for the section 801(b) policy factors, including differences related to SiriusXM's cost structure, provides a guidepost for rate-setting that is more valid that the rates set in *Web III.*

C. SOUNDEXCHANGE'S ARGUMENTS AGAINST A SEPARATE RATE FOR SIMULCASTING LACK MERIT.

106. SoundExchange's arguments against a separate rate for simulcasting are contrary to the evidence, common sense, and section 114.

107. SoundExchange's primary argument is that simulcasting is different from terrestrial radio. But although the medium of transmission is different, the evidence showed that the programming and primary audience are, for all relevant purposes, the same. SoundExchange's arguments to the contrary are inconsistent with the evidence and common sense.

108. SoundExchange also argues that there is no need for a separate rate for simulcasting because "the market will use the bargaining process" to address the need. SX PFF ¶¶ 933 (citing Rubinfeld CWRT ¶¶ 205-06). But the evidence unequivocally shows that is not true. As Mr. Newberry's undisputed testimony confirms, when SoundExchange obtains a favorable rate from the Copyright Royalty Board, as it did in *Web II,* it is unwilling to deviate significantly from that rate. *See* NAB PFF ¶¶ 250-51 (citing testimony from Mr. Newberry). The record makes clear that such bargaining would not occur.

109. SoundExchange quibbles about NAB's proposed definition of simulcasting. But this is a non-issue. NAB has tightened its proposed definition to

remove the only clause about which SoundExchange has raised concerns and to make clear that simulcasting is not customized.

110. SoundExchange also wrongly implies that the Librarian in *Web I* established a general principle that simulcast and Internet-only webcasting rates should be the same. SX PFF ¶ 38. But *Web I* was a record-specific decision regarding the parties' valuation of a single agreement. It does not support SoundExchange's asserted theory in this case.

111. Last, SoundExchange argues that its rate proposal should be favored because it "allows the record labels to recover their fixed costs." SoundExchange, however, has not provided the evidence necessary to assess the labels' costs to determine what rates would be necessary cover those costs, or to show that NAB's proposal would not enable the record labels to recover their costs. The failure to provide evidence that is in the record labels' possession should be construed against SoundExchange. In any event, the evidence shows that the record labels are highly profitable, so cost recovery is not a concern. *See* NAB PFF ¶¶ 166-68.

112. Conversely, SoundExchange fails to respond to the record evidence demonstrating that its percentage of revenue fee proposal is unreasonable, unworkable and inappropriate for simulcasting. *See infra* Part IV. Among other things, SoundExchange fails to respond to its own witnesses' admissions that it would be inappropriate to charge a fee on revenue earned for non-music programming and continues to seek to levy such a fee. *See infra* ¶¶ 182-183. These factors alone demonstrates the appropriateness of a fee structure specific to simulcasting.

1. SoundExchange Has Failed To Prove That Its Asserted Distinctions Between Terrestrial Broadcasting and Simulcasting Are Material to the Rates To Be Set in This Proceeding.

113. SoundExchange improperly uses the pejorative term "discount" to characterize to NAB's proposal that specific market-based rates be set for simulcasting. SX PFF Part X.C. NAB established in its Proposed Findings of Fact and Conclusions of Law that royalty rates for radio simulcasters should be set at the low end of the range of reasonable rates and that an appropriate rate for simulcasting is $0.0005 per performance. NAB PFF Parts VI.B, XI.C. Whether this is ultimately a different rate from other webcasters will, of course, depend on the rates set for those webcasters. SoundExchange complains that NAB has not "compared" its proposed rate to the rate proposed for "full" DMCA functionality. *See* SX PFF ¶ 897. But no such comparison is necessary or appropriate because NAB is not seeking a "discount" of a stated amount or percentage but rather is suggesting what the appropriate rates should be for simulcasting, taking into account the unique aspects of that service.

114. NAB has established that the programming on simulcasting is, for all relevant purposes, the same as that heard on terrestrial radio, which SoundExchange does not dispute is highly promotional, offers a mix of music and non-music programming, and focuses on the interests of local audiences. *See* NAB PFF ¶¶ 35-65 (attributes of simulcast programming); ¶ 83 (concession by SoundExchange counsel in his opening statement that radio programming is promotional).

115. NAB has also demonstrated in Parts II.A and II.B, above that the two central premises of SoundExchange's case—that statutory services are allegedly "converging" with interactive services and that statutory services are substitutional rather

than promotional—do not apply to simulcasting. Thus, simulcasting differs from other services on the very facts that SoundExchange itself claims are the key factors relevant to rate setting. That alone justifies a rate at the low end of the scale for simulcasting.

116. SoundExchange argues that Dr. Katz "assumes that terrestrial radio and simulcast are identical." SX PFF ¶ 899 (citing Katz WDT ¶¶ 81-84); *see also* SX PFF 900 (also citing "assumptions"). In fact, however, Dr. Katz did not "assume" that simulcasting and terrestrial broadcasts were identical, he rather cited evidence demonstrating their similarities in pertinent respects. *See* Katz ¶¶ 81-84. Moreover, the evidence at trial amply confirmed these similarities.

117. SoundExchange nonetheless argues that simulcasting and terrestrial radio have "key differences" between their promotional effects, functionality and content. SX PFF Part X.C.1. SoundExchange focuses on four purported differences: (1) potential geographic reach; (2) search functionality; (3) potential for customization; (4) potential to pause, rewind and record. The latter three alleged differences are based entirely on two aggregator sites, TuneIn and the functionality of iHeartRadio. NAB has shown that each of these arguments is unfounded and based on nothing more than conjecture. SoundExchange has failed to offer any evidence showing that, despite overwhelming functional similarities, the simulcasts and broadcasts are different in any material respect. Instead, SoundExchange relies on speculation by its witnesses about the effects of potential attributes of a service that it has made no showing are ever actually used by listeners. *See supra* ¶¶ 40-44.

118. SoundExchange argues that the potential broad geographic reach of the internet and the availability of a few aggregator sites such as TuneIn and iHeartRadio

means that listeners have greater choice, and therefore the songs they hear have less promotional effect. SX PFF ¶¶ 901-13. This argument fails even an initial review, because SoundExchange has brought forth NO evidence that:

- Any appreciable number of simulcast listeners come from outside a radio station's geographic area;
- Any appreciable number of simulcast listeners actually use the search functionality of aggregator sites;
- TuneIn has a large audience size or what the demographic region of such audience may be for station streams; and
- Even if listeners from outside a geographic area listen to a simulcast, the song has any less promotional effect than a terrestrial broadcast of the same song.

See supra Part II.A.

119. NAB has shown that the possibility that listeners would use remote simulcasts or the aggregation sites in a way suggested by SoundExchange is remote, at best. NAB witnesses have proven that—from their weather to their traffic to their ads—radio stations are inherently localized, and listeners would be unlikely to listen to inherently local content that does not apply to them when they can get the same music elsewhere for free. *See supra* ¶¶ 45-47. Even where listeners are out of town, the evidence shows that they still may be local listeners. As John Dimick testified, "You know, if you're out of town when a hurricane hits Miami, you know, you might not be able to hear our over-the-air signal from wherever you are, but you can access it through TuneIn or one of our other places." 5/26/15 Tr. 5803:13-17 (Dimick).

120. As set out above, *see supra* ¶¶ 41-44, the Kooker experiments regarding search functionality referenced in SX PFF ¶ 907 were shown to be unworkable as a song-finding mechanism except in extremely narrow circumstances. Even then, there would

be no way to hear the actual beginning of a song. NAB has shown that, while listeners potentially could search and re-search, and re-search again stations looking for the music they want, they would always have to join songs mid-stream, probably after an advertisement pre-roll. *See* NAB PFF ¶¶ 75-81. There is no evidence that listeners actually do this in large numbers, especially when it is undisputed that they have access to services such as YouTube for free. *See supra* ¶ 43.

121. SoundExchange's so-called "evidence" to the contrary is nothing more than speculation – the hypothetical possibility that someone in San Francisco could listen to a Seattle radio station; the possibility that a listener might be able to join a song near the beginning if they search or wait long enough and have a fast finger on the mouse; and complete conjecture that someone listening to their local terrestrial station is more "engaged." *See* SX PFF ¶¶ 904, 907, 908. SoundExchange claims that its expert Dr. Blackburn testified that increased search functionality on services such as iHeartRadio, "would decrease the likelihood of a user going out and purchasing the music." SX PFF ¶ 909 (citing 5/4/15 Tr. 1594:17-1596:20 (Blackburn)). But what Dr. Blackburn actually said was very different:

> But if I'm listening to Pandora and I'm getting this music delivered to me, songs that I like without any effort on my part, I mean, that at the very least is going to greatly reduce my incentive to go out and purchase music or pay for subscriptions or what have you.

5/4/15 Tr. 1594:17-1594:22 (Blackburn). SoundExchange's counsel then asked a leading question as to whether this opinion was limited to Pandora, and Dr. Blackburn then started discussing the iHeartRadio search function, but did not testify that that search function would affect sales, as SoundExchange wrongly suggests. *Id.* at 1594:23-1596:20.

122. Moreover, in response to Judge Strickler's question regarding simulcasting, Dr. Blackburn backtracked and acknowledged the limitations of his unsupported speculation:

> JUDGE STRICKLER: Is it your understanding that on an iHeart simulcast station, if you get notice that another Taylor Swift song is playing, that you are able to get that song from the start or are you joining that song already in progress?
>
> THE WITNESS: So, I mean, I've used it. I think you've just joined the song in part. You pick up the stream where it is. So it might be towards the end of the song, in which case you have to search again and find another one. It might be at the beginning of the song where you can enjoy whatever percentage of it is left.
>
> JUDGE STRICKLER: You would equate joining a song in progress with the same customer satisfaction as being able to get the song from the start?
>
> THE WITNESS: I don't think it's the same, right. It's obviously -- it's maybe a second best, but it still allows me to find what I want, right, as opposed to just turning it on and being completely at the whim of what it gives me. It sort of lies somewhere in between that and then being able to click in and play the song or, you know, even choose the particular song right from the beginning. It's just an example of moving it a little bit closer in that direction.

Id. at 1596:21-1597:22. So, Dr. Blackburn admitted that what he was referring to with Pandora, "getting this music delivered to me, songs that I like without any effort on my part," is absolutely not true when it comes to simulcast. *Accord* SX PFF ¶ 901 (admitting that search functions on iHeartRadio and TuneIn do not "let a user identify a song and play it from the beginning. Rather, a user joins the song in progress, but can refresh the search in an attempt to locate the song again from the beginning.")

123. Similarly, despite SoundExchange's attempt to truncate Dr. Peterson's testimony to support its position (SX PFF ¶ 904), Dr. Peterson actually testified that, in his opinion, [[

[redacted]]] 5/14/15 Tr. 3905:21-3906:4 (Peterson). He responded to counsel's hypothetical regarding simulcasting thus:

[[redacted]]]

Id. at 3909:24-10:17 (emphasis added); *see supra* ¶ 45-47.

124. SoundExchange also claims that an ability on TuneIn to pause, rewind and record simulcasts distinguishes simulcasts from terrestrial radio. SX PFF ¶¶ 916-18. This is analogous to holding a tape recorder up to the radio and playing it back later. *See supra* ¶ 71. The user still is not able to access a particular song on demand, so at most they can listen to or obtain a recording of part of a song. Again, SoundExchange has presented no evidence that demonstrates that these functions are actually used, their significance in the marketplace, or the possibility that they affect the promotion or substitution analysis. One could just as easily surmise that having a partial recording only frustrates and incentivizes listeners to purchase the entire track.

125. The idea that these so-called "differences" make simulcasts more competitive with webcasters than with other terrestrial radio broadcasters (SX PFF ¶¶ 911-12) is entirely unsupported. The only "evidence" cited by Professor Rubinfeld in support of this theory is a news article about new features on TuneIn. *See* Rubinfeld CWRT ¶ 209. There is no showing by SoundExchange of the use of these features in the marketplace, and Professor Rubinfeld's claim (*id.*) that "applications already exist that essentially convert simulcasts into on-demand radio" is indefensibly overstated, given the record evidence. Finally, the fact that, [[ ]] (SX PFF ¶ 912 (quoting SX Ex. 2207-1)) does not constitute proof of any change that affects promotion, as SoundExchange suggests.

2. SoundExchange's Argument that the Judges Should Only Set a Rate for Full Statutory Functionality and that Simulcasters Can Negotiate an Appropriate Rate Below the Statutory Rate Is Contrary to Law and the Evidence.

126. SoundExchange asserts that the license at issue in this case "covers the full functionality under the statute." SX PFF ¶ 933. SoundExchange offers no support for that statement and it is wrong as a matter of law. Nothing in the statute precludes the Judges from defining any class of licensed service that the record supports. That class of service can include limitations on functionality.

127. Section 114(f)(2)(B) obligates the Judges to set rates according to the applicable competitive market willing buyer/willing seller standard for all webcasters – not just for webcasters that SoundExchange claims should pay the highest rates. 17 U.S.C. §114(f)(2)(B). Moreover, the statute specifically mandates that the rates and terms set by the Judges "shall distinguish among the different types of eligible

nonsubscription services then in operation." *Id.* Nothing in the statute supports the idea that the rates must be set only for webcasters that would pay the most in the relevant hypothetical market.

128. The Judges recognized the possibility of setting different rates in their notice commencing this proceeding: "If the marketplace indeed would establish multiple rates, the adoption of a rate structure consistent with that result might be more realistic than a single per-performance rate." *Web IV Commencement Notice*, 79 Fed. Reg. 412, 413 (January 3, 2014).

129. Indeed SoundExchange acknowledged the possibility of a separate rate for simulcasting when it negotiated the Webcaster Settlement Act agreement with NAB. The agreement as originally negotiated was limited to simulcasting: "[o]nly retransmission of terrestrial broadcasts are covered; no Internet only side channels." SX Ex. 1574. ¶ 3.c.

130. SoundExchange cynically suggests that a separate rate for simulcasting is not necessary, because "if there is market demand for segmentation, the market will use the bargaining process to effectively achieve segmentation." SX PFF ¶ 933. Contrary to SoundExchange's argument, NAB's Proposed Findings of Fact show that the evidence is clear that there is no reasonable prospect that simulcasters and record labels would negotiate any appropriate competitive license fee below the rate set by the Judges. NAB PFF ¶¶ 232-42.

131. Moreover, an appropriate negotiated competitive license fee for simulcasting is highly unlikely in light of SoundExchange's monopoly status, the major labels' individual market power, the ability of the record labels to coordinate strategy through their participation on SoundExchange's Board of Directors and Licensing

Committee, and the existence of significant transaction costs. *See* NAB PFF ¶¶ 232-42; *id.* ¶¶ 247-48, 259-61 (discussing SoundExchange's function as a monopoly seller and the structure of SoundExchange that makes "it an unrealistic alternative" to bargain separately with the majors). And any rate that might, against the odds, be negotiated would exceed a competitive rate.

132. Indeed, SoundExchange's argument that simulcasters and record labels would negotiate an appropriate fee is belied by SoundExchange's own repeated contention that the labels are must-have complements for noninteractive services, including simulcasters. *See, e.g.*, NAB PFF ¶ 343; SX PFF ¶¶ 740-44. License fees negotiated with must have complements would not be competitive. NAB PFF ¶¶ 296, 305-19, 343-46.

133. SoundExchange's position is directly refuted by what occurred in the WSA negotiations. Mr. Newberry's testimony is undisputed that, following its victory in *Web II*, SoundExchange was unwilling to even consider deviating from the rates it had won – according to SoundExchange, any lower rate in one year, would require a higher rate in a later year. 5/20/2015 Tr. 5088:4-5089:13 (Newberry); Newberry WDT ¶¶ 24-25. In light of this undisputed testimony, SoundExchange's suggestion that an excessive CRB rate would likely be remediated by subsequent negotiations is preposterous.

134. Moreover, SoundExchange's argument that simulcasters should be left to negotiate for an appropriate rate is inconsistent with the statutory goal of minimizing transaction costs. As SoundExchange's own expert recognized, "remember that you don't want to set the statutory rate too high. The reason is, my understanding, from my perspective, so this is an economist's interpretation of what's going on is, you really want

to minimize transactions cost." 5/29/15 Tr. 6694:2-10 (Lys). Those transaction costs would further limit the likelihood of an appropriate negotiated rate for simulcasting.

135. In short, SoundExchange's argument that the Judges should leave an appropriate rate for simulcasting to bargaining is, in effect, an argument that there be no appropriate rate for simulcasting.

136. SoundExchange returns to its discredited rhetoric to argue that an appropriate rate for simulcasting would be a "discount" and a "subsidy." SX PFF Heading X.C. & ¶¶ 936-37. A rate appropriate for simulcasting would be neither. It would, rather, be a recognition that willing buyers and willing sellers in an effectively competitive market would approach simulcasting differently than they approach other types of webcasting. As Aaron Harrison testified:

> Q. So the way the rate is affected is that the higher the level of interactivity, the higher the rate, right?
>
> A. That's right.
>
> Q. And the lower the level of interactivity, the lower the rate, right?
>
> A. Right.
>
> Q. And the reason for that is you think on-demand or higher levels of interactivity are more substitutional than less on-demand, correct?
>
> A. Correct.
>
> Q. And, in fact, if you were to rank streaming services from least substitutional to most, the order would be simulcast, then custom, then on-demand, correct?
>
> A. Yes.
>
> Q. So simulcast is the least substitutional, right?
>
> A. Right.

4/30/15 Tr. 1101:7-35 (Harrison).

137. SoundExchange's "discount" rhetoric is reminiscent of the rhetoric employed for a short time by SoundExchange's expert Dr. David Blackburn:

> JUDGE STRICKLER: When you say "Pandora pays a subsidized rate," in what sense is it a subsidy?
>
> THE WITNESS: I mean, I just mean that in shorthand for being a lower rate than other webcasters pay.
>
> JUDGE STRICKLER: It's not meant to connote a subsidy. It may be that the other webcasters were paying the statutory rate or paying a rate that's inflated. It begs the question as to which rate is a subsidy rate, which is an inflated rate, and how the two compare.
>
> THE WITNESS: Right. So it would probably be more accurate for me to say it's subsidized relative to the other competitors. The point is it's a lower rate relative to the other competitors, absolutely.
>
> JUDGE STRICKLER: It might actually be the simplest way to just say it's a lower rate rather than a higher rate.
>
> THE WITNESS: Yes, absolutely, sure.

5/4/15 Tr. 1582:21-1583:16 (Blackburn). SoundExchange's use of the words "discount" and "subsidy" to describe a separate rate that is appropriate for simulcasting has no more probative force than Dr. Blackburn's brief use of the term "subsidy."

138. SoundExchange argues that NAB failed to present evidence that a rational record company would price a license to simulcasters in a way that recognized the limited revenue earned by simulcasting. SX PFF ¶ 937. But that argument ignores the substantial evidence presented by NAB that in an effectively competitive market, prices charged by rational sellers would tend toward the seller's costs and that simulcasting imposes low, if not negative, opportunity costs. NAB PFF Part VI.B.2. The rate sought by NAB is not a subsidy; it is a competitive market rate.

139. SoundExchange quotes Professor Rubinfeld to the effect that NAB offered no evidence that demand elasticities are different for simulcasting and other webcasting

services. SX PFF ¶ 934. It is, of course, highly ironic that Professor Rubinfeld claims that evidence of demand elasticities is "essential," as he, himself, did not present evidence of demand elasticities, despite the fact that he based the critical assumption of his interactive benchmark (that the ratio of license fees to subscription prices would be the same for interactive and noninteractive services) on the requirement that the demand elasticities for the two services would be the same. *See* NAB PFF ¶ 359.

140. Moreover, contrary to SoundExchange's claim, Professor Rubinfeld himself testified that elasticities of demand "may vary substantially not only among individuals, but also across a range of services preferred by those individuals," would "reflect differences in the technical features of the services as well as their business models," Rubinfeld CWDT ¶ 110, and that that "the elasticity of demand per service offered by the NAB, a simulcast service may be different than the elasticity of demand for a Pandora product because they offer different functionality." Katz AWRT ¶ 47 & n.64 (quoting Rubinfeld Dep. Tr. at 165).

141. SoundExchange also argues that NAB presented no evidence that that different users would listen to a simulcast over a different webcasting service, SX PFF ¶ 934, but that, too, is false. NAB's witnesses testified that, due to the nature of local radio, simulcasters appeal to users who want something other than a music service. *See, e.g.*, Newberry WDT ¶ 11 ("People listen because of [the] connection [to the community]. . . . Music is just part of what we offer; it is not the only thing. There are plenty of places for people to get music, if that is what they want."); *see* NAB PFF Part III.A.

3. NAB Has Narrowed Its Proposed Definition of Simulcasting.

142. SoundExchange argues that the services' proposed definitions of simulcasting in their rates and terms (which is called "Broadcast Retransmissions" in NAB's Proposed Rates and Terms) would allow greater customization and variation over the course of the rate period. SX PFF ¶¶ 922-29. Most of SoundExchange's argument is focused on iHeart's definition of simulcasting. NAB leaves the arguments concerning that definition to iHeart.

143. The only aspect of NAB's original proposed definition of "Broadcast Retransmission" that SoundExchange identifies as a cause for concern is the fourth exception clause of the definition, which allowed for "occasional" programming substitutions that "did not change the character of the content of the transmission." *See* SX PFF ¶ 929. This exception was intended to be a narrow exception that would have allowed broadcasters limited flexibility where circumstances warranted.

144. In order to avoid any controversy, NAB has already revised its proposed definition of "Broadcast Retransmissions" to address these concerns by removing the challenged fourth exception clause. *See* NAB Proposed Rates and Terms § 380.11 (June 19, 2015) (submitted with NAB's Proposed Findings of Fact and Conclusions of Law).

145. SoundExchange also argues that "nothing technically prevents simulcasters from customizing each individual stream." SX PFF ¶ 929. But that is not what simulcasters do or plan to do. As John Dimick testified, such customization is not done: "There's no way for the user to customize our stream. You either start it, or you stop it. But that's about the only thing that you can do. ... And it's very much a one-point-to-many-point sort of system. There's no way to customize what it is that we do or

for a listener – an individual to customize anything." 5/26/15 Tr. 5799:19-5801:5 (Dimick).

146. NAB did not intend its definition of "Broadcast Retransmissions" to permit customization of sound recordings. To avoid any controversy about customization, NAB has also already amended its proposed definition of "Broadcast Simulcast" to make clear that the sound recordings contained on simulcasts are the same for all listeners – they are not customized. *See id.*; NAB Proposed Rates and Terms § 380.11 (June 19, 2015) (submitted with NAB's Proposed Findings of Fact and Conclusions of Law).

147. As NAB discussed in its Proposed Findings of Fact, a simulcast (*i.e.*, a "Broadcast Retransmission") is intended to be essentially the same programming as the over-the-air transmission of a terrestrial broadcaster. NAB PFF Part III.A. The remaining exceptions proposed by NAB are limited and reasonable and have not been challenged by SoundExchange. *See* NAB PFF ¶¶ 609-14.

4. SoundExchange Overstates the Librarian's Determination in Web I, Which Was a Factual Determination Based Solely on the Record of that Case and Did Not Generally Reject Separate Rates for Simulcasting and Internet-Only Webcasting.

148. SoundExchange asserts that the Librarian in *Web I* "found no rational basis for setting different rates for Internet-only webcasters and broadcast simulcasters" (SX PFF ¶ 38), implying that the Librarian established a general principle that simulcast and Internet-only webcasting rates should be the same. He did no such thing. Rather, the Librarian's decision made a record-specific fact finding limited to that proceeding regarding the parties' valuation of the single agreement upon which the CARP and Librarian based their rate determination.

149. In *Web I*, the CARP based its rate determination on a single agreement entered into between RIAA and Yahoo!. *Web I*, 67 Fed. Reg. at 45251-55. That agreement included a bifurcated rate structure under which "[o]ne rate was set for performances in radio retransmissions (RR) (0.05¢ [$0.0005] per performance) and another rate was set for transmissions in Internet-only (IO) programming (0.2¢ [$0.0020] per performance)." *Id.* at 45251. The CARP found that "Yahoo!'s only aim in the negotiation process was to achieve a rate that translated into an acceptable overall level of payment," but it nonetheless used an adjusted version of these separate rates to set a separate, lower, rate for simulcasters than for Internet-only webcasters. *Id.*

150. On review, the Librarian (adopting the recommendation of the Register of Copyrights) "accept[ed] the CARP's conclusion that the differential rate structure was developed to effectuate particular objectives of the parties, distinct and apart from establishing an actual valuation of the performances," observing that "the record evidence supports this finding." *Id.* at 45252. It determined that:

> a careful review of the record support's [sic] the Panel's further finding that in effect, <u>the real agreement between Yahoo! and RIAA was for a single, unitary rate for the digital performance of a sound recording and not the two separate rates set forth in the agreement</u> – rates, which the Panel found were artificially high (for IO transmissions) and low (for RR).

Id. (emphasis added). The Librarian concluded that the Yahoo! agreement should not be construed as establishing distinct valuations for the two types of services and, therefore, set a unitary rate for both Internet-only and simulcast transmissions based on the overall effective rate under the RIAA-Yahoo! agreement. *See id.* at 45255; *see also id.* at 45253 ("[T]he 'effective rate' achieved through the unique rate structure represents the value

these parties placed on the performance of a sound recording, without regard to origin of or the entity making the transmission.").

151. In other words, the Librarian's decision in *Web I* to set a unitary rate for Internet-only and simulcast transmissions was based on the factual construction of the single agreement in the record of that case on which the CARP had based its rate determination. It did not represent an overarching determination that it is *per se* inappropriate to set different rates for simulcast services than for Internet-only services. The *Web I* conclusion has no significance for this proceeding in which there is robust record evidence supporting such a distinction.

5. <u>SoundExchange's "Cost Recovery" Argument is Unsupported.</u>

152. SoundExchange argues that its rate proposal should be favored because it "allows the record labels to recover their fixed costs." SX PFF Heading VII.F & ¶ 496 ("'[t]he interactive service agreements are a proper benchmark for another reason – their economics allow record labels to recover their recurring fixed costs"). SoundExchange also criticizes Professors Shapiro and Katz because their economic analysis "does not take into account the recording industry's fixed, recurring costs." *Id.*

153. SoundExchange's argument in this regard cannot be accepted, because there is no evidence from which the Judges can ascertain what rates would be necessary to allow the labels to cover the alleged "fixed, recurring costs." While SoundExchange claims that the labels' costs "are described in greater detail, *infra* [sic] Section IV," (SX PFF ¶ 496), that section merely shows a hodgepodge of selected costs (mostly not fixed)

from selected labels from selected years.[5] The record contains no cost data even remotely comprehensive enough to determine what rate (if any) would be necessary to enable the labels to recover their fixed costs; there also is no basis for SoundExchange to claim that NAB's proposed rate would be insufficient to allow the labels to recover legitimate costs.

154. Obviously, given the labels' participation in this case, SoundExchange, as their representative, could have presented such data, but chose not to. Under established law, it is therefore proper to presume that the unproduced evidence would be adverse to SoundExchange: "when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him." *Int'l Union v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972).[6]

155. Even apart from SoundExchange's failure to provide evidence and the resulting presumption, it is clear that an analysis based on cost recovery would have been unfavorable to SoundExchange. Although SoundExchange fought to keep the evidence out, the record now shows that, on an enterprise level, the labels are profitable and are doing far better than merely recovering their fixed costs. *See* NAB PFF ¶¶ 166-68 (citing

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[5] As it did in its direct case presentation, SoundExchange's proposed findings note selected expenses for selected labels. *See, e.g.,* SX PFF ¶¶ 187 (Universal spend on advances and write-offs), 188 (Sony expenditures on talent and recordings), 195 ("pre-release costs"), 202 (gross marketing costs for Universal), 203 (selling and marketing for Sony), 206 (IT infrastructure), 207 (manufacturing and distribution for physical products for a subset of Universal labels), 208 (digital and physical distribution for Sony).

[6] It is also worth noting that, notwithstanding the arguments being asserted now in Paragraphs 496-99 of SoundExchange's Proposed Findings, its witnesses [[ ]]

record evidence showing profitability).[7] In view of this evidence, and the evidence that streaming services are consistently unprofitable, SoundExchange's claim that "[d]igital streaming services can play the hits, without fretting over the losses incurred because of the misses" (SX PFF ¶ 216) is particularly disingenuous; the record evidence demonstrates unequivocally that, over the last decade, the side "fretting over the losses" consistently has been the services, not the labels.

6. SoundExchange's Additional Arguments Are Without Merit.

156. SoundExchange argues that an appropriate rate for simulcasting might discourage innovation (SX PFF ¶¶ 930-31), but the record is devoid of any evidence about the magnitude or effect of any such theoretical incentive, particularly when weighed against other incentives, including potential revenue increases. SoundExchange relies entirely on Professor Katz in support of its argument,[8] but Professor Katz said only that in evaluating innovation, a simulcaster would take rates into account "if you were rational" and "if such an innovation existed." 5/26/15 Tr. 5746:4-11 (Katz). Moreover, SoundExchange ignores Mr. Newberry's testimony that it is high rates for simulcasting, not the prospect of low rates, that have stymied innovation. *See* Newberry 5/20/15 Tr. 5109:22-5110:1 ("Q: Do you expect that innovation to continue into the next five years? A. I would like to see it continued. But unfortunately, the rate structure now is crippling a lot of that opportunity for innovation.").

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[7] SoundExchange ignores this evidence of profitability, instead noting declining revenues and job cuts. *See* SX PFF ¶¶ 234-35.

[8] SoundExchange also cites paragraph 211 of Professor Rubinfeld's CWRT, but that paragraph says nothing about incentives to innovate.

157. SoundExchange also claims that a specific rate for simulcasting would "invite gamesmanship," suggesting that webcasters would flock to owning radio stations in order to qualify its streams as simulcasts. *See* SX PFF ¶¶ 1331, 1333. But that is speculative fantasy. Owning radio stations is an expensive business – and there are only so many radio stations. SoundExchange can point to no evidence that it would make any sense for a webcaster to incur the costs of radio station ownership to save sound recording royalties.[9] Moreover, there is no evidence in the record suggesting that a custom radio service with even a few hundred, much less thousands, of separate streams could convert those streams into simulcasts, even if it were able to own a few radio stations. In any event, NAB proposes defining simulcasting to exclude any customization, so this argument is a red herring. NAB PFF ¶¶ 609-611. The speculation that a separate simulcast rate will cause non-customized webcasters to clamor for radio stations is no basis for ignoring the clear evidence in the record that simulcasting should have a separate rate.

158. Finally, SoundExchange's argument that NAB did not "compare[] the rate proposed for simulcasters to the rate proposed for full DMCA functionality," SX PFF ¶ 897, is beside the point. NAB offered extensive support for its proposed rate for simulcasting. NAB PFF Part VI. NAB also presented extensive testimony demonstrating differences between simulcasting and other forms of webcasting that are directly relevant

[9] SoundExchange points to a paragraph in Professor Rubinfeld's CWRT that cites a footnote in Professor Fischel and Lichtman's Written Direct Statement for the proposition that iHeartMedia converted "its webcast stations to simulcast stations" for the purpose of minimizing costs, but the cited footnote does not support so broad a statement – it says only that Professor Fischel and Lichtman understood that "some' non-custom webcasts had been converted to HD simulcasts (without stating any reason), but that the total number of performances on such non-custom "is relatively low." SoundExchange cites no evidence that the conversion had a significant effect on royalties.

to the rate that should be set for simulcasting. NAB PFF Part III. No other comparison is required.

IV. SOUNDEXCHANGE'S PROPOSED FINDINGS OFFER NO LEGITIMATE ECONOMIC SUPPORT FOR ITS UNWORKABLE "GREATER-OF" FEE STRUCTURE.

159. In the Notice Announcing Commencement of Proceeding, the Judges invited participants to provide evidence regarding the "potential disadvantages of establishing a statutory royalty rate not based on a per performance royalty rate." Notice at 414. The Judges focused on how revenue is measured, the definition of revenue, and auditing and enforcement. *Id.* The Judges also posed the economic question of whether a percentage of revenue royalty would be "disproportionate to webcasters' use of sound recordings." *Id.*

160. Many of the concerns that animated the Judges' decision in *Web II* to reject a percentage of revenue royalty remain valid in this proceeding. The Judges found in *Web II* that "percentage-of-revenue models present measurement difficulties because identifying the relevant webcaster revenues can be complex, such as where the webcaster offers features unrelated to music." *Web II* at 24089. NAB has presented substantial evidence that those measurement difficulties are particularly acute for simulcasters, and that a percentage of revenue fee would require complex unbundling of broadcasters' "bundled" sales, determining the value of simulcasting advertising and apportioning revenue between broadcasters' heavily intertwined music and non-music programming. NAB PFF Part IX.C.2. The Judges in *Web II* also observed that a percentage-of-revenue fee "demand[s] a clear definition of revenue so as to properly relate the fee to the value of the rights being provided." *Id.* NAB has shown that SoundExchange's definition of

revenue is grossly over inclusive and vague. NAB PFF Part IX.C. Indeed, SoundExchange's own witnesses could not explain [[ ]]. NAB PFF ¶ 569 (citing 5/7/15 Tr. 2518:23-2520:25 (Wilcox)). The Judges in *Web II* also found that, even for music formatted programs, the broadcasters had made a showing that other factors, such as on-air talent, impact revenue, which diminishes the tie between a percentage of revenue fee and the use of the licensed sound recordings. *Web II at 24089*. NAB has presented substantial evidence on this point as well, demonstrating the value of on-air talent and other programming and factors to broadcaster success. NAB PFF Part III.A. Last, the Judges determined that, in the audit context, a revenue driven royalty "will give rise to additional, different issues of interpretation and controversy related to how revenues are defined or allocated." This is confirmed by both Professor Weil's and Professor Lys's concerns regarding definitions of revenue. NAB PFF Part IX.C.2.a.

161. In its Proposed Findings of Fact and Conclusions of Law, NAB responded in detail to SoundExchange's "greater-of" proposal, addressing each of the issues identified by the Judges in the Notice of Commencement. NAB PFF Part IX; ¶¶ 551-606. NAB demonstrated that, with respect to simulcasts, the "greater-of" structure is unprecedented, unworkable, and unsound. SoundExchange's proposed findings offer little in response to the economic issues identified by the Judges. Indeed, SoundExchange relies on inapplicable agreements, fails to account for record label market power, and asks the Judges to establish an unreasonable risk allocation. Moreover, SoundExchange completely misses the point regarding the practical

workability for simulcasters of a percentage of revenue fee structure. SoundExchange's approach:

- Creates a "heads I win, tails you lose," situation in favor of the record labels by coupling a confiscatory per play rate with an extortionate percentage of revenue;
- Overreaches by appropriating a share of revenue generated by non-music related content created by simulcasters, thereby failing to comply with the statutory mandate to base fees on the relative contributions of the parties;
- Functions as a tax, creating a disincentive for innovation by imposing higher license fees on simulcasters that are better able to generate value from the licensed sound recordings and providing SoundExchange with a share of "upside" that results from the efforts of the simulcaster rather than from the intrinsic value of the licensed music;
- Applies its proposed percentage fee to revenue and not profits, thereby further disincentivizing innovation and potentially providing record labels with a share of "upside" revenue that could actually accompany a "downside" in profits for the services;
- Is unprecedented for simulcasting; and
- Is unworkable and not administrable.

These issues are detailed in NAB's Proposed Findings of Fact and further below.

A. THERE IS NO REVEALED MARKET PREFERENCE FOR A "GREATER-OF" FEE STRUCTURE FOR SIMULCASTING.

162. SoundExchange asserts that there is a "widespread revealed market preference" for a "greater-of" royalty structure. SX PFF Part VII.A.I. NAB's Proposed Findings of Fact demonstrate that there is no revealed market preference for a "greater-of" structure for simulcasting. NAB PFF Part IX.E. SoundExchange's Proposed Findings confirm NAB's showing.

163. Most obviously, all of the agreements identified by SoundExchange that involve a party that engages in simulcasting (SX PFF ¶¶ 327-28) reflect that [[ ]].

- iHeartMedia – Warner Agreement: [[ ]]; and
- iHeartMedia Independent Label Agreements: [ ] NAB PFF ¶ 605 (citing to Fischel & Lichtman AWDT ¶ 85).

164. Indeed, not only is it clear that [[ ]] Moreover, iHeartMedia has shown, if anything, that [[ ]] IHM PFF ¶ 344 ([[ ]]); NAB PFF ¶ 606.

165. None of the other agreements relied upon by SoundExchange has anything to do with simulcasting. In short, [[ ]]

B. MORE GENERALLY, THERE IS NOT A "REVEALED MARKET PREFERENCE" FOR A "GREATER-OF" FEE STRUCTURE FOR NONINTERACTIVE WEBCASTING.

166. As is true throughout its proposed findings, SoundExchange largely ignores simulcasting and focuses its discussion on custom radio services. SoundExchange asserts that there is a "revealed preference" for a greater-of fee structure

for custom radio. SX PFF ¶¶ 320-31. Even here, its argument is dramatically overstated.

167. SoundExchange relies, of course, on the interactive agreements that formed its primary benchmark. SX PFF ¶¶ 320-24. But those are the direct result of the market power wielded by the record labels—discussed at length in Part VI.A, below. *See also* NAB PFF Part VIII.A.1. The resulting "heads I win, tails you lose" fee structure sheds no light on the preferences of the parties in an effectively competitive market. Moreover, many of the interactive service agreements relied upon by SoundExchange do not contain both per-play and percentage-of-revenue prongs—19 of 45 major-label contracts examined by Professor Rubinfeld have no per-play royalty prong. Katz AWRT ¶ 143; *see also* Fischel & Lichtman WRT ¶ 107.

168. SoundExchange also relies upon the Apple agreements with Sony and Warner, the iHeartMedia agreements with Warner and the indie labels, agreements between the major labels and Nokia (MixRadio) and Rhapsody (unRadio) agreements with the major record labels, and the Pandora-Merlin agreement. SX PFF ¶¶ 326-31. The facts and circumstances of these agreements show that they do not provide meaningful evidence of a revealed preference.

169. Apple iTunes Radio. SoundExchange relies on the Apple iTunes Radio agreements with Warner and Sony. SX PFF ¶ 326. [[

]]

170. iHeartMedia-Warner and iHeartMedia-Indie Labels. There is substantial evidence that [[

]]

171. Pandora-Merlin: The Pandora-Merlin Agreement similarly does not reveal an economically meaningful market preference. [[

]] Further confirming that the fee structure of the Pandora-Merlin agreement does not reflect the functioning of a free market, the [[

[redacted]]] *See* NAB PFF ¶¶ 218, 603. Similarly, while Pandora is proposing such a structure in this proceeding, that proposal is a direct result of the [[[redacted]]]

172. Nokia MixRadio and Rhapsody unRadio: For many of the reasons that these agreements do not corroborate SX's fee proposal (*see* NAB PFF Parts VIII.E.2-3), they do not support a greater-of formula. [[[redacted]]] NAB PFF ¶¶ 515-18, 525-527. Thus, the record labels were able to exert their full market power. Like the interactive service agreements themselves, these agreements are not valid indicia of revealed preference in an effectively competitive market. Further, as Professor Katz discussed, [[[redacted]]] *See* NAB PFF ¶¶ 510-22 (citing Katz AWRT ¶ 248).

173. In sum, there is no economically meaningful revealed preference for a greater-of fee structure even for custom radio. There is no evidence whatsoever to support such a structure for simulcasting. *See, e.g.*, Fischel & Lichtman AWDT ¶ 85. Thus, there is no basis for the Judges to adopt a greater-of royalty structure for simulcasting.

C. SOUNDEXCHANGE'S POSITION THAT ITS "GREATER-OF" STRUCTURE BENEFITS LICENSEES IS ECONOMICALLY UNSOUND.

174. SoundExchange asserts that a greater-of royalty structure will benefit all parties, including the services. The alleged "benefit" conferred upon the services is that there will be a "lower" applicable per play rate. SX PFF ¶ 377.

175. Of course, if SoundExchange were correct that addition of the percentage of revenue fee should result in a lower per performance fee than would otherwise be imposed, SoundExchange should be proposing a reduction in the current per performance fee, which is not coupled with a percentage of revenue fee, not the 20+% increase that it is proposing. SoundExchange cannot have it both ways.

176. The absurdity of SoundExchange's position is highlighted by its claim that, absent a percentage of revenue component, its proposed per-play rate would be higher. SX PFF ¶¶ 341-345. SoundExchange doesn't stop there – it goes on to say just how much higher: a breathtaking $0.004653 per performance. SX PFF ¶ 344. In other words, SoundExchange asserts that the current statutory per-play rate (that is not part of a greater-of formula) is half what Professor Rubinfeld's interactive service benchmark says it should be.

177. Notably, the current rates were, themselves, the result of prior interactive service benchmark analyses presented by SoundExchange in *Web II* (which directly influenced the WSA agreements) and *Web III*. SoundExchange's contention that they are half what they should now be only underscores the inconsistency of that benchmark and the invalidity of SoundExchange's benchmark analysis in this case.

178. Contrary to SoundExchange's position, the evidence demonstrates that the existing per performance rates are already exceptionally high and greatly exceed the fees that would exist in an effectively competitive market. This is particularly true for simulcasting. *See* NAB PFF Part IV.A-C. SoundExchange's argument that without a percentage of revenue fee the rates would be even higher does not withstand even casual scrutiny.

179. Second, the "greater-of" royalty structure misallocates risk "by creating a structure in which the streaming service bears almost all of the risk and the record company is largely insulated from downside risk while sharing in upside benefits for which it has little responsibility." Katz AWRT ¶ 140. Although SoundExchange argues that the record labels should share in the "upside," it has offered "no economic justification for rewarding record companies for the incremental value created by webcasters given that, by definition, the incremental value is that created by the webcaster above and beyond that created directly by the music itself." Katz AWRT ¶ 148. The increased revenues or profits realized by a webcaster will be because that webcasters has been successful in competing with other webcasters, which success will be inherently driven by factors other than the music played, as all of the webcasters have access to the same music. The risk, which is borne by the webcaster, all stems from the webcaster's ability to execute its chosen business model. Katz AWRT ¶ 149. The Judges previously recognized this problem in *Web II*, finding that revenue can derive value from many sources "that have nothing to do with music." *Web II* at 24089.

180. SoundExchange's assertion, SX PFF ¶ 353, that there is an inherent risk asymmetry that is unfavorable to the labels strains credulity. The only "risk" to the label

is that its product will be used – for which it would be fully compensated through the per performance rate. Most sellers view that as a benefit. Only the recording industry appears to view that as a "risk." The absurdity of the position is particularly acute in the case of simulcasting, where SoundExchange has presented no evidence of any opportunity cost.

181. Conversely, the risk to a service from an unreasonably high rate is that it goes out of business and loses its entire investment. That is a far greater risk than any the record companies face from the statutory license – as demonstrated by the overflowing graveyard of statutory services that have not been able to survive in the face of the statutory license. *See* NAB PFF ¶ 153; Pakman WDT ¶¶ 19-26. There is, indeed, a risk asymmetry. But the asymmetry is that the risk to the services is far, far greater than any risk to a record company.

182. Third, SoundExchange's proposed structure fails to account for non-music content as part of the Applicable Revenue definition by not excluding any revenue derived from non-music programming from its all overbroad definition of revenue. *See* NAB PFF ¶¶ 559-61. Substantial evidence, including testimony from SoundExchange's own witnesses, was presented at the hearing that reveals this fundamental flaw:

- Professor Rubinfeld "presumed" that the percentage of revenue would be applied to <u>only the music portion</u> of the programming. 5/6/15 Tr. 2056:16-2057:2 (Rubinfeld) (emphasis added);
- Mr. Wilcox's testimony suggests that [[ ]] 5/7/15 Tr. 2518:23-2520:25 (Wilcox); NAB PFF ¶ 569;

- Professor Lys also agreed that "if there's no music played on [a] show, then it stands to reason that the revenue allocated to that – of that show should not be allocated to attributable revenue." 5/4/15 Tr. 1520:2-8 (Lys);

- Jon D. Pedersen, iHeartMedia's Chief Financial Officer provided testimony that SoundExchange's percentage of revenue fee "ignores the non-music components of iHeartMedia's simulcast service by treating all simulcast revenues as subject to its revenue share." Pedersen WRT ¶ 15; 5/14/15 Tr. 3681:9-3682:11 (Pederson) (testifying that it would be "impossible for me to try to determine" how much of the revenue on one of iHeartMedia's popular radio shows (the Ryan Seacrest show) results from the music versus the on-air talent); and

- "[I]t would be logical to account for the fact that non-music programming may draw listeners and result in advertising revenue and, therefore, revenue attributable to the percentage of revenue analysis should exclude revenue attributable to non-music programming." Weil WRT at 8. But SoundExchange's percentage of revenue proposal contains no adjustment for the fact that not all of the programming on music-formatted stations, and their simulcasts, is music. Weil WRT at 6; 5/14/15 Tr. 3930:17-3931:5 (Weil); NAB PFF ¶¶ 563-64.

SoundExchange does not address this fundamental problem in its Proposed Findings of Fact and despite the substantial evidence presented on this point, SoundExchange did not alter its definition of "revenue" or otherwise account for the deficiency in its Proposed Rates and Terms. *See* SX PFF ¶ 341 (reflecting that SoundExchange's maintains its October 7, 2014 Proposed Rates and Terms). It is SoundExchange's burden to propose a fee structure that is reasonable and workable. It has failed to do so, despite a clearly identified, important, and conceded problem. This failure alone should result in the Judges' dismissing SoundExchange's percentage of revenue fee for simulcasting.

183. The deficiency in SoundExchange's revenue definition applicable to non-music programming highlights a key difference between simulcasters and other webcasters, and demonstrates how simulcasters are further disadvantaged by SoundExchange's proposed greater-of structure.

184. Fourth, SoundExchange's proposal remains fundamentally flawed as SoundExchange is seeking a percentage of "revenues" and not profits. Far from a "benefit," this fact both disadvantages and disincentivizes simulcasters, and potentially rewards SoundExchange when there has actually been no "upside." NAB PFF ¶ 598 (explaining that a webcaster that undertook costly investment that turned out to succeed in raising its revenues, but not by as much as the cost of the investment, would simultaneously see its profits fall and its royalty payment rise). Katz AWRT ¶ 150.

D. SOUNDEXCHANGE'S PROPOSED PERCENTAGE OF REVENUE FEE IS UNSUPPORTED AND UNWORKABLE FOR SIMULCASTING.

185. On top of the economic flaws, a percentage of revenue fee has been shown to be unworkable for simulcasters on a practical level. Aside from SoundExchange's definition of "Attributable Revenue" being highly over-inclusive and failing to take into account standard deductions (NAB PFF Part IX.C.1), it is also not implementable for simulcasters (NAB PFF Part IX.C.2).

186. SoundExchange offers thin evidence in support of the appropriateness of its definition of "Attributable Revenue." SX PFF ¶¶ 431-39. Aside from broad statements that "accountants are "trained" to allocate and that it is "common" for companies to allocate bundled revenue (SX PFF ¶ 435), SoundExchange appears to respond to Professor Weil by saying only that SoundExchange's proposal requires that a service's method of allocation be a "reasonable method, employed in good faith." SX PFF ¶ 438.

187. But SoundExchange's Proposed Findings of Fact gloss over the important issues raised by NAB and other services regarding the practical effects of

SoundExchange's proposal. The appropriate question is not whether accountants are trained to allocate or whether companies allocate revenue in other contexts, but rather whether the guidance provided is sufficiently clear that simulcasters will be able to do so in a manner that all parties will agree is correct (without further disputes). When viewed in that way, and given the evidence put forth by the Services, the percentage of revenue proposal should be rejected.

188. SoundExchange's own expert accounting witness provided instructive testimony on this point in this and prior Copyright Royalty Board proceedings. Indeed, Professor Lys has testified that in order to minimize disputes, "tailored" agreements that capture the business model of the service are needed. NAB PFF ¶ 574 (citing Lys CWDT ¶ 61). Definitions for important terms like "Revenue" need to be "clear cut to administer and easy to audit." *Id.* (citing 5/29/15 Tr. 6726:3-15 (Lys)); *see also* Wilcox WDT at 13-14. This type of tailoring to specific circumstances is exactly the opposite of a broad industry wide definition of "Attributable Revenue" that SoundExchange now seeks to impose.

189. SoundExchange's definition of revenue has been shown to contain a host of decision points that require interpretation and therefore will create controversy. *See, e.g.*, NAB PFF ¶ 576. As Professor Lys agreed, each party will interpret the regulations to its own advantage. NAB PFF ¶ 578 (citing 5/29/15 Tr. 6725:22-6726:1 (Lys)). Such interpretive discretion will not work in the real world. As Professor Lys also testified, "where a revenue definition is open to multiple interpretations . . . the definition is <u>virtually certain to be deficient from an accounting and auditing perspective</u>." 5/29/15 Tr. 6726:16-6728:1 (Lys) (emphasis added); *see also* 5/14/15 Tr. 3680:10-3682:11

(Pederson) (testifying that "SoundExchange's fair method of allocation proposal allows for wide interpretation of how to actually allocate revenue between sources. If you – there are no hard and fast rules governing how that would happen . . . . if you took ten reasonable people and have them try to do this, you'd come up with ten different results. . . . [I]if there's lots of interpretation and gray area, I'm trying to actually come up with a result that is predictable, understandable across the industry and how to be auditable . . . to me, I think it is just completely impractical.")

190. Professor Weil's testimony confirms these points. There is no "uniquely correct" way to allocate. NAB PFF ¶ 577. While any service "can" make an allocation of revenue, if there is ambiguity in the applicable definitions that guide such allocations—which there clearly are in SoundExchange's proposed definition—disputes will invariably follow. NAB PFF Part IX.C.2.

191. With respect to the measurement of revenue, lack of clarity in SoundExchange's proposed definition of revenue, and the resulting auditing difficulties, SoundExchange's Findings fails to address several important points made by Professor Weil and other witnesses:

- Broadcasters obtain the vast majority of their revenue from advertising, which is sold in bundles, and allocation of revenue from these bundled sales to simulcasting operations is not a process that is currently undertaken by simulcasters (NAB PFF ¶¶ 581, 583);
- Simulcasters are under no present accounting standard requirement to allocate their revenue (NAB PFF ¶ 583);
- Most, if not all, simulcasters lack the simulcasting revenue data necessary to allocate under traditional GAAP principles (*see* NAB PFF ¶ 585);
- The hundreds of broadcasters will have different levels of sophistication and differing business models, making the application of a one-size-fits all regime problematic (NAB PFF ¶¶ 584-87);

- SoundExchange's revenue proposal provides no guidance other than "Fair Method of Allocation," which is not a GAAP term nor an accepted industry term (NAB PFF ¶ 588);
- SoundExchange has not offered any methodology for how to allocate between over-the-air revenue and simulcasting revenue for commercials that are played on both (NAB PFF ¶ 589); and
- SoundExchange's own witnesses have acknowledged the difficulties in allocation (NAB PFF ¶¶ 569, 590-91).

Thus, SoundExchange has fallen far short of supporting the viability of its percentage of revenue royalty as applicable to simulcasters.

V. SOUNDEXCHANGE'S THEORIES REGARDING THE PROFITABILITY OF SIMULCASTING AND WEBCASTING DISTORT BOTH THE EVIDENCE AND THE WILLING BUYER-WILLING SELLER STANDARD ITSELF.

192. NAB demonstrated in its Proposed Findings that simulcasting has not been, is not currently, and is not expected to be in the near future, a profitable enterprise for broadcasters. NAB PFF Part IV.A. Broadcasters testified to their inability to convince advertisers of the independent value of simulcast advertising, and the record labels have acknowledged these marketplace challenges. *Id.* Parts IV.A-B. Broadcasters further testified that their simulcasting expenses, the largest of which are SoundExchange royalties, exceed their simulcasting revenue. NAB PFF ¶¶ 123, 128, 131-32. The conditions simply are not present for broadcasters to increase their simulcasting revenue, and broadcasters do not foresee those conditions changing in the near future. NAB PFF ¶¶ 129, 132. The testifying broadcasters, who have extensive and lengthy experience in the industry, also do not foresee a change in the viability and profitability of simulcasting without a material decrease in the SoundExchange royalties. NAB PFF ¶ 129; Downs WDT ¶¶ 2, 23.

193. NAB also demonstrated that the financial picture is similarly bleak for webcasters more generally. NAB PFF Part V. The evidence did not reveal a single profitable webcaster – a marketplace reality that even SoundExchange's own witnesses concedes. *See* NAB PFF ¶¶ 151, 158-64. Webcasters' unprofitability extends even to Pandora, which pays rates that are approximately 45% less than the CRB-set commercial rates yet still has never had a profitable year. *See* NAB PFF Part V.A.2. Investors are unwilling to invest in webcasting businesses. *See* NAB PFF ¶¶ 155-57. And by far the biggest reason for this pervasive unprofitability is the sound recording performance rates, which constitute webcasters' single largest cost. *See* NAB PFF ¶¶ 153-54.

194. SoundExchange attempts to sidestep the evidence of such unhealthy simulcasting and webcasting financials by:

- pointing to listener growth on statutory services without differentiating among those services that are actually experiencing growth;
- arguing that despite a long track record of webcaster unprofitability spanning over 15 years, the Judges should instead focus on the elusive concept of "future" profits;
- suggesting that it would be appropriate to set a willing buyer-willing seller rate that is so inflated that only large companies with multiple businesses in a position to subsidize unprofitable webcasting businesses are able to pay it rather than a rate that most businesses primarily or exclusively focused on webcasting would be willing to accept; and
- asserting that its rate proposal is "affordable" for these struggling simulcasters and webcasters regardless of whether that proposal is what these entities would agree to with record labels in an effectively competitive market.

As demonstrated below, each of these assertions is without merit.

A. DR. BLACKBURN'S WEBCASTING GROWTH AND SURVIVAL RATES SAY NOTHING ABOUT AN EFFECTIVELY COMPETITIVE RATE, DO NOT DIFFERENTIATE AMONG LICENSE TYPES, AND ARE MUCH LOWER FOR ENTITIES PAYING CRB-SET COMMERCIAL RATES.

195. SoundExchange points to the testimony of its economic witness, Dr. Blackburn, to attempt to show that despite the inability of simulcasters and webcasters to run a profitable business under the current rates, those rates are nonetheless acceptable because there purportedly has been market entry and survival at those royalty levels. *See* SX PFF XIV.E. As Dr. Peterson testified, however, this claim is wrong.

196. To begin with, Dr. Blackburn did not establish what levels of growth and survival would exist in an effectively competitive market against which to compare his numbers. As Dr. Peterson testified regarding Dr. Blackburn's counts:

> A. Well, first, with regard to entry count, survival and so forth, I don't find that analysis to be informative at all, because what it shows is that there is some entry and that Webcasters that enter survive for some period of time, but that would be the case whether rates – whether the rates that those Webcasters pay for the performance of sound recordings were set at monopoly levels or were set at competitive levels.
>
> So that analysis just doesn't tell us anything informative about the rates that the Webcasters are paying.

5/14/15 Tr. 3876:20-3877:11 (Peterson); *see also* Peterson WRT ¶¶ 17, 27-28.

197. Dr. Blackburn's numbers aggregated all of the various webcasting license types, paying under a range of dramatically different rates, so no inferences can be drawn from his numbers. When Dr. Peterson was asked whether "Dr. Blackburn looked at the right data for his analysis," he responded:

> A. No. Dr. Blackburn looked at all of the Webcasters together in his analysis, but the question that we have is whether there is a difference in performance of Webcasters when they pay different rates, so when we look at Webcasters who are paying rates that are at or near the CRB

> commercial rate, we actually find different results. Particularly with regard to survival, we find that the Webcasters paying the higher rates survive at a significantly lower rate or fail at a higher rate.

5/14/15 Tr. 3877:12-23 (Peterson) (emphasis added); *see also* Peterson WRT ¶¶ 18, 20-21, 23-26, 29-34.

198. SoundExchange claims that the CRB-set commercial survival rates "are in line with the survival rates for all webcasters," but this is wrong. SX PFF ¶ 1245. Dr. Blackburn himself admitted that for webcasters entering the market in 2006, the survival rate as of 2013 for webcasters paying the CRB-set commercial rates was about 40% lower than the undifferentiated survival rate of all webcasters:

> Q And the survival rate of the blue line webcasters, which is all webcasters, is about – I'll use a relative number rather than a number from this chart – it's about 40 percent higher than the red line commercial CRB webcasters. Does that look about right?
>
> A Something like that, sure.

5/4/15 Tr. 1709:3-1710:14 (Blackburn). Merely because survival rates necessarily converge at 100% when there has been no time for a webcaster to fail does not mean that the material lower survival rates of webcasters paying CRB-set commercial rates are "in line with" webcasters paying much lower rates.

199. SoundExchange's reliance on webcaster market entry "counts" conflicts with SoundExchange's own position taken elsewhere in its Proposed Findings that it is the webcasting activity associated with those counts, rather than the counts themselves, that matter. Specifically, when opposing the Services' position regarding a proposed payment term, SoundExchange argued that "the relative number of agreements" that include that term is "irrelevant to the willing buyer/willing seller inquiry" and that what matters is the number of licensed performances represented by those agreements. *See* SX

PFF ¶ 1273. Here, however, SoundExchange presented no data regarding webcaster performances – only a headcount.

200. The reason why SoundExchange counted heads rather than performances in this instance is obvious: An analysis of actual performances, using constant dollar royalty payments over time as a proxy, reveals that performance growth overwhelmingly has been concentrated in a single category of webcasters not paying CRB-set commercial rates at all – pureplay webcasters. *See* Peterson WRT ¶ 33 & Fig. 5. Moreover, as NAB demonstrated in its Proposed Findings, online broadcaster performances have actually been flat. NAB PFF ¶ 146. And when iHeartMedia/Clear Channel performances (which include large numbers of custom radio performances) are excluded, broadcaster performances actually have declined significantly over the past five years. NAB PFF ¶ 147.

201. Figure 3 in Dr. Peterson's written rebuttal testimony further depicts how little webcaster counts have to do with the economic significance of the webcasting that those counts represent. For example, while broadcasters constitute 37% of SoundExchange statutory webcasters in 2012 by headcount according to SoundExchange's payment data, they represent less than half of that proportion—18%—of overall webcasting royalties received by SoundExchange. Peterson WRT ¶ 31 & Fig. 3. That 18% royalty percentage has declined even further since 2012, to less than 12% in 2014. NAB PFF ¶ 146. Thus, there is little relationship between the number of webcasters and the economic significance of their activity vis-à-vis SoundExchange's overall collections.

202. In short, SoundExchange's reliance on undifferentiated webcaster counts and survival rates is meaningless. To the extent that any information can be gleaned at all from SoundExchange's performance data – which is what SoundExchange itself claims is most relevant – online broadcaster performances have stagnated in the absolute and actually declined significantly if iHeart/Clear Channel performances are excluded. These statistics are not a sign of a healthy simulcasting market.

B. SOUNDEXCHANGE'S "SHORT-TERM PROFITABILITY" CRITICISM IGNORES THAT STATUTORY RATES HAVE RESULTED IN A PERVASIVELY UNPROFITABLE INDUSTRY OVER ITS ENTIRE 15-YEAR EXISTENCE.

203. Confronted with overwhelming evidence that the current rates have led to a uniformly unprofitable webcasting industry, SoundExchange attempts to avoid that inconvenient truth by arguing that current unprofitability is irrelevant to the willing buyer-willing seller determination. *See* SX PFF XIV.A-B. That argument is wrong.

204. To begin with, SoundExchange has cited no evidence that simulcasters will suddenly become profitable within the next five-year license period, which is the only time period that matters in this proceeding. Rather, it discusses only a single simulcaster – Lincoln Financial Media ("Lincoln") – and vaguely asserts that Lincoln "is focused on future profits." SX PFF ¶ 1206. This is far from a showing that simulcasters will become profitable over the next license term under the rates that SoundExchange has proposed (or anything close to those rates). Simulcasters' goal of future profitability, which goal has yet to be achieved in 15 years, should not be used as a basis for establishing confiscatory rates. Moreover, SoundExchange's position ignores the other testimony of LFMC's John Dimick, who stated that LFMC continues to scrutinize the viability of streaming. 5/25/15 Tr. 5834:2-6 (Dimick) ("Q: And is whether or not to

continue streaming something that continues to be under discussion? A: Every month when we—you know, when we pay bills."). SoundExchange's failure to establish any demonstrable evidence of future simulcaster profitability is a significant evidentiary shortcoming given NAB's particularized showing of the poor financial health of broadcaster simulcasting operations, as well as NAB's showing that there are broadcasters that have chosen not to stream at all because of the high and unpredictable royalties, others are reducing or eliminating their simulcasting because of those royalties and other simulcasters are examining the future viability of their current streaming operations. NAB PFF Parts IV.A, C.

205. Moreover, the persistent unprofitability of the webcasting industry is hardly "short-term" – the webcasting statutory license has been in place for some 17 years. Nor is SoundExchange's attempt to disregard webcaster unprofitability a new one. In the very first webcasting proceeding held nearly 15 years ago, it argued in its Proposed Findings that:

> The typical webcaster in the 1998-2002 time frame was not planning to become profitable in the short term, but to establish itself for the point after industry consolidation and advertiser adoption. At that point, every webcaster is projecting significant profit margins.

Proposed Findings of Fact and Conclusions of Law of the Recording Industry Association of America, Inc., Docket No. 2000-9 CARP DTRA 1 & 2, ¶ 156 (Dec. 3, 2001).

206. In the 2006 *Web II* proceeding, SoundExchange went so far as to claim that the webcasting industry was becoming profitable, asserting that:

> There has been tremendous growth in webcasting, with substantial market entry in the last three years, and the statements of webcasters themselves demonstrate that webcasters are growing increasingly profitable

> businesses that critically depend on the record companies' sound recordings for their success.

Proposed Findings of Fact of SoundExchange, Inc., Docket No. 2005-1 CRB DTRA, ¶ 6 (Dec. 12, 2006). SoundExchange even advanced the prediction by one of its experts that:

> Based on his analyses, Dr. Brynjolfsson testified that the webcasting industry had reached the break-even point for ad-supported services and <u>was poised to make considerable profits in the next five years</u>.

Id. ¶ 24 (emphasis added). Of course, as the record evidence demonstrates, this did not happen and still has not happened nine years later.

207. At some point, the persistent unprofitability of the webcasting industry can no longer be characterized as "short-term," and SoundExchange's repeated claims that the end to webcasters' elusive quest for profitability is just around the corner must be discounted. The rates are the primary culprit of this persistent unprofitability, and even SoundExchange's expert has said that "you want to set [the rate] such that most people can live with it." 5/29/15 Tr. 6694:8-9 (Lys). It is time for this significant course correction to be implemented.

208. SoundExchange points to Professor Lys's example of an airline reacting to an increase in fuel costs to argue that webcasters are able to respond to higher royalties by "adjusting [their] advertising or subscription rates." SX PFF ¶¶ 1189-90. Aside from the fact that Professor Lys's example is purely hypothetical and relies on numerous assumptions (*e.g.*, the hypothetical airline may happen to be offering low priced fares that it can raise), the example ignores the fundamental economic fact that if the airline raises prices, it will lose business. Thus, there is no assurance that a price increase will be beneficial. In this regard, Professor Lys's theory ignores the record evidence that simulcasters cannot increase their advertising rates without adversely affecting

advertisers' demand for simulcast ads. Simulcasters are already unable to sell such ads at the current rates. *See* [[ ]]. Simulcasters can only react to high royalties by reducing their listenership – which has already happened. NAB PFF ¶ 147.

209. SoundExchange also asserts that webcasters must pay the cost of inputs and that those costs are agnostic to the financial position of the buyer. SX PFF ¶ 1192. But inputs in a competitive market are priced at a level approaching the seller's marginal costs, not at a level calculated to extract all buyer surplus. Katz WDT ¶¶ 5, 25. Unless and until SoundExchange also asserts that the current royalties are low enough to approach its record-label members' costs – a topic that it has carefully avoided broaching, perhaps because webcasting revenues are highly profitable to labels (*see* NAB PFF Part V.B) – this assertion is irrelevant to its position.

210. To summarize, webcasting royalties have been set at levels that have led to a market in which no webcasters have been able to make a profit despite that industry having existed for over 15 years. That is not a temporal "short-term" problem. It is a demonstrated, chronic long-term problem and this bleak financial picture is particularly acute for simulcasters. The rates should be reduced significantly to reflect more accurately the rates that willing webcaster buyers would accept in an effectively competitive market, which would at least enable most companies to be viable during the applicable license term.

C. RATES THAT ARE SO HIGH AS TO ENABLE ONLY COMPANIES WILLING TO SUBSIDIZE WEBCASTING WITH OTHER LINES OF BUSINESS TO PAY THEM DO NOT REFLECT WILLING BUYER-WILLING SELLER RATES.

211. SoundExchange also attempts to obscure the poor financial health of the webcasting industry by suggesting that speculative, undescribed, and unquantified benefits from webcasting to other aspects of a company's business should be considered in setting willing buyer-willing seller rates. *See* SX PFF Part XIV.C. SoundExchange's argument is flawed in several respects.

212. First, it is easiest to gauge the true health of an industry by looking to see how that industry is faring on its own terms rather than also attempting to guess how that industry may be benefitting or harming other lines of business that certain webcasters may also operate, which vary from webcaster to webcaster. As the testimony of Roman Weil illustrated, attempting to attribute elements of costs and revenues experienced by other lines of business within a company that purportedly are attributable to webcasting is an exercise fraught with imprecision. *See* Weil WRT at 3-4 ("there is no uniquely correct way to allocate revenues among business activities. Nor are there necessarily fair ways. Nor are there principles of economic or accounting logic that point toward a particular choice among competing methods for allocating revenues.") In this regard, it is much sounder and more accurate to focus on the direct costs and benefits of webcasting rather than trying to account for purported benefits and costs from webcasting that may spill over to non-webcasting activities.

213. Second, a webcasting industry in which few, if any, webcasting-focused companies are able to make a profit, and the only industry participants who are profitable are those that are focused on other lines of businesses but are willing to subsidize

webcasting, is not a healthy industry. As webcasting investment expert David Pakman testified:

> It would be a sign of an unhealthy market if the only remaining digital music companies are efforts owned by larger companies content to subsidize their music subsidiaries with unprofitable music services while only generating profit elsewhere in the businesses.

Pakman WDT ¶ 28. Under the current rates, however, under which pureplay webcasters have not been able to profit, "this is precisely the state of the digital music market." *See id.* This is powerful evidence that the rates should be reduced. While it is certainly true that the rates need not guarantee the success of any particular webcaster, rates that have resulted in an industry where no webcasters have been able to profit are not rates to which willing webcaster buyers would agree in an effectively competitive market. Such an industry cannot be what Congress had in mind when it created the statutory license to make it easier for webcasters to enter the market and to ensure that sound recording performance rates would be set at competitive levels. *See* NAB PCL Part I.A. Nor can it be what Congress meant when it expressed its intent to grant a sound recording performance right "without hampering the arrival of new technologies." *Id.* ¶ 671.

214. Third, SoundExchange has not attempted to quantify any such spillover value – much less quantify related costs – that webcasting causes to non-webcasting lines of business. This further confirms the speculative and imprecise nature of basing rates on indirect benefits that webcasting may confer on other lines of a firm's business.

215. SoundExchange cites the Judges' *Web III* remand to support its suggestion that these spillover effects should drive the Judges' rate-setting rather than a focus on webcasting as such, but in so doing, SoundExchange misstates that opinion. While SoundExchange refers to a criticism by the Judges that Live365's expert in that case did

not "'address the synergistic nature of Live365's various lines of business,'" that statement related to the expert's unequal treatment of Live365's revenues and costs in deriving a cost model for determining a royalty. SX PFF ¶ 1209 (quoting *Web III,* 79 Fed. Reg. at 23108). Specifically, the Judges were responding to SoundExchange's complaint that the expert had "exclude[d] all revenue related to broadcasting services, but at the same time allocate[d] all of the costs associated with, among other things, bandwidth, to the webcasting service." *See* Proposed Findings of Fact of SoundExchange, Inc., Docket No. CRB 2009-1 CRB Webcasting III, ¶ 357 (Sept. 10, 2010) (cited in *Web III*, 79 Fed. Reg. at 23108). This actually illustrates how complicated it can be to allocate and quantify costs and revenues across multiple businesses. *See* NAB PFF Part IX.C.2.

216. SoundExchange's own Findings also demonstrate how error-prone and imprecise it is to attempt to set rates based on indirect costs and benefits experienced by a firm with multiple businesses rather than assessing the true value of webcasting on its own terms. Specifically, with respect to Lincoln, SoundExchange committed the same mistake of which it accused Live365's expert in *Web III* – *i.e.*, trying to allocate a portion of Lincoln's over-the-air advertising revenue to simulcasting without also allocating related costs – in its attempt to show that Lincoln would be profitable if only this allocation were performed. SX PFF ¶¶ 1214-15. As Mr. Dimick explained, his streaming profitability analysis for Lincoln did not include any allocation of the costs for the programming content, management of the company or the streaming operations, sales personnel costs, etc. Dimick WDT ¶ 28. But as SoundExchange itself acknowledged in *Web III*, these costs would have to be accounted for if a portion of Lincoln's terrestrial

broadcast revenues were allocated to simulcasting – SoundExchange cannot have it both ways. *See* Dimick WDT ¶ 28 ("Furthermore, to the extent we can ever confidently allocate a portion of over over-the-air net advertising sales to our stream based on Nielsen TLR or other data, such an allocation would have to take into account the costs associated with the programming included in the streamed content, as well as the sales and marketing costs associated with the over-the-air advertising. Indeed, if streaming is viewed as an independent operation, our streamed music stations are already getting the benefit of fully programmed content . . . the costs of which are not reflected in the above figures."). Given that there is no principled basis for performing such an allocation and given that many advertisers assign a zero value to simulcasting ads in any event (NAB PFF ¶ 121), it is much more accurate to assess the value of webcasting and simulcasting based on direct costs and benefits associated with that activity.

D. SOUNDEXCHANGE'S CLAIM THAT ITS PROPOSED RATES ARE AFFORDABLE IS IRRELEVANT TO THE WILLING BUYER-WILLING SELLER STANDARD AND IS UNSUPPORTED WITH RESPECT TO SIMULCASTING.

217. With no evidence of profitability to support its rate proposal, SoundExchange resorts to arguing that its proposed rates are affordable. SX PFF Part XIV.D. But "affordability" is not the right measure of whether rates are consistent with the willing buyer-willing seller standard applicable in this case. As Professor Katz testified, rates in an effectively competitive market that most buyers and sellers would agree to will approach the sellers' costs. NAB PFF ¶¶ 182, 197-98. By contrast, consideration of the highest rates that webcasters would be able to afford imply that the sellers are able to extract all of the buyers' surplus, which would likely exceed even rates that would be set in a monopoly market. NAB PFF ¶¶ 10, 316-19, 327. Indeed,

SoundExchange elsewhere argues that "affordability" is irrelevant to the rate-setting determination. *See* SX PFF ¶ 1129 (referring to "the fundamental disconnect between the willing buyer-willing seller standard and a webcaster's ability to pay").

218. In any event, SoundExchange points to no evidence that these rates are affordable for simulcasters. Rather, all but a single paragraph of SoundExchange's "affordability" discussion is devoted to a single webcaster – Pandora. *See* SX PFF Part XIV.D (discussing alleged affordability of SoundExchange's proposed rates with respect to Pandora in all paragraphs except 1241). And in the single paragraph directed to simulcasters, SoundExchange cites no evidence other than the mere fact that two broadcasters have "voluntarily chose[n]" to simulcast to support its assertion that the rates are affordable for simulcasters. *See* SX PFF ¶ 1241.

219. This is not evidence of affordability with respect to simulcasters as a whole, whose streaming activity has declined significantly in recent years. *See* NAB PFF ¶ 147. Moreover, with respect to the two simulcasters that SoundExchange does mention, Bryan Broadcasting and LFMC, both have also testified that they are scrutinizing the viability of their streaming operations and Bryan Broadcasting has already reduced its streaming presence for one of its music stations. NAB PFF ¶¶ 140-41. SoundExchange's "affordability" argument is thus both irrelevant and unsupported as to simulcasters.

VI. SOUNDEXCHANGE'S INTERACTIVE SERVICE BENCHMARK AND ITS ANALYSIS OF THAT BENCHMARK ARE SO FLAWED AS TO BE UNUSABLE.

220. As demonstrated in NAB's Proposed Findings of Fact, both SoundExchange's primary benchmark – major label licenses to interactive services – and

Professor Rubinfeld's analysis of that benchmark were fatally flawed. This Part of NAB's Reply Findings responds to many of SoundExchange's arguments in support of its benchmark. To the extent an issue is not discussed in this Reply, NAB refers to its Proposed Findings of Fact.[10]

A. SOUNDEXCHANGE HAS FAILED TO DEMONSTRATE THAT ITS CHOSEN BENCHMARK MARKET IS EFFECTIVELY COMPETITIVE.

221. Facing overwhelming evidence—from the mouths of SoundExchange's own representatives and record company witnesses—that the major record labels do not compete in licensing interactive services, SoundExchange now changes course and argues that the willing buyer/willing seller standard does not require the Judges to set license fees that would exist in an effectively competitive market. *See* SX PCL Part II; SX PFF ¶ 442. NAB demonstrates in its Reply Proposed Conclusions of Law that SoundExchange is wrong as a matter of law, economics, policy, and common sense. *See infra* NAB Reply PLC Part X.A.

222. Indeed, before SoundExchange concluded that it needed to abandon the ship of competition, its experts and representatives recognized that the Judges were required to set rates that would exist in a competitive market. Although he was late to admit it, Professor Rubinfeld expressed the opinion that "I understand that the 'willing seller/willing buyer' standard calls for rates that would have been set in a 'competitive marketplace.'" Rubinfeld CWRT ¶ 112. He explained that he "always had the idea of competition in [his] head, and [he] just didn't know that it would become debatable in

[10] Thus, for example, SoundExchange's attempt to justify its per-performance fee increases from 2016 through 2020 is fully addressed in NAB's Proposed Findings of Fact and need not be further discussed here. *See* NAB PFF Part VIII.F.

this proceeding." 5/5/15 Tr. 1924:18-22 (Rubinfeld). Professor Talley likewise testified that to be valid, a benchmark needed to be "sufficiently competitive" and to have "'sufficient competitive factors' to prevent negotiated rates from 'approximat[ing] monopoly rates.'" Talley WRT at 5 (quoting *Web III Remand* at n.37). In his opening statement, Mr. Pomerantz argued that the Judges have mentioned "effective competition," in their earlier decisions, and while the Judges have not "provided what they would consider to be a hard and fast definition what effective competition is, . . . you certainly have given us some indication of some factors that should be considered," including, whether the rates "approximate a monopoly" and "whether there are sufficient competitive factors in the marketplace." 4/27/15 Tr. 59:8-22 (Pomerantz).

223. Moreover, SoundExchange continues to argue that Congress intended the CRB to "ensure that [the statutorily authorized] collective action <u>could not give rise to competitive abuses</u>." SX PFF ¶ 1044 (citing 155 Cong. Rec. S6740 (June 17, 2009) (emphasis added). SoundExchange thus continues to acknowledge that the CRB has a role that includes preserving (and adopting) competitive pricing. It would make no sense for the CRB's mandate to be to prevent competitive abuses by the monopolistic collective, while authorizing the Judges to rely on rates for a market with sellers of must-have complements that charge even higher rates than the collective would extract.

224. Notably, SoundExchange's Proposed Findings of Fact are wholly silent in response to the direct evidence provided by major record company witnesses that they do not compete in licensing interactive services. *See* NAB PFF ¶¶ 297-304.[11] Nor does

[11] SoundExchange does attempt to limit Mr. Van Arman's discussion about a "race to the bottom" to circumstances where there is a statutory license, *see* SX PFF ¶ 587, but the testimony SoundExchange quotes from Mr. Van Arman's return to the stand a month after his initial testimony was in response to a specific narrow question concerning [[redacted]

SoundExchange address Professor Rubinfeld's admissions in this proceeding that the major labels repertoires are must-haves and complements for interactive services, other than to argue that Professor Rubinfeld also made other arguments to the FTC. *See* SX PFF ¶¶ 453-86 & n.13; NAB PFF ¶¶ 294-296.

225. And while SoundExchange acknowledges the submissions made to the FTC by UMG and its representatives (including Professor Rubinfeld and Mr. Pomerantz) in support of the UMG-EMI merger, SX PFF ¶¶ 453-58, 461-62, SoundExchange's Proposed Findings of Fact have no response to the extensive arguments by Professor Rubinfeld and UMG: (i) that in licensing interactive services, the major labels are complements and must-haves, and that UMG, even before the merger with EMI [[ ]], (ii) that Professor Rubinfeld's examination of the market [[ ]]; and, therefore, (iii) [[ ]] NAB PFF ¶ 306, or, as Professor Katz described the argument by Professor Rubinfeld, UMG and its representatives, [[

]] *See* 6/2/15 Tr. 7155:2-20 (Van Arman). In any event, the competitive forces Mr. Van Arman described in his original testimony apply equally where there is no statutory license, and Mr. Van Arman's broad testimony about competition is not amenable to the limitation that SoundExchange asserts. *See, e.g.*, Van Arman WDT at 14; 4/28/15 Tr. 606:19-611:8 (Van Arman) (broad testimony generally discussing the Mr. Van Arman's concern about play share incentives and the race to the bottom); *id.* at 650:3-7 (admitting that "when [he says he is] concerned about a race to the bottom, [his] concern is that record labels will compete with each other on price to get more plays").

[redacted]]] NAB PFF ¶ 307. The FTC accepted these arguments in approving the merger. NAB Ex. 4134; NAB PFF ¶ 310.

226. The submissions made to the FTC by Professor Rubinfeld, UMG and its representatives are discussed at length in NAB's Proposed Findings of Fact and need not be repeated here. NAB PFF ¶¶ 305-19, 324-25.

227. SoundExchange's response to the fact that the FTC approved the merger because it found that the major labels did not compete with each other even before the merger, is relegated to a footnote asserting (i) that the FTC has not instigated any subsequent investigation into the "must-have" status of the major labels for licensing streaming services, and (ii) the FTC did not find sufficient evidence that the merger "would significantly increase the potential for coordination among recorded music companies." SX PFF ¶ 453 n. 13. With respect to point (i), SoundExchange has made no demonstration or even argument about the standard that the FTC applies in deciding whether to investigate existing market structures. In any event, the key issue is not whether the record companies are violating the antitrust laws – it is whether they compete in licensing interactive streaming services. 5/11/15 Tr. 2804:19-2807:1 (Katz); Katz AWRT ¶¶ 10-41; Shapiro WRT at 13-18. As to that issue, the record is clear. NAB PFF Part VIII.A.1. Point (ii) is a non-sequitur. The lack of evidence that the merger would not "increase" the potential for coordination says nothing about the pre-merger existence of that potential. Moreover, the statement about coordination was not in the paragraph discussing interactive service licensing; indeed, since the majors' catalogs are complements in licensing interactive services, coordination would be expected to reduce,

not increase prices (much as a monopoly price is lower than the total of the prices charged by multiple sellers of complements). *See* NAB PFF ¶¶ 347-48.

228. Rather than address the direct evidence showing that the major labels do not compete in licensing interactive services, SoundExchange argues that the licensing market is sufficiently competitive because "competitive forces in the downstream market have determined the prices charged in the upstream royalty market." SX PFF ¶ 444. NAB's Proposed Findings of Fact demonstrate the fallacy of SoundExchange's argument, that SoundExchange failed to support it with any evidence, and that the evidence in the record rebuts SoundExchange's theory. NAB PFF ¶¶ 327-36.

229. SoundExchange presents no evidence that downstream competition has, in fact, pushed major label license fees to competitive levels. Instead, SoundExchange relies on theory, SX PFF ¶¶ 445-448, and assertions that competition has had some effect on prices. SX PFF ¶¶ 449-462.

230. But SoundExchange's theories are over-stated – contrary to SoundExchange's contention, the existence of downstream competition among interactive services <u>increases</u> the record companies' bargaining power in dealing with any service, and leads to higher, not lower prices. NAB PFF ¶¶ 327-29 ([[ ]]). Further, the fact that the labels may, in the past, have somewhat reduced their license fees to interactive services in response to piracy does not begin to demonstrate that the prices charged by the labels are now close to competitive. The evidence is to the contrary. *See* NAB PFF ¶¶ 330-36. As only one example, a participant in a competitive market does not [[

[redacted]]] PAN Ex. 5349 at 17.

231. The primary source of SoundExchange's theory is Professor Talley, SX PFF ¶¶ 446-48. But Professor Talley admitted that he had performed no empirical analysis to ascertain whether or to what degree "downstream competition is, in fact, impacting the upstream negotiations" in the interactive market. 5/27/15 Tr. 6092:6-6093:2 (Talley). Professor Talley's modeling and analysis were purely theoretical; he admitted that he had not studied either the downstream interactive service market or the upstream market in which the record companies license interactive services. *See, e.g.*, *id.* at 6080:22-6083:20 (entirety of the materials relied upon were cited or listed in report, which consisted of the testimony of Professors Shapiro and Katz, a book, "some academic articles, and [a] handful of online articles"); *id.* at 6058:9-12 ("Well, I need to be careful here. I haven't done an empirical analysis of that market, but to the extent that the conditions are there, and I think they are. . . ."); *id.* at 6097:15-6098:15 (for Professor Talley's purpose (rebutting Professors Shapiro and Katz), he "did not need any real-world data" and he "did not try to calibrate the model with market data, that's correct").

232. In preparing his written testimony, Professor Talley did not review any of the discovery materials produced in the case relating to the interactive upstream or downstream markets, any actual interactive service, or any documents memorializing any interactive service licensing negotiations. *Id.* at 6083:15-6087:23, 6090:3-6091:24. Indeed, when asked at his deposition, Professor Talley could name only one interactive service (Spotify) and only two noninteractive services (Pandora and iHeart), before being prompted. *Id.* at 6087:24-6089:17.

233. More specifically, although SoundExchange's theory relies on an assumption that interactive services face "an elastic downstream demand curve" (SX PFF ¶ 446, 465), Professor Talley admitted that he had not attempted to calculate any elasticity of demand whatsoever, because "within the ambit of how I was retained as an expert, I did not view that as part of my charge." 5/27/15 Tr. 6093:3-18 (Talley). Indeed, although its argument depends on the record companies "facing a highly elastic demand curve" (SX PFF ¶ 465), nowhere in its Proposed Findings of Fact does SoundExchange point to any quantification of any elasticity of demand related to either the upstream interactive service licensing market or downstream interactive service market.

234. Indeed, the only direct statement about elasticity of demand cited by SoundExchange is contained in [[ ]], an unsupported assertion that includes, as one reason for the elasticity of demand, competition among interactive services – which as discussed above, actually increases record company bargaining power and prices. *See supra* ¶ 230; NAB PFF ¶¶ 327-29.

235. SoundExchange claims that UMG's arguments about downstream competition were among the "building blocks" of the FTC's decision not to challenge the merger. SX PFF ¶ 453. But the FTC explicitly relied only on the proposition that the majors' catalogs were must haves and complements rather than substitutes in its statement about the merger. NAB Ex. 4134. SoundExchange points to no evidence that the FTC considered its arguments about downstream competition to be relevant.

236. In any event, the theory that SoundExchange cites addresses upstream elasticity of demand. *See* SX PFF ¶¶ 446-47 (discussing the extent to which downstream

"'elasticities' would 'be passed up to the demand for the input as opposed to less cost intensive inputs.'"). It does not say that prices would reach competitive levels.

237. SoundExchange relies on Professor Talley's model allegedly to show how downstream competition "can" constrain upstream prices. SX PFF ¶ 448. But that model, like the rest of Professor Talley's work, was not grounded in the realities of this market. Rather, it was based on a purely hypothetical model of bargaining that simply assumed a particular distribution of agreements and "posited" certain parameters, without any effort to calibrate the model to the real world. 5/27/15 Tr. 6096:9-6099:21 (Talley). Professor Talley admitted that if he were using his model to attempt "to formulate an affirmative recommendation of rates and proffer them, then to take – the approach that I employed might be used, but <u>it would then require a calibration</u>." *Id.* at 6097:15-6098:7 (emphasis added). But that is, in essence, what SoundExchange is attempting to by using Professor Talley's model to support its rate proposal.

238. SoundExchange claims that Professor Katz agreed that interactive services faced downstream competition from piracy, YouTube, and Pandora, and that those alternatives push down the price that record companies can charge interactive services. SX PFF ¶ 460. But Professor Katz's response was a carefully limited response to overly broad questions. For example, he made clear that interactive services faced competition only "to some degree" from those alternatives, and he relied on Mr. Pomerantz "lumping [the free alternatives] – altogether" in saying that those services would have "some sort of an effect, and I believe it's in a downward direction," but that he was not opining how far that such competition might have pushed down the price. 5/11/15 Tr. 2973:8-19 (Katz).

239. SoundExchange is similarly fast and loose with its statement that Professor Katz acknowledged that the price that emerges as a result of downstream competition could be the same as the price that emerges through effective competition. SX PFF ¶ 465. In fact, Professor Katz was responding to a hypothetical positing that such was the case, and he simply acknowledged that it was "conceivable, if you're talking about hypotheticals" and "possible." 5/11/15 Tr. 2976:25-2978:6 (Katz). But simply saying something is "conceivable, if you're talking about hypotheticals" or "possible" does not imply that likely, or that it is in any way true in this case.

240. Immediately after the statements cited by SoundExchange, Professor Katz made clear that he had addressed two questions in his testimony – (i) whether the market for licenses to interactive services was effectively competitive, and (ii) whether the prices in that market were being pushed to the equivalent level – and based on his review of the evidence, he concluded that even with such downstream competition, the market for sound recording licenses to interactive services was not effectively competitive, and that prices were not at effectively competitive levels. *Id.* at 2974:10-2978:6, 2983:4-2984:10 (Based on his examination of the [[ ]] "yes, there are these theoretical possibilities. I believe when you look at the facts, it says, both, it's not creating competition upstream and it hasn't squeezed the downstream market so much that there is no scope for market power.")

241. As discussed in NAB's Proposed Findings of Fact, Professor Katz demonstrated, among other things, that [[

[redacted]]] *See* NAB PFF ¶ 334. For a complete discussion of the issue rebutting SoundExchange's theory that piracy was pushing licensing fees to the competitive level, *see* NAB PFF ¶¶ 330-36.

242. SoundExchange also argues that negotiations between the major labels and interactive services demonstrate that the labels cannot freely dictate price. SX PFF ¶¶ 469-81. NAB demonstrated in its Proposed Findings of Fact that this point did not demonstrate that the market was competitive because even monopolists engage in negotiations and do not always receive everything they would like. NAB PFF ¶¶ 337-42. Moreover, the labels' "concessions" relied upon by SoundExchange do not demonstrate a lack of monopoly power. SoundExchange's putative examples isolate single terms of larger deals and do not show the course of negotiations or what, if anything, was obtained by the record labels in return.

243. SoundExchange once again quotes Professor Katz out of context in support of its claim that Spotify exercised bargaining power in its dealings with the majors. SX PFF ¶ 469. Professor Katz expressly said, in the same passage "If I had come to the conclusion looking at the facts to say, well, the record companies are must-have, yet I somehow see evidence that Spotify has a lot of bargaining power that is really pushing prices down, I would want to see that as something of a tension, and then I would want to understand what was going on. But in fact, when I examined it, I didn't see that tension and I don't see Spotify having sufficient bargaining power in any of the

three senses to make up for the fact that [the majors] are a must-have." 5/11/15 Tr. 2981:3-18 (Katz).

244. As Professor Katz testified, buyer side bargaining power cannot offset seller market power in this market, because, absent the existence of "other suppliers to which it could credibly threaten to shift purchases today or in the near future . . . a buyer—no matter how large and sophisticated—cannot force a seller to reduce price." Katz AWRT ¶¶ 38-40; Katz WDT Part IV.D.1.

245. Finally, SoundExchange argues that there is no evidence that the majors collude in licensing interactive services. But, as explained in NAB's Proposed Findings of Fact, that argument is a straw man. Major labels selling must-have complements need not collude to exercise monopoly power. NAB PFF ¶ 348.

246. In sum, compelling evidence demonstrates that the majors do not compete in licensing interactive services, and that their catalogues are must-haves and complements. SoundExchange's entire response is theory and speculation, supported by neither evidence nor analysis, that piracy has driven prices to competitive levels. Theory and speculation do not counter concrete and compelling evidence that SoundExchange's preferred benchmark is not competitive, and that the labels have the power and [redacted]]], PAN Ex. 5349 at 17.

B. CONTRARY TO SOUNDEXCHANGE'S CLAIMS, SOUNDEXCHANGE DID NOT CORRECT THE FLAWS IN THE INTERACTIVE BENCHMARK IDENTIFIED BY THE JUDGES IN *WEB III.*

247. SoundExchange recognizes that, in *Web III*, "the Judges highlighted certain issues with respect to Dr. Pelcovits' analysis of the interactive benchmark," but

claims "SoundExchange has addressed" those issues in this proceeding. SX PFF ¶ 347. SoundExchange and Professor. Rubinfeld did no such thing.

248. The Judges first recognized that Dr. Pelcovits failed "to take into account the advertising revenue received in both the interactive benchmark market and the statutory noninteractive market," and that as a result "the interactive benchmark model as developed by Dr. Pelcovits is compromised, and its usefulness reduced." *Web III Remand*, 79 Fed. Reg. at 23118.

249. As NAB demonstrated, SoundExchange again failed properly to take account of the dominant advertising supported business model of noninteractive services. NAB PFF ¶¶ 361-70. This failure was particularly important given the fundamental differences in the business models of interactive and noninteractive services. NAB PFF ¶¶ 361-63. As Professor Katz explained, "the advertising-supported and subscription models attract different customers. Specifically, customers who choose to pay for subscription services are an unrepresentative minority of all consumers who stream music. . . . Non-interactive, ad-supported appears to be a high-volume, low-margin business, appealing to customers with a lower willingness to pay for access to music." *Id.* ¶ 363 (citing Katz AWRT ¶ 55, IHM Ex. 3118 at 11). SoundExchange's response to Professor Rubinfeld's failure to account properly for ad-supported services is discussed in Part VI.F, below.

250. The Judges also observed that the value of Dr. Pelcovits' benchmark analysis was "diminished by [the] lack of sufficient data" relating to the number of noninteractive performances per subscriber. *Web III Remand*, 79 Fed. Reg. at 23118. Dr. Pelcovits sought to compare the number of performances per subscriber for non-

interactive and interactive services. This was a necessary step in order to derive interactive and noninteractive subscription revenue per performance, which was the comparison at the heart of both Dr. Pelcovits' and Professor Rubinfeld's analyses.

251. Rather than correcting the problem identified by the Judges in *Web III*, Professor Rubinfeld did not even attempt to make this adjustment. In other words, although he used the ratio of subscription prices in an effort to adjust the per-performance royalties paid by interactive services to represent per-performance royalties that should be paid by noninteractive services, he did nothing to account for differences in the number of performances made by subscribers to each type of service. In short, Professor Rubinfeld responded to the Judges' *Web III* criticism by ignoring the adjustment that (i) Dr. Pelcovits believed it was necessary to make, and (ii) the Judges criticized Dr. Pelcovits for failing to make in a reliable way. Ignoring a criticism is not "address[ing]" it.

252. SoundExchange itself recognizes that this difference is significant, relying on data cited by Professors Fischel and Lichtman to the effect that, in 2013, Pandora subscribers averaged [[[redacted]]] performances per month, while Spotify subscribers averaged [[[redacted]]] performances per month. SX PFF ¶ 1147, citing Fischel/Lichtman WRT ¶ 61. As Professors Fischel and Lichtman demonstrate, Professor Rubinfeld's interactivity adjustment would thus significantly overstate the license fee per performance for noninteractive services estimated by Professor Rubinfeld's analysis. Fischel/Lichtman WRT ¶ 61. The data cited by Professors Fischel and Lichtman show that even looking only at subscription data, Professor Rubinfeld's analysis overstates his noninteractive license fee by a factor of 1.58 ([[[redacted]]]).

253. As discussed in NAB's Proposed Findings of Fact, Professor Katz's approach, which properly accounts for revenues per play for both ad-supported and subscription services, corrects this error as well, because it is based on revenue per performance, not per subscriber. NAB PFF ¶ 370.

254. The Judges also criticized Dr. Pelcovits for failing to analyze agreements between the interactive services and independent labels. *Web III Remand*, 79 Fed. Reg. at 23118. As discussed below, Professor Rubinfeld looked at certain independent deals, but did not include them in his analysis. *See infra* ¶ 270.

255. The Judges also criticized Dr. Pelcovits for failing to adjust for the downward trend in rates in the interactive benchmark market. *Web III Remand*, 79 Fed. Reg. at 23118. Both Dr. Pelcovits and Professor Rubinfeld used periods ending during the year in which the proceeding started (2009 and 2014). Dr. Pelcovits used an 18-month period, Professor Rubinfeld used a 12-month period. *Compare id. with* Rubinfeld CWDT ¶ 32. But while Professor Rubinfeld used a shorter period, he still failed to account for the continuing downward trend in his Interactive benchmark license fee rates. Instead, he argues that despite that trend, rates should increase over the license term. *See* NAB PFF Part VIII.F.

256. Professor Rubinfeld acknowledged that interactive service license fee rates were declining. 5/6/15 Tr. 2142:3-6 (Rubinfeld). He further admitted that, [[[redacted]]] *Id.* at 2230:20-2231:22.

257. The Judges in *Web III* also criticized certain aspects of Dr. Pelcovits' hedonic regression. *Web III Remand*, 79 Fed. Reg. at 23119. [[ ]] 5/5/15 Tr. 1833:25-1834:7 (Rubinfeld). That failure does not resolve the issue raised by the Judges in *Web III*; it simply obscures it.

C. SOUNDEXCHANGE'S INTERACTIVE BENCHMARK MARKET IS EVOLVING AND IS NOT IN EQUILIBRIUM.

258. SoundExchange admits that its interactive benchmark market has "evolved considerably" since *Web III*. SX PFF ¶ 348. As SoundExchange argues, the business models of those services continue to evolve. SX PFF ¶ 222; 5/05/15 Tr. 1792:15-1793:14 (Rubinfeld) ([[ ]]). Moreover, the evidence demonstrates that not a single interactive service is earning a profit with its current business. *See infra* ¶ 264. Thus, the evidence suggests that the market for licenses to those services is not in equilibrium. As such, their license fees are not a reliable basis for rate setting for noninteractive services. *Cf. Web I CARP Report*, CARP DTRA 1&2 at 47 (observing that where "[b]oth sides had considerable uncertainty about the ultimate equilibrium value for the right," "license agreements should be approached with caution"), *aff'd* 67 Fed. Reg. 45240, 45248 (June 8, 2002) ("Carp Report").

259. SoundExchange admits many of the largest interactive services on which it bases its fee proposal, including Spotify (the largest), Google Play, and Beats, did not "even exist[] at the time of *Web III* in 2009." SX PFF ¶ 349.

260. SoundExchange also highlights the ongoing changes in subscription prices for interactive services, SX PFF at n. 10; *compare* SX Ex. 45 (comparison of subscription

prices submitted with Rubinfeld CWDT) with SX Ex. 146 (comparison of subscription prices submitted with Rubinfeld CWRT). These changes over the course of just four months highlight the unsettled nature of the interactive services.

261. The evidence suggests that the interactive services have realized that they cannot make it purely as on-demand services, so they have started to offer lean-back functionality. SX PFF ¶¶ 349-50. SoundExchange calls this "convergence," *see* SX PFF ¶ 352, but what it actually suggests is that the interactive services have not been successful as interactive services and they have been forced to change. *See* SX PFF ¶ 356 (identifying changes by interactive services from 2011 through 2014).

262. SoundExchange has presented no evidence that the interactive services that exist today offer a mature and stable business model or that the industry has reached equilibrium. Indeed, SoundExchange acknowledges that Spotify, far and away the largest interactive service in the U.S., only "entered the U.S. market in 2011, after the *Web III* proceeding ended." SX PFF ¶ 354. SoundExchange also quotes Pandora as describing [[[redacted]]] SX PFF ¶ 355.

263. Although SoundExchange asserts that "'free' interactive services are far from 'experimental,'" it cites no evidence to support that assertion other than the fact that Spotify has many ad-supported users. SX PFF ¶ 354. But there is no evidence in the record that Spotify is actually profitable or stable or that its business is mature.

264. To the contrary, Mr. Pakman's testimony showed that Spotify was not profitable, and a leading research firm provided its analysis "that *no current music subscription service – including marquee brands like Pandora, Spotify and Rhapsody – can ever be profitable*, even if they execute perfectly," laying the blame for this state of

affairs squarely on sound recording royalties. Pakman WDT ¶ 27 & nn. 34, 35 (emphasis in original). A market where the leading services cannot "ever be profitable" is not in equilibrium and it would be unreasonable to rely on the license fees from that market as a benchmark.

265. Moreover, Professor Katz demonstrated that the effective per performance rate for Spotify's Free Tier, a service that included full interactive functionality on desk-top, lap-top and tablet computers, was [[[redacted]]] during the period analyzed by Professor Rubinfeld. NAB PFF ¶¶ 538-40 (quoting Katz AWRT ¶¶ 269-70 & Table 17). That is [[[redacted]]]. *Id.*

D. SOUNDEXCHANGE'S CLAIM OF A "THICK MARKET" IS OVER-STATED AND, IN ANY EVENT, AN INVALID THICK MARKET IS NO BETTER THAN AN INVALID THIN MARKET.

266. SoundExchange invokes the term "thick market" no fewer than 14 times in its Proposed Findings of Fact, as if the term were a magic talisman that cured all defects in SoundExchange's chosen benchmark. Unfortunately for SoundExchange, the term has no such magic power. A "thick market" characterized by record company monopoly power tells the Judges no more about rates that would exist in the relevant hypothetical effectively competitive market than a "thin market" characterized by record company monopoly power.

267. In any event, SoundExchange's benchmark market is not as "thick" as SoundExchange pretends. SoundExchange claims that Professor Rubinfeld "analyzed" more than 80 interactive service/label agreement pairs. *See* SX PFF ¶ 363. But what Professor Rubinfeld "analyzed" is not a relevant question. More to the point (although it

does not cure the defects in the market) Professor Rubinfeld based his analysis of the per performance rate on 26 agreements. *See* SX Ex. 59 (Rubinfeld CWDT Ex. 16a); *see also* 5/28/15 Tr. 6314:5-6317:3 (Rubinfeld) (Professor Rubinfeld reviewing Exhibit 16a to his Written Direct Testimony, but expressing uncertainty about what agreements he based his minimum per-performance rates on).

268. Examination of those 26 label-service pairs reveals that SoundExchange's "thick market" comprises agreements between just 4 sellers – all major record companies (including EMI pre-merger) selling complementary products and possessing must-have market power – and just 9 different services (the count included agreements between [[ ]]). And of those 9 services, 1, Spotify, accounted for [[ ]] of the interactive performances with a minimum per-performance fee. *See* SX Ex. 63 (Rubinfeld CWDT App. 1a). Rhapsody accounted for [[ ]], Microsoft for [[ ]] and no other service accounted for [[ ]]. *Id.*

269. SoundExchange appears to apply a double standard when assessing market evidence. SoundExchange has argued (in trying to support its efforts to shorten the length of time for services to make payments) that it is the number of performances, not the number of agreements, that matters in evaluating market evidence. *See* SX PFF ¶ 1273 ("But Mr. Pederson could not say that [[ ]] . . . This is a key distinction. . . Quite simply, when looking at a sample of deals involving parties of varying sizes, the relative number of agreements that contain any particular term in and of itself does not deliver meaningful information about market preference.") (emphasis in original).

Applying SoundExchange's standard, the alleged "thick market" devolves into 4 (now 3) must-have sellers selling to one buyer making [[ ]] relevant performances, two buyers making between [[ ]] relevant performances, and a 6 services that did not even crack the [[ ]] performance level. There is nothing "thick" about that market.

270. Moreover, as is clear from Professor Rubinfeld's testimony and Exhibits, his computation of his per performance fee did not include any agreements between interactive services and indie labels. *See* SX Ex. 59 (Rubinfeld WDT Ex. 16a). While it apparently is true that Professor Rubinfeld reviewed agreements with the indie labels or label groups that provided witnesses in the proceeding, SX PFF ¶ 364 (identifying Secretly Canadian, Beggars Group, and Merlin) he did not use those agreements in his analysis. Instead, [[ ]]

E. SOUNDEXCHANGE FAILS TO SUPPORT PROFESSOR RUBINFELD'S ESSENTIAL ASSUMPTION THAT THE RATIO OF LICENSE FEES TO REVENUES WILL BE THE SAME FOR BOTH INTERACTIVE AND NONINTERACTIVE SERVICES.

271. SoundExchange devotes just three paragraphs of its Proposed Findings of Fact to try to justify Professor Rubinfeld's core assumption that the ratio of license fees to subscription prices would be the same for interactive and noninteractive services. SX PFF ¶¶ 404-06. The fallacy of Professor Rubinfeld's assumption was fully addressed in Paragraphs 352-60 of NAB's Proposed Findings of Fact.

272. SoundExchange's primary argument is simply a repeat of Professor Rubinfeld's last minute attempt to back-fill a theory to justify his previously unsupported

assumption. *See* SX PFF ¶ 404, discussed in NAB PFF ¶ 359. But Professor Rubinfeld's explanation depended on theory that was largely unexplained, and that critically depended, in turn, on factual assumptions that (i) Professor Rubinfeld did nothing to confirm and, indeed, (ii) contradicted his own prior written and oral testimony. *See* NAB PFF ¶¶ 357, 359.[12] SoundExchange makes no attempt to address this contradiction and provides no evidence to support Professor Rubinfeld's factual assumptions. Moreover, SoundExchange fails to reconcile Professor Rubinfeld's assumption with his admission that [[ ]] and Professor Rubinfeld's reliance in his presentation to the FTC on the Nash Bargaining framework, which explicitly takes account of buyer costs. *See* NAB PFF ¶ 356.

273. SoundExchange claims that Professor Shapiro "acknowledges the relationship between subscription prices in the downstream market and royalties paid in the upstream market," SX PFF ¶ 405, but SoundExchange has the cause and effect discussed by Professor Shapiro exactly backwards. The cited testimony from Professor Shapiro discusses the effect of upstream royalties on downstream prices, not any effect of the downstream market on the upstream market. 5/8/15 Tr. 2624:10-2625:14 (Shapiro). Specifically, Professor Shapiro did not compare interactive and noninteractive services, did not say that the ratios would be the same, and certainly did not say that downstream

[12] SoundExchange also cites testimony from Professor Talley concerning the relationship between downstream and upstream elasticities of demand, SX PFF ¶ 404, but, as discussed above, *see supra* ¶¶ 231-33, Professor Talley's work was purely theoretical, and Professor Talley admitted that he had not attempted to calculate any elasticity of demand whatsoever, because "within the ambit of how I was retained as an expert, I did not view that as part of my charge." 5/27/15 Tr. 6093:3-18. Professor Talley's theoretical musings do nothing to support Professor Rubinfeld's unjustified assumption.

elasticities of demand for the two types of services would be the same, or that downstream elasticities would translate in the same way upstream in both markets.

274. When Professor Shapiro actually did address Professor Rubinfeld's core assumption "that the ratio of the average retail subscription price to the per-subscriber royalty is the same in the two markets," Professor Shapiro was explicit about his disagreement: "There's no reason to think that the royalty rates negotiated in the two different markets would have this relationship that he assumes. He provides no basis for this assumption either in terms of economic theory or anything else." 5/8/15 Tr. 2724:21-2725:22 (Shapiro); Shapiro WRT at 29-30. Thus Professor Shapiro appears to be in full agreement with Professor Katz that Professor Rubinfeld's essential assumption is "contrary to fundamental economic principles." Katz AWRT Heading II.C.

275. Finally, SoundExchange relies upon the alleged consistency in percentage of revenue license fee terms for interactive service without regard to the applicable subscription price. SX PFF ¶ 406, citing SX Ex. 143 (Rubinfeld CWRT Ex. 15). But, as NAB demonstrated, the table cited by SoundExchange says nothing about the percentage of revenue paid by noninteractive services or the relationship between interactive and non-interactive services, was entirely based on [[[redacted]]] if you really had a stand-alone service," and, in any event the consistent percentage of revenue likely reflected major label market power in licensing interactive services. NAB PFF ¶ 354.

276. In sum, SoundExchange's Proposed Findings of Fact fail to provide meaningful support for the critical assumption relied upon by Professor Rubinfeld in his benchmark analysis.

F. SOUNDEXCHANGE'S BENCHMARK ANALYSIS DOES NOT PROPERLY ACCOUNT FOR AD-SUPPORTED SERVICES.

277. The failure of SoundExchange's lead economist "to take into account the advertising revenue received in both the interactive benchmark market and the statutory noninteractive market," was the first criticism leveled by the Judges at the interactive benchmark in *Web III*, leading them to conclude that as a result "the interactive benchmark model as developed by Dr. Pelcovits is compromised, and its usefulness reduced." *Web III Remand*, 79 Fed. Reg. at 23118. The Judges further acknowledged the validity of Dr. Salinger's criticism in *Web III* that "*any* estimate of a reasonable royalty rate . . . suffers from the fundamental flaw that noninteractive Internet radio is primarily an advertising-supported business, not a subscription business." *Id.* at 23119.

278. The Judges in *Web III* further observed that "Dr. Pelcovits's decision to ignore advertising revenues in his analysis implicitly constituted an *a priori* rejection of the noninteractive webcaster business model that seeks revenue primarily through advertising rather than from subscriptions." *Web III Remand*, 79 Fed. Reg. at 23118 n. 47. In light of the fact that the nonsubscription business model is the overwhelmingly dominant model for noninteractive services, NAB PFF ¶ 361, the *a priori* rejection of that model is a clear sign that there is something very wrong with SoundExchange's model, both in *Web III* and here. NAB demonstrated the error in SoundExchange's analysis in Part VIII.A.3 of its Proposed Findings of Fact.

279. SoundExchange's response to this strongly worded precedent is to recite twice that "[a] comparison of interactive and non-interactive subscription prices is the most accurate and reliable way to isolate and measure the value of interactivity. It is an apples-to-apples comparison, is the cleanest path to isolating the value of interactivity, and provides a proper basis for the interactivity adjustment." SX PFF ¶¶ 400, 407 (relying on Rubinfeld CWRT ¶ 171; 5/28/15 Tr. 6307:2-6308:6 (Rubinfeld)).

280. SoundExchange's assertions that Professor Rubinfeld's approach is "accurate," "reliable," and "proper" are wholly conclusory and lack any economic analysis or foundation. Such assertions are not a response to the concerns expressed by the Judges in *Web III*. Similarly, the assertion from Professor Rubinfeld's CWRT that the comparison is "apples-to-apples" (Rubinfeld CWRT ¶ 171), says nothing about the validity or relevance of comparing highly significant interactive apples to virtually non-existent noninteractive apples.

281. Thus, the thrust of SoundExchange's position appears to be that a comparison of subscription prices "is the cleanest path to isolating the value of interactivity." Indeed, that was the primary explanation given by Professor Rubinfeld on the stand when asked about the criticisms of his analysis by the Services' economists: "my goal was to try to get as clean a calculation that accounted for the different functionality." 5/28/15 Tr. 6307:2-22 (Rubinfeld).

282. But cleanliness is not the same as accuracy. Differences in the mix of subscription and nonsubscription revenue are fundamental to ascertaining any value of interactivity. NAB PFF ¶ 367.

283. Moreover, the key issue is not the abstract value of interactivity, it is how that value affects the demand for licenses – and that is directly related to the services' revenues. NAB PFF ¶¶ 363-67. As Professor Katz explained, "Dr. Rubinfeld's omission of the dominant business model for non-interactive services is troubling because there are important differences between advertising-supported and subscription business models in terms of their implications for a service's derived demand for licensed music." NAB PFF ¶ 363 (quoting Katz AWRT ¶ 55).

284. As Professor Katz demonstrated, a comparison of subscription prices does not tell you the value of interactivity. NAB PFF ¶¶ 363-367. A higher percentage of customers are willing to pay for subscription interactive services than are willing to pay for subscription non-interactive services. This is no accident. Rather it is a manifestation of differences in demand for the two types of services. As Professor Katz explained, "[i]n addition to having very different levels of revenue per play, the advertising supported and subscription models attract different consumers. Specifically, consumers who choose to pay for subscription services are an unrepresentative minority of all consumers who stream music. . . . Non-interactive, ad-supported appears to be a high-volume, low-margin business, appealing to customers with a lower willingness to pay for access to music." NAB PFF ¶ 363 (quoting Katz AWRT ¶ 55); *see Peterson* WRT ¶¶ 7, 10, 71-73, 80-93; IHM Ex. 3118 at 11 [[[redacted]]]; PAN Ex. 5046 at 11-12 [[[redacted]

[redacted]]].

285. In other words, it is meaningless to discuss a "value" of interactivity that does not take account of the relative share of consumers that are willing to pay subscription fees for it, compared to the share of consumers (virtually none) that are willing to pay subscription fees for noninteractive services. That is an important aspect of the "value" of interactivity.

286. Professor Rubinfeld acknowledged that the "interactive and noninteractive [services] do depend on different business models . . . ." (5/28/15 Tr. 6307:19-22 (Rubinfeld)), and that the dominant model for noninteractive services is the ad-supported model. In light of the clear evidence, he could scarcely do otherwise. *See* NAB PFF ¶¶ 361-62. It was clear error to fail to take account of this important difference in business models that reflects consumer willingness to pay for the different types of services and, therefore, directly affects the services' demand for sound recording licenses.

287. SoundExchange argues that it is "inaccurate and improper" to compare average revenue per user (ARPU) for ad-supported services, but provides no coherent reason this is so and cites to no evidence in support of its assertion (beyond Professor Rubinfeld's own unsupported and general assertions). SX PFF ¶¶ 401, 408.

288. In any event, the use of ARPU to determine an interactivity adjustment that properly accounts for ad-supported services is a red herring. Professor Katz demonstrated that the correct analysis was to determine average revenues <u>per performance</u>, which obviates the need to compute ARPU, and accounts for differences in numbers of performances. NAB PFF ¶¶ 366-70.

289. Notably, SoundExchange's Proposed Findings of Fact are wholly silent in response to Professor Katz's demonstration of the importance of the mix of subscription and non-subscription performances for assessing the revenues of different types of services, and the effect of properly considering revenues per performance. *See* Katz AWRT ¶¶ 57-59; 5/11/15 Tr. 2854:10-2857:6 (Katz); NAB PFF ¶¶ 366-69. Professor Katz's use of revenues per performance fully addresses Professor Rubinfeld's failure to consider the mix of subscription and non-subscription offerings and avoids the need to determine ARPU.

290. It is also important to note that Professor Katz's approach of computing average revenues per performance not only addresses Professor Rubinfeld's failure to properly consider differences in business models. It also addresses his fundamental failure to adjust the ratio of either subscription prices or advertising revenues for differences in the number of performances on interactive and non-interactive services. NAB PFF ¶ 370. This was identified as an important element of the same analysis performed by Dr. Pelcovits in *Web III*, but ignored by Professor Rubinfeld here. *See supra* ¶¶ 250-51.

G. SOUNDEXCHANGE FAILS TO JUSTIFY PROFESSOR RUBINFELD'S FAILURE PROPERLY TO ACCOUNT FOR SERVICES' NON-LICENSE FEE COSTS.

291. SoundExchange asserts that a comparison of profitability rather than costs is "improper," SX PFF ¶ 402, but offers no support for this assertion. Thus, as discussed above, SoundExchange makes no attempt to address Professor Rubinfeld's admission that [[[redacted]]] and Professor Rubinfeld's reliance in his presentation to the FTC

on the Nash Bargaining framework, which explicitly takes account of buyer costs, all of which were discussed by Professor Katz. *See supra* ¶ 272; NAB PFF ¶ 356; 5/11/15 Tr. 2863:10-2866:15 (Katz); Katz AWRT ¶¶ 70-76.

292. Instead, SoundExchange argues that Professor Katz used the wrong costs in demonstrating the impact of non-license fee costs on Professor Rubinfeld's interactivity adjustment. That, of course, does nothing to show that Professor Rubinfeld's failure to consider non-license fee costs was justifiable, or that costs could have a significant impact on Professor Rubinfeld's interactivity adjustment; it just is an argument that Professor Katz did not, in SoundExchange's view, properly correct Professor Rubinfeld's analysis. But the interactive benchmark is being advanced by Professor Rubinfeld and SoundExchange; it is their burden to analyze their chosen benchmark correctly.

293. SoundExchange also argues that profitability "could reflect the fact that services like Pandora may not be trying to maximize profits in the short-term." SX PFF ¶ 403. But, in any event, as Professor Katz testified, [[ ]] 5/12/15 Tr. 3120:1-3121:5 (Katz). And, more fundamentally, as Professor Katz testified immediately after the passage cited by SoundExchange, [[ ]] *Id.* 3126:23-3127:8. In short, SoundExchange's criticism of Professor Katz in Paragraph

403 is equally damning of Professor Rubinfeld's analysis of SoundExchange's primary benchmark. SoundExchange cannot have it both ways.

294. Finally, SoundExchange claims that a profits based adjustment might create a disincentive to control costs. SX PFF ¶ 403 n.9. That is again speculation by SoundExchange with no supporting evidence. Moreover, SoundExchange's argument ignores the fact that the rate is being set based on a review of past profitability, not future profitability. Past costs were incurred without an expectation that those costs would affect the rates. Professor Katz acknowledged that consideration of costs "could create a disincentive" if services expected that "this is what's going to happen in future proceedings," but he was very clear that failure to make the adjustment for costs "would be an even bigger problem." 5/11/15 Tr. 2862:4-2863:3 (Katz). In any event, SoundExchange offers no evidence that, once rates are set, firms actually will incur unnecessary costs and thereby lose even more money in order to influence the next rate proceeding.

295. At bottom, SoundExchange has no answer to Professor Katz's demonstration [[[redacted]]] 5/12/15 Tr. 3120:9-3121:5 (Katz).

H. SOUNDEXCHANGE IS UNABLE TO JUSTIFY PROFESSOR RUBINFELD'S INVALID COMPARISON OF SUBSCRIPTION PRICES THAT INCLUDE EXTRA-STATUTORY FUNCTIONALITY.

296. SoundExchange devotes only a footnote to defending another flaw in Professor Rubinfeld's interactivity adjustment – his failure to adjust the noninteractive subscription prices on which he relied for extra-statutory functionality. SX PFF ¶ 379

n.7. SoundExchange cannot deny that Professor Rubinfeld intended his comparison of subscription prices to relate the prices charged by interactive services to the prices charged by statutory services, or that Professor Rubinfeld did not do what he testified that he was doing when he actually performed his comparison. *See* NAB PFF ¶¶ 371-72. Nor can SoundExchange deny that Professor Rubinfeld testified that he would have adjusted the subscription prices of the extra-statutory services to account for extra-statutory functionality if he "were to view [the subscription prices] as a primary source of developing a numerical benchmark," or that Professor Rubinfeld was using the subscription price comparison as a primary source of his numerical benchmark and did not make the adjustment he agreed was necessary. *See* NAB PFF ¶ 372 (quoting 5/6/15 Tr. 2047:20-24 (Rubinfeld)) (emphasis added).

297. SoundExchange instead argues that the comparison was proper, because Professor Rubinfeld "was attempting to isolate the value of interactivity, and more specifically on-demand functionality." SX PFF ¶ 379 n.7. But that argument makes no sense. By his own testimony, Professor Rubinfeld was attempting to develop a ratio between the subscription prices charged in his benchmark market and in his target market – statutory services. *See* Rubinfeld CWDT ¶ 167. Economic logic confirmed by Professor Rubinfeld, 5/6/15 Tr. 2047:16-24 (Rubinfeld), and simple math says that inclusion of extra-statutory functionality in the subscription prices used in the denominator would increase the denominator and reduce the ratio – leading to a higher implied license fee. SoundExchange's late spin cannot disguise the fact that Professor Rubinfeld did not perform the analysis he said he was performing and needed to perform within the bounds of his own model.

298. SoundExchange's claim that deleting the services used by Professor Rubinfeld reduces the ratio, SX PFF ¶ 379 n.7, misses the point. Professor Rubinfeld testified that he would need to adjust the subscription prices for the extra-statutory services downward, not delete them. That would have increased the ratio and the interactivity adjustment.

299. Moreover, Professor Rubinfeld's entire analysis is invalid on its own terms for another reason. Professor Rubinfeld employed [[ ]] 5/5/15 Tr. 1797:10-1799:8 (Rubinfeld). SoundExchange is once again applying its double standard when assessing market evidence. As noted above, SoundExchange has argued that it is the number of performances, not the number of agreements, that matters in evaluating market evidence. *See* SX PFF ¶ 1273. A simple arithmetic average of subscription prices that does not account for the relative significance of the services is not a valid comparison. Professor Katz's comparison of per performance revenues addresses this flaw in Professor Rubinfeld's work.

I. SOUNDEXCHANGE FAILS TO OVERCOME THE ERROR OF PROFESSOR RUBINFELD'S INFLATED REVENUE-BASED WEIGHTING OF PER PERFORMANCE RATES.

300. SoundExchange does not deny that Professor Rubinfeld's application of revenue weights to determine his average minimum per performance fee results in higher rates than would an average based on the number of performances. Instead, it argues that higher revenue services "would be expected to have a greater impact on willing buyer/willing seller rates." SX PFF ¶ 394. But there is no reason that is true. It is at least as likely that services with higher revenues per performance will attract fewer users,

have fewer performances, and have a lower growth potential. There is no *a priori* reason such services should be weighted more highly.

301. SoundExchange quotes a hyperbolic footnote from Professor Rubinfeld's Written Direct Testimony asserting that "it is not a long-run market equilibrium for services to 'buy' streaming share by deriving exceptionally low revenue from their service." SX PFF ¶ 395, quoting Rubinfeld CWDT ¶ 203 n.122. But Professor Rubinfeld offered no evidence that any of the services in his sample had "exceptionally low" revenues" (particularly on the relevant per-performance basis) or were "buying" streaming share. To the contrary, the labels have consistently argued that the services in Professor Rubinfeld's sample were its preferred directly licensed services. Kooker WDT at 6-7; Harrison CWDT ¶ 14.

302. More accurately, and contrary to Professor Rubinfeld's footnote, it is not a long run market equilibrium for interactive services to over-charge customers for performances. That is one way to kill growth.

303. SoundExchange nowhere addresses the showing that Professor Katz made on the stand using both a hypothetical example and real data from Professor Rubinfeld. *See* NAB PFF ¶¶ 375-77. Instead, it argues that the hypothetical example contained in Professor Katz's Written Rebuttal Testimony shows that Professor Rubinfeld would have been right to discount a hypothetical service with no revenue. SX PFF ¶ 396. But Professor Katz was not suggesting that the hypothetical services in the example in his written testimony were actual services; rather, he was demonstrating the mathematics of the bias in Professor Rubinfeld's approach that systematically over-states per-performance rates. The bias in Professor Rubinfeld's approach was even clearer in

Professor Katz's demonstration using real world data provided by Professor Rubinfeld. NAB PFF ¶ 376, discussing Katz AWRT ¶ 162. SoundExchange has no response to demonstration, or to the hypothetical discussing two services with revenue that Professor Katz discussed before the Judges.

304. Finally, SoundExchange again takes a position that is inconsistent with the view expressed elsewhere that the number of performances is the most relevant way to assess market evidence. *See* SX PFF ¶ 1273 ("But Mr. Pederson could not say that [[[redacted]]] . . . This is a key distinction. . . Quite simply, when looking at a sample of deals involving parties of varying sizes, the relative number of agreements that contain any particular term in and of itself does not deliver meaningful information about market preference.") (emphasis in original).

J. SOUNDEXCHANGE'S CONTINUED RELIANCE ON PROFESSOR MCFADDEN'S SURVEY IS MISPLACED.

305. In an attempt to salvage Professor McFadden's survey results, SoundExchange goes on the attack. SX PFF ¶¶ 411-24. These attacks, discussed further below, are an unavailing attempt to sidestep some of the fundamental problems with Professor McFadden's own survey, his results and the use of Professor McFadden's results by Professor Rubinfeld.

306. NAB has demonstrated that Professor McFadden's survey results were unreliable and were improperly used by Professor Rubinfeld. NAB PFF Part VII.A.10.a-b. With respect to Professor McFadden's methodology, NAB demonstrated that (i) Professor McFadden's survey employed confusing feature descriptions (NAB PFF ¶ 415, 417), (ii) his survey employed lengthy and confusing incentive alignment language (NAB

PFF ¶¶ 421-22), (iii) Professor McFadden failed to properly pre-test his feature descriptions, which changed substantially from his pilot survey (NAB PFF ¶¶ 418, 422), (iv) Professor McFadden had little to no industry experience and virtually no familiarity with the features that would be important to music service purchasers (NAB PFF ¶ 415), (v) his survey failed to include certain important features (NAB PFF ¶ 416), (vi) his survey was poorly implemented, including the fact that he made changes to feature descriptions from his pilot survey, which were changed in parts of the final survey, but not other parts (NAB PFF ¶ 418-19), and (vii) his survey had an "alarming" (Professor McFadden's word) drop-out rate for teenagers, and an overall high drop-out rate (NAB PFF ¶ 424).

307. Regarding the use of Professor McFadden's results, NAB also demonstrated that Professor McFadden neither endorsed Professor Rubinfeld's use of his results nor coordinated with Professor Rubinfeld regarding his conjoint survey. NAB PFF ¶ 427. Moreover, Professor Rubinfeld's attempt to use the survey to corroborate his adjustment based on the ratio of the average subscription price for an on-demand service to the average subscription price for a statutory service compares apples and oranges. Professor Rubinfeld's approach improperly (i) compared subscription prices in the market (Professor Rubinfeld's interactivity adjustment) and average willingness to pay for selected features of music services (Professor McFadden's numbers) (NAB PFF ¶ 429), and (ii) based the comparison on different sets of features (NAB ¶ 430). Professor Rubinfeld's use of Professor McFadden's data is also questionable because when examined more closely (rather than just the "average" data), the willingness to pay data show large heterogeneity, which provides no indication of consumers' divergent

preferences, as well as data that reflect respondents who were willing to *pay less for a more beneficial feature.* NAB ¶¶ 431-32. In sum, there are numerous and significant failures in the design, implementation and use of Professor's McFadden's survey and results.

308. SoundExchange first attempts to explain away Professor McFadden's failure to include important features, asserting that it would be too much information for respondents to absorb. SX PFF ¶¶ 412-13. But SoundExchange ignores the critical question of whether Professor McFadden included the most relevant features in his survey. It is SoundExchange's and Professor McFadden's burden to support the validity of the conjoint survey on which they seek to rely. Yet, Professor McFadden, who repeatedly stated that he is not an expert in the webcasting industry, was woefully unfamiliar with the potential music service features as well as the documentation supporting his own report. NAB PFF ¶¶ 415-16; 4/29/15 Tr. 913:7-15 (McFadden) ("Well, I'm not an expert myself in what these features are, and my understanding was that what we did was we went and looked at the features that seemed to be commonly listed in comparisons of streaming services and on websites. There may be additional specifications which are included, but I've not gone—myself, I have no direct personal information on that"). Professor McFadden instead left the selection of features to the Brattle Group, whom he admitted also were not experts in webcasting. NAB PFF ¶ 416. SoundExchange also suggests that additional features would only decrease the interactivity adjustment. SX PFF ¶ 413. But that is pure speculation—SoundExchange and Professor McFadden have no way to know how the addition of more features or different would have interacted with other features and affected the responses to the

conjoint questions, in turn altering the willingness to pay "averages" relied upon by Professor Rubinfeld. The salient fact is that Professor McFadden did not test relevant features.

309. SoundExchange also glosses over the heterogeneity of Professor McFadden's resulting data, asserting that, "although there is 'heterogeneity' in the answers of respondents of Professor McFadden's conjoint study that would suggest different willingness to pay," the individual estimates are not statistically significant and averages provide a more statistically reliable result. SX PFF fn. 8 at 117. But this does nothing to explain how Professor McFadden's conjoint survey could result in respondents who were willing to pay less for a more beneficial feature. NAB PFF ¶ 432. It also does not address the defects identified by Dr. Peterson regarding Professor Rubinfeld's fundamentally improper approach of comparing subscription prices in the market and average willingness to pay for certain features of music services, particularly where that comparison was based on different sets of features. NAB PFF ¶¶ 429-30.

310. SoundExchange's attacks on Professor Hauser (SX PFF ¶¶ 416-24) are equally unavailing. NAB engaged Professor Hauser to evaluate whether Dr. McFadden's survey provided reliable results. NAB PFF ¶ 412. As NAB set forth in its Proposed Findings, Professor Hauser determine through his own evaluation, and the results of a double-blind qualitative study he oversaw, that Professor McFadden's conjoint survey data are not reliable. NAB PFF ¶¶ 413-14. Professor Hauser's study, which was carefully designed and implemented to mimic Professor McFadden's survey, showed extensive confusion of survey participants in terms of the meaning of the conjoint features and the incentive alignment. NAB PFF ¶¶ 414, 419-22.

311. First, SoundExchange asserts that confusion regarding the meaning of Professor McFadden's tested features is unimportant because Professor McFadden used terms from the websites of music services and any confusion during Professor McFadden's test would simply mimic real world confusion.[13] SX PFF ¶¶ 418-19. But Professor Hauser expressly rejected this flawed reasoning, testifying that "if different people understand the features in different ways, then [Professor McFadden] is really comparing apples and oranges when he is trying to report an average [willingness to pay]." 5/22/15 Tr. 5586:11-5587:16 (Hauser). Indeed, any confusion displayed by survey respondents is troubling. Professor Hauser debunked the fallacy that it is acceptable for survey respondents to be confused because some "real world" marketplace users might be confused:

> Q. And you agree, don't you that in the real world consumers have different levels of expertise with respect to specific features of streaming services at the time of the purchase?
>
> A. Oh, I absolutely agree. That's one of the reasons when you're writing a survey. . . you want to write it so that the vast majority understands the features that you've written them because there is this heterogeneity. Some people will be tech high. Some people may not. <u>So if you're going to make projections to a population as a whole, you want to make sure that almost all, maybe 97 percent or so of the respondents, can understand the features</u>.

5/22/15 Tr. 5598:18-5599:7 (Hauser) (emphasis added).

312. Second, SoundExchange attacks Professor Hauser's survey as being a "memory test." But SoundExchange is grossly mischaracterizing Professor Hauser's

[13] SoundExchange asserts that the technical terms used by Professor McFadden in his feature descriptions are used on certain iHeartMedia and Pandora sites. But there is no evidence that such sites were visited by survey respondents or that such sites are relied upon by all marketplace users. Moreover, Professor Hauser testified that websites "are a great beginning. I've done that myself in cases. We start with the Website and then we pretest to make sure that the average respondent who may or may not be familiar with these services could understand what the phrases mean." 5/22/15 Tr. 5595:9-21 (Hauser). But as NAB has shown, Professor McFadden's pretesting was deficient. NAB PFF ¶¶ 418, 423.

methodology. Professor Hauser testified that the double-blind coders, who could not know whether the purpose of the qualitative study was to test for confusion or whether it sought to confirm there was no confusion, were experienced and employed a conservative methodology to come to their final coding. Hauser WRT ¶¶ 63, 65. Professor Hauser's respondents had the ability to go back and look at prior web pages of the survey, to review feature definitions or the incentive alignment language. In this regard, Professor Hauser was duplicating the same functionality that Professor McFadden had in his online survey. 5/22/15 Tr. 5577:9-12 (Hauser); Hauser WRT ¶¶ 60-61. Also Professor Hauser's study was not a test in which respondents were asked to parrot back information; rather, respondents were asked to describe "in their own words" their understanding of the incentive alignment language and the feature descriptions. Hauser WRT ¶¶ 91 (explaining that parroting back the definition is not what was desired—rather the qualitative study sought "[t]o distinguish simple verbal recall versus understanding, respondents were probed on the depth of their understanding of the features"); *id.* ¶¶ 74, 80, 83, 85. At bottom, it is important for respondents to understand the survey features and incentive alignment. As NAB has shown, confusion can result in "varied and meaningfully distinct interpretations" of the tested feature levels, resulting in unreliable survey data. NAB PFF ¶¶ 414; Hauser WRT ¶ 45 ("When there are distinct interpretations of a feature, the estimated feature valuation might be more strongly driven by differences in the interpretation of features rather than by valuations of those features.")

313. Third, SoundExchange argues that survey respondents did not have to have a "precise" understanding of the incentive alignment language (SX PFF ¶ 420),

which is itself is a tacit admission that the incentive alignment language is imprecise. But Professor Hauser did not require a "precise" understanding of the language by his study respondents. *See* Hauser WRT ¶ 66 ("A respondent who indicated an element of confusion after several probing questions could still be placed into a category of a correct definition if his verbatim answers contained recognizable thoughts that reflected the intended meaning of Professor McFadden's definitions."), ¶ 86 (reflecting that some respondents were coded as understanding the incentive alignment language even though confusion remained with respect to certain details); *see also id.* ¶ 94 (reflecting that the results were "based on the more-conservative coding that did not include non-verbal cues"). SoundExchange's Findings attempt to gloss over any potential confusion in terms of the incentive alignment but Professor Hauser explained the dangers of such confusion, testifying that "if people were confused about the incentive alignment, they may feel that they should always choose a free service. If they thought they wanted to maximize the gift and they didn't understand it or they might feel they have to choose the most expensive service, and some people said that. . . . <u>The problem is that there was so much confusion among these, we don't know which way the bias went</u>." 5/22/15 Tr. 5579:3-24 (Hauser) (emphasis added); Hauser WRT ¶¶ 88 (setting forth possibilities resulting from confusion regarding the incentive alignment, (i) including ignoring the incentive alignment, which defeats its purpose, (ii) reacting unpredictably, (iii) making choices "disconnected from their preferences," which would skew the results, and (iv) specifically acting according to misinterpretation of the incentive alignment, which would also skew the results).

314. Fourth, SoundExchange attacks Professor Hauser for not reporting all of the data to some of the answers to his qualitative study. SX PFF ¶¶ 423-24. This attack relates to the subject of Professor McFadden's "Supplemental Testimony" that SoundExchange has attempted to file. NAB agrees with iHeartMedia's Motion to Strike SoundExchange's "Supplemental Testimony" of Professor Daniel R. McFadden, filed June 9, 2015 (and iHeartMedia's Reply filed June 18, 2015). NAB requests that the Judges strike any and all references to Professor McFadden's "Supplemental Testimony" in SoundExchange's Findings of Fact and Conclusion of Law, including but not limited to SX PFF ¶¶ 423-24, as well as any references that may be included in SoundExchange's Reply Findings of Fact and Conclusions of Law. NAB will not rehash the arguments contained in those pleadings, however, the submission of Professor McFadden's "supplemental testimony" was untimely, contained new analysis of new data offered in support of new conclusions, and resulted in an ambush of Professor Hauser because he was unable to substantively testify regarding the untimely new data and analysis. Allowing SoundExchange to enter this testimony into the record would allow them to install untested "evidence" in the form of an unchallenged surrebuttal, which would be contrary to the structure of the proceeding and patently unfair to the Services.

315. If the Judges choose to consider SX PFF ¶¶ 423-24, Professor Hauser testified that he did not believe he needed to code the other questions based on the demonstrated confusion of the survey respondents regarding the feature questions and incentive alignment. 5/22/15 Tr. 5637:10-5638:4 (Hauser). Moreover, with respect to the question "did you or did you not understand the explanations of features in the

survey," asking confused respondents whether they are confused is not likely to result in consistent and reliable responses. Even Professor McFadden testified that:

> The problem there is that people after the fact will often try to look like they're more intelligent, perhaps, than they are or more considering and calculating in their decisions than they actually are. So you have to be careful about interpreting people's, sort of, debriefing responses that they themselves sometimes don't give you a good picture of what was actually going through the people's minds at the time they were making the choices.

4/29/15 Tr. 853-856 (McFadden). Professor McFadden's testimony demonstrates his agreement that responses to this question would verify nothing.

316. Last, SoundExchange falsely asserts that Professor Hauser did not report on the results to Question 34 ("If you were presented with these options and had to spend your own money, would you choose the same options?") of his study. SX PFF ¶ 424. In fact, Professor Hauser reported on the results to Question 34 in his Written Testimony. Hauser WRT ¶ 89. Professor Hauser noted, as does SoundExchange, that 83% of respondents responded in the affirmative. But that is not the positive result SoundExchange spins it to be. First, the question is biased to the affirmative. Hauser WRT ¶ 89. Also, as Professor Hauser noted, 13.2% of respondents—likely a low number given the question bias—admitted to not making "choices aligned with their preferences." *Id.*; SX PFF ¶ 424. It is wrong for SoundExchange and Professor McFadden to ignore the negative implications of such a large percentage of respondents expressly disavowing their choices (which does not even take into account the percentage of individuals that affirmed their choices based upon a confused understanding of the conjoint features).

317. There is no basis to take the willingness-to-pay results of survey respondents who were confused regarding the tested conjoint feature descriptions and incentive alignment, determine the average of those "results" despite their large heterogeneity, and use that "average" to "corroborate" Professor Rubinfeld's flawed interactivity adjustment. Professor McFadden's survey results should be rejected as unreliable and unsupportive of Professor Rubinfeld's interactivity adjustment.

VII. NEITHER THE APPLE ITUNES RADIO AGREEMENTS NOR SOUNDEXCHANGE'S OTHER CORROBORATING AGREEMENTS SUPPORT SOUNDEXCHANGE'S RATE PROPOSAL.

318. In its findings of fact, NAB showed that agreements for five non-DMCA compliant services – Apple iTunes Radio, Beats The Sentence, Nokia MixRadio, Rhapsody unRadio and Spotify Shuffle – do not support SoundExchange's rate proposal. *See* NAB PFF Part VIII.C, E. SoundExchange's arguments provide no additional persuasive evidence to support its contentions. SX PFF Part XI.

A. SOUNDEXCHANGE'S RELIANCE ON THE APPLE ITUNES RADIO AGREEMENTS IS MISPLACED.

319. SoundExchange argues that the Apple iTunes Radio agreements with Sony and Warner "support SoundExchange's rate proposal." SX PFF ¶ 939. They do not.

320. SoundExchange argues that the Apple agreements are particularly "appropriate" as benchmarks because the "were not contemplated to be used as benchmarks in this proceeding," SX PFF Heading XI.A.3, [[[redacted]]]).

321. SoundExchange attempts to parody this showing by asserting that the services claim "some conspiracy between Apple and the labels." SX PFF ¶ 949. But that was not the point of the services' showing. The evidence clearly shows that this proceeding caused an upward bias in the rates and [[ ]]. NAB PFF ¶¶ 456-57. Moreover, the evidence confirms that [[ ]] NAB PFF ¶ 456 (quoting email from [[ ]], IHM Ex. 3517). According to SoundExchange, "to the extent that parties anticipated that the agreement and its projections could and would be used as evidence in this proceeding, they cannot be reliable evidence." SX PFF ¶ 798. The evidence demonstrates that the Apple agreements are not "reliable evidence."

322. SoundExchange's eagerness to introduce the Apple agreements belies its argument that the labels did not intend the agreements to be used in this proceeding. *See, e.g.*, SoundExchange Introductory Memorandum at 2 n.1 (lamenting the inability to introduce the Apple agreements and noting that "the record companies asked Apple to waive certain contractual provisions"); Rubinfeld WRT (with redactions concealing a fully drafted Appendix 2 discussing the Apple agreements, in the hope that a *deus ex machina* would allow SoundExchange to spring the agreements as new benchmarks). Similarly, the fig leaf of Dr. Kendall's testimony relied upon by SoundExchange belatedly to unmask Professor Rubinfeld's concealed Appendix 2 exposed the lengths to which the labels would go to use the agreements in this case and belies any argument that the non-use provisions in the Warner and Sony agreements were effective. *See* Order Denying Licensee Services' Motion to Strike SoundExchange's "Corrected" Written

Rebuttal Testimony of Daniel Rubinfeld and Section III.E of the Written Rebuttal Testimony of Daniel Rubinfeld and Granting Other Relief, Docket No. 14-CRB-0001-WR (2016-2020) (Apr. 2, 2015).

323. SoundExchange offers no response to the other important influence of the statutory license – the fact that but for the agreement, Apple would have been required to pay the CRB statutory rate. *See* NAB PFF ¶¶ 451-53, 481-85.

324. SoundExchange now offers extensive surmise about the purpose of the [[ ]]. SX PFF ¶ 955-82. But when SoundExchange had the chance to introduce evidence concerning those payments – evidence that would have been subjected to discovery and meaningful cross-examination – it did not even attempt to do so.

325. SoundExchange admits that Sony and Warner entered into agreements with Apple that were [[ ]]. SoundExchange attempts to characterize the changes as [[ ]] but that characterization is wholly unsupported by any citation. *See* SX PFF ¶ 966. [[ ]] *See* SX PFF ¶ 967.

326. SoundExchange claims that nothing in either [[

]]

327. Although SoundExchange asserts that [[

]] SoundExchange's argument is speculation that is not supported by the record.

328. SoundExchange's discussion of the Warner Agreement is similarly based on speculation without evidence. SX PFF ¶ 973. [[

]]

329. SoundExchange accuses the services of engaging in "nothing more than speculation," SX PFF ¶ 974, but the evidence related to the [[

[14] SoundExchange's citation to page 1 of SX Ex. 2071 appears to be a typo, as that page does not discuss reporting requirements at all.

[redacted]]] In any event, this was SoundExchange's benchmark, and it had access to the relevant data. Despite Professor Rubinfeld's admission [[[redacted]]] NAB PFF ¶ 467. This was not the services' failing. It was SoundExchange's, and it vitiates the validity of the benchmark.

330. Finally, with respect to the [[[redacted]]] SoundExchange does not address Professor Katz's observation that the payments were likely an artifact of the major labels' must-have market power. *See* NAB PFF ¶¶ 477-78.

331. SoundExchange does not deny that the unique revenue streams available to Apple from iTunes Radio would make Apple willing to pay more than other webcasters. *See* NAB PFF ¶¶ 459-62; SX PFF ¶¶ 975-82.

332. Instead it argues that the effect on Apple's willingness to pay, is offset by the fact that the labels obtain unique benefits, too (*e.g.*, in increased revenues from the sale of iTunes downloads). SX PFF ¶¶ 975-82. SoundExchange cites neither economic theory nor factual evidence to support its lawyers' contention that the two effects would offset. To the contrary, the argument compares apples and oranges, and, taken on its own terms, would prove too much.

333. SoundExchange relies entirely on theory that the labels would be willing to accept less in their dealings with Apple. It cites to no factual evidence that the major

labels actually accepted a lower price from Apple due to the benefits from the potential sale of additional iTunes downloads. Ironically, although SoundExchange had access to such factual information, it cites only Professor Katz and Shapiro in its discussion of these theoretical motivations. *See* SX PFF ¶¶ 975-82.

334. Moreover, although SoundExchange cites Professor Katz in support of the theory that the download benefits might make the labels willing to accept a lower price, he nowhere testified that the potential benefit to the labels would have any offsetting effect against the benefits to Apple. Tellingly, neither did Professor Rubinfeld.

335. The opportunity benefits to the labels would be relevant in a truly competitive market where prices reflect sellers' costs. But there is no reason to believe that was is the case in the Apple iTunes Radio agreements. The agreements were negotiated in the shadow of the statutory license, the major labels' catalogues are must-have complements for iTunes Radio (*see* Rubinfeld CWRT ¶¶ 141-42), the labels are able to coordinate their strategy for the noninteractive market through their involvement in SoundExchange, and the [[[redacted]]] Thus, the fact that the labels obtained ancillary benefits from the Apple agreements tells nothing about the fees that would be established in a hypothetical effectively competitive market unaffected by the statutory license.

336. Indeed, simply stating SoundExchange's argument highlights its absurdity. According to SoundExchange Sony and Warner the license fees computed by Professor Rubinfeld, which already far exceeded the current statutory rate, were actually biased downward by the labels' alleged willingness to accept "lower" rates than they otherwise would have accepted. Given the numbers involved, that makes no sense.

337. Conversely, to the extent the agreement was not the direct result of the statutory rates, Apple's willingness to pay would have been directly relevant to the rates established in the agreements. As Universal said, must-have record labels have [redacted]]] PAN Ex. 5349 at 17 (emphasis added). The added benefits to Apple would have increased the amount of that [[[redacted]]] Thus, as the services correctly argued, it would have resulted in an upward bias in the agreed license fees.

338. SoundExchange argues that it was appropriate for Professor Rubinfeld to examine only the retrospective performance of the Apple iTunes Radio agreements in his analysis. SX PFF Part XI.A.6. As demonstrated in NAB's Reply PCLs, SoundExchange's legal arguments in support of this point lack merit. *See infra* NAB Reply PLC Part X.B.2. Its factual arguments are also wrong. *See* NAB PFF Part ¶¶ 443-50.

339. SoundExchange argues that the parties assumed different risks by structuring the agreement with an [[[redacted]]]. *See* SX PFF ¶ 985. That is true as far as it goes. But it highlights the differences between the Apple iTunes Radio agreements and the statutory license fee rate that the Judges are charged with establishing. If anything, it shows that the Apple iTunes Radio agreements are not useful benchmarks.

340. Moreover, the different risks inherent in large [[[redacted]]] cannot be removed by examining the results of that [[[redacted]]] after the

fact. *Ex post* analysis says nothing about what the parties would have agreed to at the time of their agreement under a [[ ]] had they been negotiating such a deal. *See* NAB PFF Part VIII.C.1.

341. SoundExchange's assertion that *ex post* analysis "corrects for that uncertainty and risk and provides an objective value to performances made under the terms of the agreement," SX PFF ¶ 987, is both wholly unsupported and transparently false. Consider, for example, a $100 even-money bet on the Super Bowl made in a Las Vegas casino. Such a bet requires an up-front lump sum payment of $100.[15] If you lose the bet, you have nothing, but it would be wholly inappropriate to say that the bet was worth nothing when made, and it would be absurd to argue from the *ex post* outcome that a casino would (or should) offer you a bet on the next Super Bowl that might pay $200 for nothing (the *ex post* value of the previous bet). Conversely, if you win the bet and have $200, it is equally absurd to say that you would have made the bet at the time it was made for $200, or, more to the point, that you be willing to pay $200 for a 50-50 bet on the next Super Bowl that would leave you with only $200 if successful and nothing if unsuccessful. Such *ex post* review tells nothing about the economic value of the agreement at the time it was made.

342. SoundExchange also attacks Professor Katz's demonstration that Professor Rubinfeld dramatically understated his adjustment for [[ ]] by basing that adjustment on assumptions about Pandora instead of actual data available to Professor Rubinfeld. *See* SX PFF ¶¶ 991, 994-97. SoundExchange's criticisms of Professor Katz are unfounded.

[15] For ease of exposition, this example does not include the $10 vigorish typically charged by a casino for losing bets.

343. SoundExchange first claims that Professor Katz was wrong to include in the [[ ]] SX PFF ¶¶ 995-96. But it cannot dispute that [[ ]] *See, e.g.*, 5/20/15 Tr. 5017:18-5018:3 (Shapiro). Although SoundExchange quotes an unrelated statement by Professor Shapiro concerning the value of incremental downloads, it ignores Professor Shapiro's testimony directly on this very issue of [[ ]]

5/20/15 Tr. 5019:17-5020:12 (Shapiro). An Apple's-to-apples comparison would require consideration of [[ ]]

344. SoundExchange next argues that Professor Katz was wrong because it speculates that [[ ]] SX PFF ¶ 997. Notably, SoundExchange offers no factual support for this speculation. There is nothing in the record to support the idea that

Apple would alter its service, and Professor Rubinfeld did not rely on such a rationale in making his estimated adjustment.

345. Moreover, if SoundExchange's speculation has any validity, it serves only to highlight differences between iTunes Radio and statutory services that undermine SoundExchange's reliance on the iTunes Radio agreements.

346. In any event, both of SoundExchange's criticisms of Professor Katz are inconsistent with Professor Rubinfeld's own reasoning, on which SoundExchange is presumably relying. According to Professor Rubinfeld, his [[ ]] 5/6/15 Tr. 2074:9-15 (Rubinfeld) (emphasis added). That would include [[ ]]. It would also include actual skips observed on the iTunes Radio service.

347. SoundExchange also criticizes Professor Shapiro for treating [[ ]] under the iTunes Radio agreements. SX PFF ¶ 1012. But the terms of the iTunes Radio agreements expressly define [[ ]] SX Ex. 128 at 27 § 1(x) (Warner); SX Ex. 128 at 51 § 1(y) (Sony). Although SoundExchange claims that these [[ ]] it points to no evidence that these [[ ]] It is too late for SoundExchange to be manufacturing evidence. SoundExchange's argument merely again highlights the significance of Professor Rubinfeld's fundamental failure to address [[ ]].

348. Finally, SoundExchange's reliance on Table 11 of Professor Katz's testimony is misplaced. Professor Katz made clear that he did not believe Professor Rubinfeld's ex post analysis was proper or that it was appropriate to amortize the [[ ]] *See* Katz AWRT ¶ 234. Table 11 corrects for only one error made by Professor Rubinfeld – the failure properly to adjust for [[ ]]. It does not support SoundExchange's fee proposal. Moreover, Table 11 demonstrates that, by using the actual [[ ]] the rates implied by the Apple iTunes Radio agreements are [[ ]] far below SoundExchange's fee proposal.

B. SOUNDEXCHANGE'S RELIANCE ON THE "SECTION III.E." SERVICES IS MISPLACED.

349. SoundExchange argues that the services discussed in Section III.E of Professor Rubinfeld's Corrected Written Rebuttal Testimony corroborate SoundExchange's proposal. For all of the reasons set out in Part VIII.E. of NAB's Proposed Findings of Fact, they do not.

350. SoundExchange asserts that the record companies "concede deeply discounted rates" to these product offerings, but cites no evidence to support this claim. SX PFF ¶ 1015. Not even Professor Rubinfeld makes such an assertion. And, as Professor Katz testified, [[ ]].[16]

[16] This is not the only wholly unsupported assertion by SoundExchange in its discussion of the Section III.E. services. For example, the repeated statements that the license fees for the various services "closely approximate the rates that a willing buyer and willing seller might agree" or "are indicative" of such rates, *e.g.*, SX PFF ¶¶ 1023 (Beats), 1028 (Spotify), are unsupported argument, not statements of fact supported by the record.

351. SoundExchange devotes five paragraphs to arguing that the functionality of Beats is similar to the functionality of statutory services. SX PFF ¶¶ 1018-22. Despite that, SoundExchange concedes that "[i]n one respect, The Sentences' functionality exceeds the statutory requirements – compliance with the performance complement." SX PFF ¶ 1022.

352. More fundamentally, even if the Beats Limited Free Service were identical to a statutory service, it would not provide useful information. SoundExchange <u>does not respond at all</u> to most significant economic points about Beats presented by Professor Katz – that the Beats Limited Free Service was a tiny part, [[ ]] of a much larger service, [[ ]] *See* NAB PFF ¶ 503. Moreover, because they were linked to the larger Beats service, both in the way they were negotiated and due to the [[ ]] described by Professor Rubinfeld, the royalty rates cannot be viewed in isolation. NAB PFF ¶¶ 503-09. As such, the rates applicable to the Beats Limited Free Service do not provide a useful comparison.

353. SoundExchange also fails to respond to the demonstration that the Beats Limited Free Service ceased to be offered after October 2014 after a very short existence. This further undermines the usefulness of the rates. NAB PFF ¶ 504-05. In sum, SoundExchange's reliance on Beats' Limited Free Service is misplaced.

354. SoundExchange's discussion of the Spotify Free Tier, SX PFF ¶¶ 1026-29, wholly ignores the fact that the Spotify Free Tier of service includes fully on-demand functionality on desktop, laptop and tablet computers. *See* NAB PFF ¶ 531. Thus,

contrary to SoundExchange's assertion, it is not a service that "offers functionality that is much closer to the functionality offered by Pandora and iHeartRadio than to the functionality offered by an on-demand service." SX PFF ¶ 1027. It is an on-demand service.

355. SoundExchange artificially tries to disassociate the Mobile Shuffle function from the entirety of the service, but that makes no sense – the Spotify Free Tier is offered as a service. Indeed, as Professor Katz demonstrated, the rates and terms for all of the Spotify products [[ ]] NAB PFF ¶¶ 534-35.

356. Moreover, SoundExchange's claim that the Mobile Shuffle part of the Spotify Free Tier is closer to Pandora and iHeartRadio than to on demand services is not supported by the evidence. Unlike Spotify's Mobile Shuffle, Pandora and iHeartRadio do not permit users [[ ]] – a function that is much closer to an on-demand service than to custom radio.

357. SoundExchange has no response for Professor Katz's discussion of the fact that [[ ]], NAB PFF ¶ 533, a difference that requires an adjustment.

358. Nor does SoundExchange have a response to Professor Katz's demonstration that the effective per performance rate being paid by Spotify for its Free Tier is [[ ]]. NAB PFF ¶ 540.

359. SoundExchange admits that Rhapsody's "unRadio offers some limited on demand functionality." SX PFF ¶ 1030. That is an understatement of unRadio's extra-statutory functionality, which was detailed in NAB's Proposed Findings of Fact, and includes allowing users to name 25 favorites for on-demand play, caching for off-line listening, and unlimited skipping. NAB PFF ¶¶ 525-27. Neither Professor Rubinfeld nor SoundExchange takes these important differences into account.

360. Nor does SoundExchange address the fact that unRadio accounts for only [[ ]], the royalty rates paid for unRadio do not offer reliable information for corroborating any benchmark. NAB PFF ¶ 529.

361. SoundExchange does not deny the atypicality of Nokia's MixRadio or that it is an [[ ]] SX PFF ¶¶ 1031-33; *see* NAB PFF ¶¶ 510-14, 520. Indeed, SoundExchange admits that the service has [[ ]] SX PFF ¶ 1015. In short, MixRadio is an outlier that does not provide useful information.

362. SoundExchange attempts to downplay, but does not deny, MixRadio's extra-statutory functionality. SX PFF ¶ 1032. Similarly, SoundExchange ignores the fact that Nokia is [[ ]]. *See* NAB PFF ¶¶ 516.

363. Nor does SoundExchange have any response for Professor Katz's showing that MixRadio was [[ ]]. Nor did Professor Rubinfeld provide any information about the significance of MixRadio relative to [[ ]]. The rates for MixRadio cannot properly be viewed in isolation. *See* NAB PFF ¶¶ 521-22.

364. In short, the Section III.E. services do not corroborate SoundExchange's fee proposal.

VIII. SOUNDEXCHANGE FAILED TO PROVIDE ANY BASIS FOR RELYING ON THE WSA AGREEMENTS IN SETTING A RATE.

365. In its Proposed Findings, the NAB first noted that "[n]o party has advanced either the NAB-SoundExchange Webcaster Settlement Act ("WSA") agreement or the SiriusXM-SoundExchange WSA agreement as a benchmark in this case." NAB PFF ¶ 243. SoundExchange now concurs that "no party offered these WSA agreements as benchmarks in this proceeding." SX PFF ¶ 1034. As such, the parties are in rare agreement that the WSA agreements should not be used as benchmarks to set a rate in this proceeding.

366. Notwithstanding its express disavowal of the WSA agreements as benchmarks, SoundExchange persists in noting that Professor Rubinfeld considered the WSA agreements to be "probative, arms'-length deals" that were properly considered in *Web III*. *Id.* SoundExchange also relies on the testimony of its CEO, Michael Huppe, which purports to refute the testimony of Steve Newberry, principal negotiator for the NAB, and David Frear of SiriusXM, regarding the circumstances surrounding the negotiation of these agreements. *See generally* SX PFF ¶¶ 1034-81. Mr. Huppe does

nothing to rebut the key point established in the services' testimony—*i.e.*, that the rates in the WSA agreements were presented on an overall "take-it-or-leave-it" basis, with no room for negotiation of the overall rate structure. In addition, while Mr. Huppe testifies concerning various theoretical "options," the testimony demonstrates overwhelmingly that there were no realistic options available to the services at the time of the WSA negotiations.

367. As set out in NAB's Proposed Findings, Mr. Newberry stated unequivocally in both his written and oral testimony that, while SoundExchange was willing to negotiate modest adjustments on the rates for individual years, it was unwilling to budge on the overall rate structure. Thus, any reduction in one year would require a corresponding increase in another year. NAB PFF ¶¶ 250-51 (citing 5/20/15 Tr. 5089:1-3 (Newberry); Newberry WDT ¶ 24). Notwithstanding his conclusory attempts to posture the discussions as [[[redacted]]] 6/3/15 Tr. 7568:1-3 (Huppe), Mr. Huppe never disputes Mr. Newberry's testimony that the overall rate package was presented by SoundExchange from the outset on a take-it-or-leave-it basis. Similarly, it is undisputed that the final rate structure reflected SoundExchange's demands. *See* NAB PFF ¶ 251.

368. The NAB WSA agreement has rates for 2009-2015. SoundExchange claims that, at the time of the 2009 negotiations, the rates for 2011-2015 *Web III* period were "unknown" and that "[g]iven that the statutory rates for 2011-2015 had not yet been established, *Web II* did not cast any shadow over the remaining years of the settlement." SX PFF ¶¶ 1037-38. While it is true, of course, that the rates for 2011-2015 were not known for certain insofar as they had not been established, SoundExchange does nothing

to refute the NAB's showing that the broadcasters had no legitimate reason to expect that the rates entered by the same Judges in *Web III* would be any more favorable than the disastrous outcome of *Web II*. *See* NAB PFF ¶ 253 (citing testimony from Mr. Newberry, 5/20/15 Tr. 5020:25-5081:26, 5082-11-15, 5082:16-5083:3, 5115:17-5118:12 (Newberry)). SoundExchange's vaguely asserts that "the streaming market was a 'rapidly changing space' at the time," SX PFF 1040, but there is no suggestion by SoundExchange that the unidentified rapid changes would likely result in a lower rate (and, in fact, SoundExchange argued for and obtained even higher rates in *Web III*).[17]

369. SoundExchange claims that, based on Mr. Newberry's testimony that there was no reason to expect a better outcome in *Web III* than in *Web II*, broadcasters could have reasonably expected an outcome of $0.0019 (the rate for the last year of Web II) and that there as "no testimony as to why NAB would have expected a material increase in *Web III*." SX PFF ¶1038 n.50. But this focus on the last year ignores the undisputed fact that the *Web II* rates increased every single year during the term. 72 Fed. Reg. 24084, 24096 (May 1, 2007). SoundExchange suggests no reason why a rational observer in 2009 would have assumed that the constant annual rate increases would

[17] In response to Mr. Newberry's statement that the broadcasting industry was suffering from the effects of the Great Recession and could not afford to engage in another rate proceeding, SoundExchange notes that (i) the total revenues of the broadcast industry are greater than the total revenues of the recording industry, and (ii) the recording industry was also suffering the effects of the recession, and therefore SoundExchange would be incentivized to avoid litigation costs. *See* SX PFF ¶ 1050. But numerous differences are obvious: increasing sound recording royalty rates are SoundExchange's *raison d'etre,* whereas the core business of broadcasters and the principal source of their revenues is terrestrial broadcasting. *See* 5/20/15 Tr. 5082:5-11 (Newberry). Given its mission, SoundExchange has always had funds from its collections to litigate CRB proceedings; settling with the NAB also would not and did not obviate SoundExchange's interest in litigating *Web III*. In addition, as discussed by Mr. Newberry, the broadcasters had actively litigated *Web II* and lost; in contrast, SoundExchange has won, and that outcome necessarily affected the willingness to engage in further litigation. *Id.* at Tr. 5079:13-5083:3.

suddenly cease. *Cf.* Newton's First Law of Motion (bodies in motion continue in motion unless acted upon by an outside force).

370. Apart from litigating in *Web III*, which was not a realistic option for the reasons discussed above and in NAB PFF ¶¶ 252-54, SoundExchange suggests that the NAB had other "options" to the unfavorable WSA settlement including (i) direct negotiations with labels, (ii) reliance on others to litigate *Web III*, and (iii) stopping streaming altogether. SX PFF ¶¶ 1051-54. None of these, however, represented a viable alternative to acceding to SoundExchange's demands.

371. With respect to direct negotiations, Mr. Newberry testified that SoundExchange representatives made it clear that any rate negotiations must go through SoundExchange. 5/20/15 Tr. 5086:10-16 (Newberry) ("[their position] pretty clearly made to us was that SoundExchange and that group of negotiators were the persons that we needed to address the rate issues with"); *id.* at 5120:19-20 ("SoundExchange said, 'We're the body you need to discuss the rates with.'"). Neither Mr. Huppe nor any other SoundExchange witness disputed these statements or presented any contrary testimony or other evidence.

372. In addition to contradicting its express representations at the time, SoundExchange's claim that direct negotiations with the labels were a viable alternative is refuted by both the limited timeframe for negotiations and the demonstrated history of SoundExchange's ability and willingness to interfere with such negotiations when attempted by a service. *See* 5/20/15 Tr. 5086:4-16 (Newberry) (noting six-week window and interest of 15,000 broadcasters); NAB PFF ¶¶ 259-66 (citing evidence of, inter alia, absence of any directly licensed agreement as of the time of the WSA agreements,

representation of major labels on SoundExchange Board and Licensing Committee, and coordinated interference with SiriusXM's attempts to negotiate direct licenses). Indeed, contrary to its position that direct negotiations were a viable option, SoundExchange concedes that the tight WSA deadlines "necessitated collective action by both the record industry and the services." SX PFF ¶ 1045.

373. SoundExchange notes that "the section 114 statutory license specifically contemplates collective action." SX PFF ¶ 1044. SoundExchange goes on to state, however, that "[t]o ensure that this collective action could not give rise to competitive abuses, Congress also created a rate court backstop." *Id.* (citing 155 Cong. Rec. S6740 (June 17, 2009) (emphasis added). The admission that the Copyright Royalty Board is intended to prevent the potential for "competitive abuses" inherent in collective action is completely at odds with SoundExchange's repeated claim elsewhere in its proposed findings and conclusions that the "willing buyer/willing seller" standard does not involve the concept of effective competition and that the Judges can and should impose monopolistic or supra-monopolistic rates. *See, e.g.*, SX PFF ¶¶ 142-45, SXPCL ¶¶ 12-38.

374. SoundExchange notes that it did not act as a "classic monopolist" because it represented multiple interests. SX PFF ¶ 1043. But cartels often represent multiple interests; in that situation, there is still a single seller. *See* NAB PFF ¶ 248 (citing 5/26/15 Tr. 5710:5-5711:3 (Katz)). In addition, SoundExchange's arguments regarding a purported "bilateral monopoly" (SX PFF ¶¶ 1043, 1055-56) are unavailing for the reasons detailed in NAB PFF ¶¶ 188-90 and 249.

375. SoundExchange also suggests that, instead of entering into the WSA agreement, the NAB could have simply relied upon others to litigate the *Web III* case. But as Mr. Newberry pointed out, that would have led to even greater uncertainty, would have lost some of the benefits that were gained as consequence of the negotiations, and could have resulted in even higher rates. 5/20/15 Tr. 5082:5-15, 5086:22-5087:9 (Newberry).

376. Finally, SoundExchange suggests that broadcasters could have ceased simulcasting as an alternative to entering into the WSA agreements. SX PFF ¶ 1052. But that was not an option that NAB negotiators could adopt for the entire industry. 5/20/15 Tr. 5087:2-25 (Newberry). And, as consequence of the excessive rates in the WSA agreement, many stations in fact are not streaming, including 8 of Mr. Newberry's 10 music stations. 5/20/15 Tr. 5092:11-5094:1 (Newberry).

377. SoundExchange complains that the NAB did not object sufficiently when the terms of the agreement were entered into. *See* SX PFF ¶¶ 1058-59. SoundExchange neglects to mention Mr. Newberry's description of the WSA agreement to his Board as "less bad" than the status quo. 5/20/15 Tr. 5088:8-16 (Newberry). More fundamentally, however, as SoundExchange notes, the "more probative" evidence consists of market behavior. SX PFF ¶ 1060. On that front, the picture is far less rosy than SoundExchange suggests. For example, Mr. Newberry was one of the 380 broadcasters that SoundExchange touts as agreeing to the WSA deal, but he is only simulcasting 2 of his 10 music stations because the rates are so high. 5/20/15 Tr. 5092:11-5094:1 (Newberry); *see also* NAB PFF ¶¶ 138-49 (documenting limited growth of simulcasting due to excessive rates).

378. The reasons that the WSA agreement with SiriusXM is not a "probative, arms'-length deal" are amply explained in ¶¶ 38-63 of SiriusXM's Proposed Findings of Fact ("SXM PFF"). SiriusXM was under immense financial pressure and on the verge of filing for bankruptcy. *See* SXM PFF ¶¶ 43-46. As a consequence of the disastrous *Web II* rates, it had already drastically curtailed use of its streaming product (as opposed to its core satellite radio business). *Id.* ¶¶ 42 (60-65% drop in listening hours). This lessened any interest in devoting resources to negotiating rates, particularly in view of Mr. Frear's undisputed testimony that SoundExchange took the same intransigent position with respect to substantive changes to the rates that it took with the NAB. 5/22/15 Tr. 5435:15-5436:2 (Frear). And the "options" that SoundExchange proposes were no more viable for SiriusXM than they were for the NAB. SXM PFF ¶¶ 54-59.

379. SoundExchange notes that NAB "agreed" that the WSA agreement would be precedential. SX PFF ¶ 1061. But SoundExchange never disputes Mr. Newberry's explicit testimony that SoundExchange presented this non-negotiable demand on the eve of the deadline for reaching a deal. *See* NAB PFF ¶ 269 (citing evidence). SoundExchange employed the same tactics in its negotiations with SiriusXM. 5/22/15 Tr. 5443:4-11 (Frear) (demand for precedential status "came in at the last minute").

380. SoundExchange claims that the precedential designation is appropriate, because there were no "unique business, economic, [or] political circumstances" surrounding the WSA agreement with NAB and SiriusXM. SX PFF ¶ 1068. SoundExchange contrasts this with the Pureplay deal, where SoundExchange suggests that it was under political pressure. *Id.* ¶ 1069. But Mr. Newberry's testimony demonstrates the economic pressure the broadcasters were under at the time of the WSA

negotiations. 5/20/15 Tr. 5081:21-5082:15 (Newberry). Mr. Frear's testimony shows the same with respect to SiriusXM. 5/22/15 Tr. 5429:15-5431:5 (Frear) (noting need to refinance debt following collapse of Lehman Bros. and credit markets and imminent bankruptcy filing at time of negotiations). Consistent with its overall market power, the evidence supports the conclusion that SoundExchange is able to and does demand precedential status for the agreements it favors (such as the NAB and SiriusXM WSA deals) and unilaterally refuses such status for agreements that it disfavors, such as the Pureplay deal. In reality, "unique circumstances" is a pseudonym for "deals that SoundExchange doesn't like." *See* NAB PFF ¶ 271 (citing Katz testimony regarding selection bias).

IX. THE EVIDENCE THAT SOUNDEXCHANGE OFFERED TO SUPPORT ITS TERMS PROPOSALS IS UNPERSUASIVE, AS IS ITS EVIDENCE AGAINST NAB'S TERMS PROPOSALS.

A. SOUNDEXCHANGE HAS FAILED TO SUPPORT ITS PROPOSED CHANGES TO THE EXISTING TERMS.

1. The Reporting and Payment Period Should Remain at 45 Days.

381. NAB and other services put forth substantial evidence demonstrating the importance of maintaining the 45-day reporting period. NAB PFF ¶¶ 624-30; IHM PFF ¶¶ 441-42. As the services have demonstrated, SoundExchange's shortened reporting and payment period: (i) would be inconsistent with the 45-day reporting and payment period for numerous other statutory services (NAB PFF ¶ 625); (ii) would be inconsistent with the 45-day period SoundExchange has advocated for noncommercial educational webcasters (*id.*); (iii) is already pending in the Notice and Recordkeeping Rulemaking Proceeding, in which NAB and other services vigorously opposed shortening the time

period, offering extensive evidence of the burden that would follow such a change (NAB PFF ¶¶ 626-29; IHM PFF ¶ 441); and (iv) to the extent that a "greater-of" revenue structure is adopted – which it should not be – would be an even greater burden on services to generate the data to support both the per performance and percentage of revenue analyses that services would need to undertake in the shortened time period. Moreover, the fundamentally different business model of simulcasters and the lack of evidence that they can support the shortening of the reporting and payment period strongly militate toward maintaining the current 45-day period. NAB PFF ¶¶ 626-29.

382. SoundExchange's primary arguments for its proposal to significantly shorten the reporting and payment period are that the "market" calls for a 30-day payment term and that a shorter window might expedite payments to copyright holders. SX PFF ¶¶ 1268-70. But SoundExchange's "market" argument is unsupported. First, there is only one agreement between a major record label and a simulcaster. *See* NAB PFF ¶ 604. Neither SoundExchange nor Professor Lys can extrapolate from one agreement to a reasonable payment term for all simulcasters. Second, Professor Lys' count of payment provisions relies heavily on interactive agreements. SX PFF ¶ 1269. But the monopoly power of the record labels enables them to secure terms they would not otherwise be in a position to secure in an effectively competitive market. *See* NAB PFF Part VIII.A.1.

383. Moreover, other than the testimony from Mr. Bender that SoundExchange "should be" able to distribute royalties more quickly (SX Ex. 2 at 20-21) with a shortened reporting and payment period, there is nothing else in evidence to support his speculation. And Mr. Bender's argument itself creates a "Catch 22" for services given that

SoundExchange also opposes having to refund overpayments made by Services. SX PFF ¶¶ 1298-306. On the one hand, SoundExchange seeks to shorten the reporting period to more quickly pay royalties, without regard to the effect on the accuracy of reports and payments that may cause. On the other hand, SoundExchange claims that "there is no assurance that overpayments can be recovered once they are distributed" and that sometimes "clawing back these royalties is simply impossible." *Id.* Both of Soundexchange's positions are unreasonable and are not supported by the record.

2. <u>The CPA Requirement Should Be Maintained</u>.

384. SoundExchange similarly relies on the "market" agreements to support removing the CPA requirement from the regulations, as well as the testimony of Mr. Wilcox (who is not a CPA) that industry experience is more relevant than a CPA certification. SX PFF ¶¶ 1276-82. For the same reasons as stated above regarding shortening the 45-day payment and reporting period, the "market" arguments made by SoundExchange are unavailing. *See* NAB PFF ¶ 622 ([[[redacted]]]). Also, Mr. Wilcox's self-serving testimony should be given little weight as his personal opinions about what is needed for an audit are not helpful for establishing an industry-wide regulatory standard. While industry knowledge is necessary, Professor Weil made clear that this is not an issue, as a CPA will ensure that he or she has the necessary industry knowledge before taking on an auditing project. NAB PFF ¶ 621; *see also Web II*, 72 Fed. Reg. at 24109 ("If technical skills are required to process the data of a Service, the auditor can request assistance.").

385. NAB and the other services have demonstrated how the proposed change would be detrimental (NAB PFF ¶¶ 615-23), including that: (i) removing the CPA

requirement removes any objective qualification for the auditor selection, which will invite disputes (NAB PFF ¶ 618); and (ii) CPAs are governed by principles, rules and requirements of their applicable state accountancy boards and professional organizations, including the requirements to act with integrity, objectivity, independence, due care, competence and diligence. NAB PFF ¶¶ 619-20. These are important and valuable requirements that benefit all parties and ensure the integrity of the system, and to remove them from the regulations would be a "step backwards." NAB PFF ¶ 620 (citing Professor Weil's testimony); *see also Web II,* 72 Fed. Reg. at 24109 (holding that the certification of the auditor "raises confidence levels in the audit").

B. NAB'S PROPOSED TERMS CHANGES ARE SUPPORTED BY THE RECORD.

386. SoundExchange offers little to no new support for its opposition to NAB's terms, relying in its Proposed Findings primarily on Mr. Bender's Written Rebuttal Testimony. NAB has largely addressed the issues raised by Mr. Bender's Written Rebuttal Testimony in its Proposed Findings, and does not fully restate them herein. *See* NAB PFF Part X.

387. Definition of Broadcast Retransmission: In its October 2014 submission, NAB proposed a revised definition for "Broadcast Retransmission" in order to provide a basis for a separate simulcast rate. NAB PFF ¶¶ 609-14. SoundExchange asserts that this definition was overbroad, allowing for the replacement of too much content. Bender WRT at 14-1; SX PFF ¶¶ 1328-31. To address this issue, NAB has refined and narrowed the definition, submitted with its Proposed Findings of Fact. NAB's definition now explicitly excludes "transmissions in which the sound recordings that are performed are customized to a user" and limits the scope of substitutions. *See* NAB Proposed Rates and

Terms (June 19, 2015) § 380.11; NAB PFF ¶ 609. These refinements address SoundExchange's concerns. *See supra* Part III.C.3. In addition to addressing SoundExchange's stated concerns, NAB otherwise demonstrated that its simulcast definition is reasonable, reflecting the non-customized nature of the transmissions but providing some needed flexibility to: (a) substitute programming that does not fall within the scope of the statutory license; (b) replace programming that a broadcaster does not have the right to simulcast; and (c) allow for other issues, such as compliance with ratings agency requirements. *See* NAB PFF ¶¶ 612-14.

388. Definition of Aggregate Tuning Hours: NAB, like the NRBNMLC, has proposed a definition of ATH that makes clear that ATH that do not include "Performances" subject to the statutory license do not affect a licensee's fee or reporting obligations. NAB PFF ¶ 631-33. This is a commonsense clarification based on the notion that ATH without Performances subject to the statutory license should not adversely affect a licensee's fee liability or other obligations under that license. NAB PFF ¶ 633; Emert WDT ¶ 46; Henes WDT ¶ 31. Notably, SoundExchange offers no general argument opposing this commonsense principle. It merely argues that the change could affect noncommercial broadcasters' fee liability by somehow altering the ATH threshold. NAB understands that the NRBNMLC is addressing this argument. In any event, SoundExchange's argument is no reason not to clarify the definition for commercial broadcasters. In short, SoundExchange offers no counter to the showing made by NAB that its proposed ATH definition is appropriate and should be adopted.

389. Exclusions from the Definition of Performance: NAB has proposed two additional exclusions to the definition of performance to account for (1) short

performances that obviously have little to no value to listeners and (2) second connections to the same sound recording from the same IP address. NAB PFF ¶¶ 643-47. SoundExchange opposes the exclusion for short performances based upon the principles that "copyright owners and artists should be compensated any time their music is used by a service" and that services should not allow listeners to "skip" songs. SX PFF ¶¶ 1320-22. With respect to SoundExchange's first point, there are many instances in which copyright owners have agreed to allow exclusions to the definition of performance for short performances. *See* Katz AWRT ¶ 105 (noting that many of Professor Rubinfeld's benchmark agreements have "duration minima," which "make both economic and common sense"). Further, NAB established that there is no value to a simulcast listener for short performances. NAB PFF ¶ 644. With respect to SoundExchange's assertion regarding "skipped" songs, this is obviously inapplicable to simulcasters. 6/2/15 Tr. 7145:1-17 (Bender) (conceding that listeners "cannot skip songs on a simulcast [of an] over the air broadcast[.]"

390. With respect to the second connection issue, SoundExchange does not appear to take issue with NAB's technical concerns, but rather argues that such connections are already exempted. SX PFF ¶ 1322. If SoundExchange agrees that such connections are exempt, it should have no problem with NAB's requested amendment to make this exemption more explicit.

391. Single, Lower Late Fee: NAB and other Services urge the Judges to repeat their prior rejection SoundExchange's proposal to adopt multiple late fees. The Services established that two separate late fees could result in punitively high interest penalties. NAB PFF ¶¶ 635-36; PAN PFF ¶ 420. SoundExchange offers nothing more than

speculation regarding whether "services would have [an] incentive to submit their accounting statements in a timely manner when they are behind on their payments." SX PFF ¶ 1292. SoundExchange has failed to demonstrate that a double fee is necessary or that it would result in any different reporting and payment practices of the Services. *See* PAN PFF ¶¶ 420-21.

392. NAB and iHeartMedia also urge the Judges to set a more reasonable late payment interest rate tied to a statutory standard, allowing the rate to change with, and reflect, changes in the financial marketplace, as opposed to being constant at the extremely high rate of 18% per annum. NAB PFF ¶ 638; IHM PFF ¶¶ 427-31. SoundExchange complains that this is not in line with the marketplace. SX PFF ¶ 1296. iHeartMedia, however, established that with respect to the Rubinfeld interactive services agreement, [[ ]] IHM PFF ¶ 430 (citing Lys CWDT ¶ 39 & Figure 5); *see also* IHM ¶ 428 (establishing that [[ ]]). SoundExchange has failed to provide any support for the necessity of such an exorbitantly high rate. IHM PFF ¶ 430.

393. <u>Corrections and Recovery of Overpayments</u>: SoundExchange opposes the Services' request to install a process for revising and resubmitting payments to correct errors in a Service's submission to SoundExchange (NAB PFF ¶¶ 639-42, IHM PFF ¶¶ 432-34, PAN PFF ¶ 422), asserting that it would be too difficult to make such corrections and claw back monies already paid to artists. SX PFF ¶¶ 1301-02. But SoundExchange has a process for correcting overpayments. NAB PFF ¶ 641; PAN PFF ¶ 422; IHM PFF ¶ 433. Moreover, it is fundamentally unfair to have a simple mistake on

the part of a Service become a non-refundable windfall to SoundExchange. NAB PFF ¶ 641. That unfairness is compounded in the context of SoundExchange's proposal to truncate the time that Services have to calculate and submit their royalty payments. *See* SX PFF ¶¶ 1268-75; *supra* Part IX.A.1. SoundExchange's argument that installing an overpayment correction process would disincentivize Services to get it right the first time (SX PFF ¶ 1300) is absurd – no business has any incentive to overpay its licensors. In sum, SoundExchange simply has not supported its one-sided, inequitable position that it can conduct audits and collect underpayments for several years, but overpayments by a Service are forfeited the second the mistake is made. NAB PFF ¶ 641; PAN PFF ¶ 422; IHM PFF ¶ 434.

394. Six-Month Audit Period: NAB has proposed a reasonable time period for audit completions to reduce the potential for abuse and disruption. NAB PFF ¶ 648. The NAB filed comments in the Notice of Recordkeeping Rulemaking reflecting that audits of broadcasters are taking a substantial amount of time and are a drain on broadcaster resources. *See* Joint Comments of the National Association of Broadcasters and the Radio Music License Committee Regarding the Copyright Royalty Judges' Notice of Recordkeeping Rulemaking, Docket No. 14-CRB-0005 (RM), Ex. D ¶ 16, Ex. M ¶ 17 (June 30, 2014). SoundExchange's only argument appears to be that the length of time of the audit is partially dependent on the Service (SX PFF ¶ 1333), but that concern must be balanced against the extensive burden of these audits on Broadcasters.

395. Notice and Cure: NAB has proposed the adoption of a reasonable notice and cure provision. NAB PFF ¶¶ 649-50. Such provisions are commonplace, and are reflected in the agreements in evidence. *Id.* ¶ 650. SoundExchange's argument against

this provision is confusing, seemingly implying that this provision would require an official notice before contacting a licensee about any "perceived issue." *See* SX PFF ¶ 1308. The proposed language, however, only requires such notice in the event that there has been a "material breach" that SoundExchange then "intends to assert" against the Broadcaster. *See* NAB Proposed Rates and Terms (June 19, 2015) § 380.18. SoundExchange is always free to resolve purported compliance issues informally, by calling or emailing a Service.

396. Minimum Fee Provision: NAB proposed conforming changes to the Minimum Fee proposal. NAB PFF ¶ 651. SoundExchange apparently believes that this change would enable broadcasters to avoid paying minimum fees for some of its channels, but that is not the case. SX PFF ¶ 1333. NAB has proposed rates that apply only to radio stations that are simulcast, not to channels that do not qualify as simulcasts. *See* NAB Proposed Rates and Terms (June 19, 2015) § 380.12(c) (the proposal is confined to "Eligible Transmissions" which are limited to "Broadcast Retransmission[s] that [are] subject to licensing under 17 U.S.C. §114(d)(2) and the payment of royalties under 37 C.F.R. Part 380."). Side channels operated by Broadcasters that do not qualify as simulcasts would be subject to separate rates and terms separately set by the Judges, and the minimum fees applicable to those side channels would apply. NAB PFF ¶ 652.

397. Third-Party Programming: NAB has proposed allowing simulcasters the flexibility to make a reasonable estimation of Performances contained in third-party programming, where such programming does not contain the necessary Performance data. NAB PFF ¶ 653. SoundExchange opposes the proposal, arguing that the only way to "ensure artists and owners are properly compensated for this programming is to require

broadcasters to obtain the necessary reporting information." SX PFF ¶ 1333. But this ignores certain marketplace realities. NAB offered testimony in this proceeding and in the Recordkeeping Rulemaking that such third-party programming is often challenging for broadcasters in terms of performance counting and that allowing an estimation of such performances is in line with the NAB-SoundExchange 2006-2015 WSA term sheet. NAB PFF ¶¶ 654-55; SX Ex. 1574 § 6(b). Moreover, this flexibility does not give broadcasters free rein to ignore their reporting responsibilities, as it requires broadcasters to make "commercially reasonable, good-faith efforts to cause such third parties to provide information regarding the number of Performances in such programming." NAB PFF ¶ 653. The proposal thus strikes the right balance between requiring broadcasters to make reasonable efforts to obtain performance information regarding programming provided by third parties without imposing a requirement that is sometimes simply commercially unworkable. Given the foregoing, NAB respectfully suggests that this needed flexibility might actually result in increased payments to SoundExchange.

X. REPLY CONCLUSIONS OF LAW

A. SOUNDEXCHANGE'S ELEVENTH-HOUR ATTEMPT TO DEFINE COMPETITION OUT OF THE RATE-SETTING STANDARD CONTRAVENES SECTION 114, ITS LEGISLATIVE HISTORY, CONSISTENT PRECEDENT, AND, MORE GENERALLY, THE RECOGNIZED PURPOSE OF STATUTORY LICENSES AND RATE-SETTING BODIES.

1. The requirement that the willing buyer-willing seller standard determine rates that reflect those that would be agreed to in a competitive market had appeared to be well-settled and undisputed. Indeed, SoundExchange's own lead economist, Professor Rubinfeld, acknowledged "that the 'willing seller/willing buyer' standard calls for rates that would have been set in a 'competitive marketplace.'"

Rubinfeld CWRT ¶ 112 (citing *Web I*, 67 FR at 45244-45). Moreover, SoundExchange's lead counsel acknowledged during his opening statement that the Judges had referenced "effective competition in some of [their] earlier decisions" and identified "some factors that should be considered" in determining whether the market is effectively competitive, including "whether there are sufficient competitive factors in the marketplace." 4/27/15 Tr. 59:8-22 (SoundExchange counsel). And SoundExchange in its proposed findings acknowledged that the Judges exist as a "rate court backstop" to prevent "competitive abuses" that may result from permitting the collective negotiation of statutory licenses. SX PFF ¶ 1044 (emphasis added).

2. These statements echoed a long history of prior section 114 proceedings in which SoundExchange and its witnesses recognized that the relevant "market" in which the willing buyer-willing seller determination is made must be competitive. For example, SoundExchange's economist, Janusz Ordover, testified in *SDARS I* that:

> [F]or an economist, absent a public policy decision actually to distort pricing structure (through taxes or subsidies), the fundamental objective in a rate setting proceeding such as [*SDARS I*] should be to "mimic" what an effectively competitive marketplace accomplishes in an unregulated setting.

Test. of Janusz Ordover, Docket No. 2006-1 CRB DSTRA, at 12 (Oct. 30, 2006) (emphasis added). Similarly, in *Web II*, SoundExchange acknowledged that the market in which willing buyer-willing seller rates are set must be "workably competitive." *See* Br. of Intervenor SoundExchange, Inc., Nos. 07-1123, 07-1168, 07-1172, 07-1173, 07-1174, 07-1177, 07-1178, 07-1179, at 12 (D.C. Cir. Aug. 7, 2008) ("[T]he law does not require a rate that would be negotiated in a market that is either perfectly competitive or more competitive than real-world, workably competitive markets."). In light of these

repeated acknowledgments by SoundExchange and its witnesses, the competition issue had appeared to be undisputed.

3. In the face of overwhelming new evidence that its favored interactive services market is not effectively or workably competitive, including admissions by SoundExchange's own expert that the [[ ]] (NAB Ex. 4129 at 42; PAN Ex. 5345 at 1), SoundExchange has reversed course and now seeks to persuade the Judges that no competition at all is required to satisfy the willing buyer-willing seller standard. *See, e.g.*, SX PCL ¶ 22 (asserting that statute does not expressly or impliedly require a particular level of competition; just the actual marketplace without the statutory license). Rather, so long as the buyers and sellers were not forced to enter into a deal and have reasonable knowledge of relevant facts, any agreed-to rates – including monopoly rates, cartelized rates, or supracompetitive rates agreed to in a market with sellers of "must have" Cournot complements – purportedly would satisfy this standard. *See* SX PCL ¶¶ 19-20.

4. SoundExchange's attempt to eradicate competition from the rate-setting standard would:

- fly in the face of Congress's carefully crafted statutory structure, which not only permits the collective negotiation of statutory rates in order to reduce transaction costs but also establishes a rate-setting body to determine those rates and ensure that the collective cannot extract supracompetitive prices;
- contravene the legislative history to section 114, which confirms Congress's intent that section 114 rates be set at competitive levels;
- cast aside the Judges' own prior pronouncements as well as those of the Librarian of Congress that willing buyer-willing seller rates must reflect rates that would be agreed to in a competitive market;

- disregard the well-understood definition of fair market value (and willing buyer/willing seller), which (contrary to SoundExchange's arguments) directs that the valuation take place in a competitive market; and
- subvert the very purpose for which statutory licenses and music license rate-setting decisionmakers were created – *i.e.,* to prevent copyright owners from extracting supracompetitive rates.

The Judges should reject SoundExchange's belated attempt to divorce competition from the Judges' core rate-setting mission.

1. SoundExchange's Attempt To Read Competition Out of Section 114 Cannot Be Reconciled with the Statutory Structure, which Empowers the Judges, not the Collective, To Establish Rates.

5. SoundExchange's argument that the hypothetical market for which willing buyer-willing seller rates are to be set need not be competitive at all cannot be reconciled with section 114, which establishes the Copyright Royalty Judges as the body that sets rates. Congress did not grant rate-setting authority to the recording industry collective, which it empowered to negotiate rates if possible. Yet, under SoundExchange's new position, any rates agreed to by an informed buyer and seller not under compulsion to agree to those rates would satisfy the willing buyer-willing seller standard – even if those rates were reached in a monopolistic or cartelized market. This contravenes the very structure of the section 114 statutory license regime that Congress established.

6. When Congress created the section 114 statutory license, it fashioned a carefully balanced statutory scheme, with many components working together to achieve Congress's purpose. In particular, not only did Congress grant antitrust immunity to enable a licensing agent such as SoundExchange to negotiate statutory rates collectively, on behalf of all copyright owners, but it also authorized a rate-setting body – at that time, the CARP – to determine those rates if the parties were unable to agree to rates. *See* 17

U.S.C. § 114(e) (providing that copyright owners "may designate common agents on a nonexclusive basis to negotiate" statutory license rates under section 114 "[n]otwithstanding any provision of the antitrust laws"); *id.* § 801(b)(1) (providing that one function of Judges is "[t]o make determinations and adjustments of reasonable terms and rates of royalty payments as provided in section[] ...114"); *see also id.* § 114(f)(2).

7. Congress allowed the recording industry to appoint a common agent and engage in centralized licensing to reduce all parties' transaction costs by eliminating the need for hundreds of licensors to negotiate with potentially hundreds of licensees. At the same time, however, authorization of the collective agent greatly increases the risk that the centralized licensor agent, as the sole entity representing all sellers, will demand monopoly prices. *See* 5/26/15 Tr. 5710:5-5711:3 (Katz). To address this concern, rather than allowing the centralized licensor to dictate supracompetitive rates, Congress established a statutory license and placed authority to set rates under that license in the hands of the CARP in cases where the parties were unable to agree upon rates. *See* 17 U.S.C. §§ 114(d)(2), (f)(2), 801(b)(1). While Congress has since transferred rate-setting responsibilities from the CARP to the Judges, the statutory structure, including both nonexclusive collective license negotiations and independent rate-setting oversight, remains in place today.

8. Congress directed the CARP to set rates under the section 114 webcasting statutory license and the section 112(e) ephemeral recording statutory license that are "reasonable," which, as discussed below in NAB Reply PCL art X.A.3, has been interpreted to require competitive market rates. *See* 17 U.S.C. § 801(b)(1); *see also* H.R. Rep. No. 105-796, at 86 (1998) (Conf. Report) (providing that where parties are unable to

negotiate rates under the webcasting statutory license, "a copyright arbitration proceeding should be impaneled to determine reasonable rates and terms" (emphasis added)). Notably, the requirement that statutory rates be "reasonable" remains in place today and applies specifically to the rates set in this proceeding under sections 112(e) and 114. *See* 17 U.S.C. § 801(b)(1) (providing that function of Judges is "[t]o make determinations and adjustments of reasonable terms and rates of royalty payments as provided in sections 112(e), 114, 115, 116, 118, 119, and 1004" (emphasis added)).[18] Similarly, as will be discussed further below, SoundExchange is wrong when it argues that Congress's use of the term "willing buyer-willing seller" in the statutory standard does not require competitive rates. It is well established that the term incorporates a requirement of a competitive market.

9. If Congress had considered it acceptable for a "willing buyer-willing seller" rate to be one that a centralized licensor (*i.e.,* "monopolist") could extract, it could have created a statutory license and given a licensing collective such as SoundExchange antitrust immunity to negotiate rates unilaterally on behalf of the industry. There would have been no need (and it would have made no sense) for Congress also to establish a costly and burdensome independent rate-setting process – now in the hands of the Judges – to determine "reasonable" rates in the absence of an agreement if rates extracted by a monopolist were acceptable. Congress could have simply left rate-setting to the recording industry collective. *See* Katz WDT ¶ 16. Congress's entrustment of rate-setting to the CARP, and now the Judges, demonstrates its intent that the Judges exercise meaningful oversight to ensure that statutory rates are set at a competitive level, and a

[18] The next sentence of section 801(b)(1) identifies the more limited set of statutory licenses to which the section 801(b)(1) factors apply.

contrary interpretation of the willing buyer-willing seller standard is entirely at odds with the carefully balanced statutory license scheme that Congress created.

10. As the Supreme Court has observed:

> It is a "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." A court must therefore interpret the statute "as a symmetrical and coherent regulatory scheme," and "fit, if possible, all parts into an harmonious whole."

FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) (quoting *Davis v. Michigan Dept. of Treas.*, 489 U.S. 803, 809 (1989), *Gustafson*, 513 U.S. at 569, and *FTC v. Mandel Brothers, Inc.*, 359 U.S. 385, 389 (1959); *accord King v. Burwell*, ___ U.S. __, __, 2015 WL 2473448, No. 14–114, at *11 (June 25, 2015); *Mellouli v. Lynch*, 135 S. Ct. 1980, 1989 (2015); *Roberts v. Sea-Land Servs., Inc.*, 132 S. Ct. 1350, 1357 (2012); *United States v. Wilson*, 290 F.3d 347, 355 (D.C. Cir. 2002); *United States v. Wilson*, 290 F.3d 347, 355 (D.C. Cir. 2002).

11. "'[S]tatutory language has meaning only in context.'" *Graham Cnty. Soil & Water Conservation Dist. v. United States*, 559 U.S. 280, 289 (2010) (quoting *Graham Cnty. Soil & Water Conservation Dist. v. United States*, 545 U.S. 409, 415 (2005)). "It is the classic judicial task of construing related statutory provisions to make sense in combination." *Wilson*, 290 F.3d at 355 (quotation marks and citation omitted) (construing statute as a whole and in manner consistent "with the history and background against which Congress was legislating"). Indeed, the Supreme Court recently found "the context and structure of [an] Act" to be so important that it overrode "what would otherwise be the most natural reading of the pertinent statutory phrase," a tension not present in this case, where the operative statutory language is commonly understood to

require that rates reflect competitive market rates. *See King*, __ U.S. at __, 2015 WL 2473448, at *14.[19]

12. SoundExchange's effort to remove competition from the concept of "reasonable," and "willing buyer-willing seller" rates is inconsistent with the ordinary usage of those terms and with the structure of section 114. It should be rejected.

2. The Legislative History to Section 114 Confirms that Congress Was Concerned with Preserving Competition When It Created that Statutory License.

13. Congress's intent that the rates under the section 114 statutory license be set at competitive levels is further demonstrated by the legislative history leading up to the enactment of that license. *See* NAB's Proposed Conclusions of Law ¶¶ 700-01 ("NAB PCL"). As introduced in the Senate, the original version of the proposed "Digital Performance Right in Sound Recordings Act of 1995" would have permitted copyright owners to designate common agents to negotiate statutory and non-statutory license rates, even on an exclusive basis:

> (e) Authority for Negotiations. . . . [A]ny copyright owners of sound recordings and any entities performing sound recordings affected by this section may negotiate and agree upon the terms and rates of royalty payments for the performance of such sound recordings and the proportionate division of fees paid among copyright owners, and may designate common agents to negotiate, agree to, pay, or receive such royalty payments.

[19] Moreover, courts will reject an interpretation of a statute that is "nonsensical and superfluous." *See Corley v. United States*, 556 U.S. 303, 314 (2009) (rejecting Government's interpretation of statute because "it renders § 3501(c) nonsensical and superfluous" and thus was "at odds with one of the most basic interpretive canons, that '"[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant"'" (quoting *Hibbs v. Winn*, 542 U.S. 88, 101(2004) (quoting 2A N. Singer, Statutes and Statutory Construction § 46.06, pp.181–186 (rev. 6th ed. 2000))).

S. 227, 104th Cong. (1995), *available at* https://www.congress.gov/bill/104th-congress/senate-bill/227/text/is?q={"search":["s227"]}.

14. The Department of Justice ("DOJ") expressed concern that this provision could result in "a federally authorized cartel to set higher-than-competitive prices," which "could cause great mischief.". 141 Cong. Rec. S11945-04, S11962 (daily ed. Aug. 8, 1995) (Letter from Acting Assistant Attorney General Markus to Sen. Leahy (June 20, 1995)). As Senator Leahy explained, "I know that is not what the original sponsors of this legislation intended." *Id.* at S11961 (Statement of Sen. Leahy).

15. Congress addressed this concern by barring the collective negotiation of non-statutory sound recording performance licenses and making the collective negotiation right nonexclusive with respect to statutory licenses. *See* Pub. L. No. 104-39, 109 Stat. 336, 340 (1995). Due to Congress's prior establishment of the CARP, it did not need to bar the collective negotiation of statutory license rates outright. Rather, as the accompanying House Judiciary Committee Report observed, "[i]f supracompetitive rates are attempted to be imposed on operators, the copyright arbitration royalty panel can be called on to set an acceptable rate." H.R. Rep. No. 104-274, at 22 (1995) (emphasis added). Moreover, Congress's expressed competitive concern with seller-side market power was not limited to collective negotiations, but to those with individual record companies as well. *See, e.g.*, S. Rep. 104-128, at 24 (explaining that the CARP could be called on to set rates if "necessary" after "industry or individual negotiation" (emphasis added)). These committee reports reinforced Congress's strong intent to ensure competitive rates, stating that Congress's revisions to address DOJ's competitive concerns "should not result in anticompetitive terms being imposed on consumers" and

"should prevent copyright owners from using any common agent to demand supracompetitive rates from operators." H.R. Rep. No. 104-274, at 22-23; *see also* S. Rep. No. 104-128, at 28 (1995) (observing that revised language "should help prevent copyright owners from using a common agent to demand supracompetitive rates").

16. In response to Congress's amendments, the DOJ stated that the modified bill "adequately addresses the competition concerns of the Department of Justice." 141 Cong. Rec. S11945-04, S11963 (daily ed. Aug. 8, 1995) (Letter from Assistant Attorney General Fois to Sen. Leahy (July 21, 1995)). In its response, it explicitly recognized the importance of the rate-setting body in guarding against supracompetitive rates, observing that "any impasse on license fees, terms and conditions can be resolved by the rate panel, if necessary." *Id.* at S11962-63. This legislative history reveals Congress's intent to ensure that competitive rates are set under the section 114 statutory license.

3. As SoundExchange Admits, the Judges and the Librarian Uniformly Have Found that Willing Buyer-Willing Seller Rates Must Reflect Those that Would Be Agreed to in an Effectively Competitive Market; Those Pronouncements Cannot Be Disregarded.

17. The Judges also repeatedly have stated that the hypothetical market in which they must set willing buyer-willing seller rates must reflect effective competition, and the Librarian similarly has held that that market must be competitive. SoundExchange recognizes these repeated pronouncements but attempts to persuade the Judges to cast them aside, suggesting that the Judges and the Librarian were wrong and arguing that their prior determinations are not binding. *See* SX PCL Part II.B.2. The Judges were right; it is SoundExchange that is wrong.

18. In the first rate-setting proceeding after the willing-buyer-willing-seller standard was created, the Librarian of Congress determined that the standard required competitive market rates. *See Web I*, 67 Fed. Reg. at 45244-45. Review of the Librarian's decision demonstrates that this was a holding, not dictum, as SoundExchange incorrectly claims. *See* SX PCL ¶¶ 30-32.

19. In *Web I*, the Librarian observed that "[t]o set rates based on a willing buyer/willing seller standard, the CARP first had to define the relevant marketplace in which such rates would be set." *Web I*, 67 Fed. Reg. at 45244. It then described how the CARP defined that marketplace as follows:

> Because of the diversity among the buyers and the sellers, the CARP noted that one would expect "a range of negotiated rates," and so interpreted the statutory standard as "the rates to which, absent special circumstances, most willing buyers and willing sellers would agree" in a competitive marketplace.

Web I, 67 Fed. Reg. at 45,244-45 (footnote and citation omitted). The Librarian then expressly "adopt[ed] the Panel's characterization of the relevant marketplace." 67 Fed. Reg. at 45245 (emphasis added). As these passages demonstrate:

(1) It was necessary for the CARP to define the relevant market in order to set "willing buyer-willing seller" rates.

(2) The CARP defined the relevant market as a competitive one.

(3) The Librarian expressly adopted the CARP's competitive market definition.

These passages establish that the Librarian's determination was a holding, not dictum.

20. SoundExchange points to the D.C. Circuit's opinion in the *Web II* appeal to assert that the Librarian's competitive market holding was dictum. SX PCL ¶¶ 30-32. But the D.C. Circuit did not quote or discuss the portions of the Librarian's decision

where it (1) found that the CARP's definition of the relevant market was "necessary" to its rate determination or (2) expressly adopted the CARP's determination that the willing buyer-willing seller market must be competitive. *See Intercollegiate Broad. Sys, Inc. v. Copyright Royalty Board*, 574 F.3d 748, 757 (D.C. Cir. 2009). In making its passing "dictum" remark, the court quoted only the Librarian's description of the CARP's reasoning, not the operative portions of the Librarian's ruling. *Id.*

21. In any event, the D.C. Circuit did not find that the willing buyer-willing seller standard required no competition at all but merely that "[t]he statute does not require that the market assumed by the Judges achieve metaphysical perfection in competitiveness." *Id.* (emphasis added). It explicitly refused to delve too deeply into the issue of competition, instead observing that in *Web I*, it had "refused to 'examine the correctness of the Librarian's decision' regarding competitiveness." *Id.* (quoting *Beethoven.com LLC v. Librarian of Cong.*, 394 F.3d 939, 952 (D.C. Cir. 2005)). Given that the D.C. Circuit did not address the Librarian's core conclusion that a competitive market definition was necessary to the CARP's rate determination and that the Librarian had expressly adopted it, and given that the court refused to examine the Librarian's decision regarding competition, SoundExchange overreads the scope and import of the D.C. Circuit's passing comment.

22. Moreover, the Judges themselves recognized that the Librarian's *Web I* competitive market determination was a holding and that an effectively competitive marketplace is a requirement of willing buyer-willing seller rates:

> [A]s the Librarian of Congress held in *Web I*, the "willing seller/willing buyer" standard calls for rates that would have been set in a "competitive marketplace." 67 FR at 45244-45 (emphasis added). *See also Web II*, 67 FR at 24091-93 (explaining that *Web I* required an "effectively

> competitive market" rather than a "perfectly competitive market." (emphasis added)).

Web III Remand, 79 Fed. Reg. at 23114 n.37 (first emphasis added).

23. The Judges were right to characterize as a holding the Librarian's adoption in *Web I* of the CARP's competitive market requirement as an inherent part of the willing buyer-willing seller standard and consistently to follow that holding ever since. Acting in that fashion best accords with the structure and purpose of the statutory license and the Judges' core purpose to guard against supracompetitive statutory rates. SoundExchange's invitation to walk away from these consistent prior determinations that willing buyer-willing seller rates must reflect at least a level of "effective competition" should be declined.

4. Contrary to SoundExchange's Claim, Competition Is an Essential Underpinning of the Willing-Buyer-Willing-Seller/Fair Market Value Standard.

24. SoundExchange's key argument in trying to erase competition from the rate-setting standard is that the willing buyer-willing seller "standard is a test for determining fair market value" and that "fair market value" does not encompass any notion of competition. SX PCL ¶¶ 12-27. As discussed below, SoundExchange is wrong about the correct construction of "fair market value."

25. One of the sources upon which SoundExchange principally relies – Black's Law Dictionary – directly contradicts SoundExchange's claim and expressly provides that "fair market value" is assessed in a competitive market. The version of *Black's* upon which SoundExchange relies defines "fair market value" as:

> The amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. By fair

> market value is meant the price in cash, or its equivalent, that the property would have brought at the time of taking, considering its highest and most profitable use, if then offered for sale in the open market, in competition with other similar properties at or near the location of the property taken, with a reasonable time allowed to find a purchaser.

Black's Law Dictionary 537 (5th ed. 1979) (emphasis added). The edition of Black's Law Dictionary in place when the statutory willing buyer willing seller standard was enacted includes the same competition language in its definition of "Fair Market Value." *See* Black's Law Dictionary 597 (6th ed. 1990). SoundExchange quotes the first sentence of the definition above but conspicuously omits the important second sentence, which makes clear that competition is expressly part and parcel of the fair market value assessment. *See* SX PCL ¶ 14.

26. Multiple cases rely on this competition-based definition of "fair market value" as well. For example, the D.C. Circuit, in considering a rate-setting determination by the Department of Transportation, observed that:

> The extent to which market value may be considered "fair" is surely affected by whether the market is competitive rather than dominated by a government with monopoly power.

Alaska Airlines, Inc. v. DOT, 575 F.3d 750, 760 (D.C. Cir. 2009); *see also, e.g.*, *McCormick v. Camp Pocono Ridge, Inc. II*, 781 F. Supp. 328, 335 (M.D. Pa. 1991) (citing Black's Law Dictionary definition of "fair market value"); *Brownstein v. Arco Petroleum Prods. Co.*, 604 F. Supp. 312, 315 n.3 (E.D. Pa. 1985) (same); *Kim v. Mobil Oil Corp.*, No. CV 85-4689 PAR (JRX), 1986 WL 15779, at *15 (C.D. Cal. July 16, 1986) (reciting Black's Law Dictionary definition of "fair market value" and describing definition as consistent with "common law concepts"); *see also Kaplan v. United States*, 279 F. Supp. 709, 711 (D. Ariz. 1967) ("[T]he cases generally support the conclusion that

"fair market value" means the cash price the property would have brought at the time of acquisition, considering its highest and most profitable use, if offered for sale on the open market in competition with like properties in the vicinity, given a reasonable time to find a purchaser." (emphasis added)); *State v. Calkins*, 314 P.2d 449, 455 (Wash. 1957) ("The general rule supported by the weight of authority is that evidence of the price received at a free and voluntary public auction is competent and admissible as some evidence of value where, presumably, a willing buyer meets a willing seller in open competition." (emphasis added)).

27. The notion that "fair market value" presupposes a competitive market is not new. Indeed, in a decision issued over 80 years ago, esteemed Judge Learned Hand discussed the term "fair market value" and found that it presupposed a competitive market:

> Perhaps there need not be a "market" to establish a "market value," but there must be some assurance that the value is what a "market" would establish; and a "market" itself presupposes enough competition between buyers and sellers to prevent the exigencies of an individual from being exploited. It may well imply that the goods have several possible buyers, so that a necessitous seller shall not be confined to one; and that there are several possible sellers of the same goods or their substantial equivalent, so that a hard-pressed buyer shall not have to accept the first offer. 'Willing' adds nothing, for, if the trade goes through at all, both must be willing, and the degree of their reluctance is not a serviceable measure.

Helvering v. Walbridge, 70 F.2d 683, 684 (2d Cir. 1934) (Hand, J.) (emphasis added).

28. As even further confirmation that "fair market value" embodies the notion of competition, the ASCAP and BMI rate courts themselves – which indisputably view their task as setting competitive market rates (*infra* PCL Part I.E.2) – have characterized their rate-setting task as determining "fair market value" – *e.g.*, "the price that a willing buyer and a willing seller would agree to in an arm's length transaction." *Showtime*, 912

F.2d at 569; *accord ASCAP v. MobiTV*, 681 F.3d 76, 82 (2d Cir. 2012); *United States v. BMI (Application of Music Choice)*, 426 F.3d 91, 95 (2d Cir. 2005) ("The rate court is responsible for establishing the fair market value of the music rights, in other words, the price that a willing buyer and a willing seller would agree to in an arm's length transaction." (internal citations and quotations omitted)) ("*Music Choice*"). If competition formed no part of the definition of "fair market value," these well-established bodies – which perform a rate-setting role analogous to the Judges' rate-setting function – would not refer to their task as determining "fair market value" rates.

29. SoundExchange argues that Professor Katz did not cite "any principle of law that would connect an 'effective competition' standard to the willing buyer/willing seller standard." SX PCL ¶ 18. That, of course, is not surprising; Professor Katz is a distinguished economist, not a lawyer. He did, however, make clear that to an economist, "[t]he creation of a rate-determination process and its willing-buyer/willing-seller standard can best be reconciled with economic principles and common sense by interpreting willing buyers as those who have meaningful choices among competing sellers, rather than facing a single, all-or-nothing offer from a monopolist." Katz WDT ¶ 17.

30. The cases cited by SoundExchange (SX PCL ¶ 14) do not help its position, as they all involve the valuation of specific items of private property rather than the determination of a rate that applies across an entire industry. *See infra* ¶ 31 (distinguishing cases). Regardless of the valuation rules that apply to individual private property, the very purpose of rate-setting is to prevent a seller with monopoly power from demanding supracompetitive rates, as the D.C. Circuit has made clear:

> It is of course elementary that market failure and the control of monopoly power are central rationales for the imposition of rate regulation.

Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1508 (D.C. Cir. 1983) (emphasis added); *see also E. & J. Gallo Winery v. EnCana Corp.*, 503 F.3d 1027, 1036 (9th Cir. 2007) ("Congress originally gave FERC rate-setting jurisdiction over certain segments of the natural gas market to address concerns about monopolization in the natural gas market."); *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 477 (2002) ("At the dawn of modern utility regulation, in order to offset monopoly power and ensure affordable, stable public access to a utility's goods or services, legislatures enacted rate schedules to fix the prices a utility could charge." (citations omitted)); S. Rep. No. 102-92 at 1 (1991) ("The purpose of this [Cable Act] legislation is to promote competition in the multichannel video marketplace and to provide protection for consumers against monopoly rates and poor customer service."). Notably, SoundExchange has failed to identify a single rate-setting context where preserving competition was not a significant reason for governmental rate regulation in the first place.

31. In any event, SoundExchange's cases are, in fact, consistent with the principle that competition is an essential part of a fair market value assessment. While SoundExchange cites those cases to suggest that competition plays no role in the fair market value determination, the cases in fact involved markets where competition was inherently present, and they sometimes even directly discussed that competition and its relevance to the valuation inquiry. Specifically:

- *Morris v. State*, 334 P.3d1244, 1246 (Alaska Ct. App. 2014), upheld a jury's determination of the retail price of a parka and expressly found it relevant that "other reputable retailers were asking even higher prices for the same parka" – *i.e.*, competition was present. *Id.* at 1249. The decision also expressly relied

on Black's Law Dictionary for its definition of "fair market value," which, as discussed above, includes the concept of competition. *Id.* at 1248 & n.8.

- *Rhodes v. Amoco Oil Co.*, 143 F.3d 1369, 1373 n.4 (10th Cir. 1998), involved the valuation of a franchised gas station. *Id.* at 1370. The court again relied on the Black's Law Dictionary definition of "fair market value," which expressly refers to competition. *See id.* at 1373 n.4. The court even found fault with one expert's valuation because it "did not consider the impact of two new, major competitors in the immediate vicinity of the subject property and their influence on traffic patterns." *Id.* at 1374.

- *Honeywell Information Systems, Inc. v. Maricopa County*, 575 P.2d 801, 804 (Ariz. Ct. App. 1977), considered the value of computer equipment for tax purposes in a market that the decision itself described as having a variety of competing sellers. *See id.* at 808 ("The electronic data processing industry as a whole is made up of a variety of companies and businesses, large and small, which offer numerous types of products and/or services to users of electronic data processing equipment.").

- *Amerada Hess Corp. v. Commissioner*, 517 F.2d 75, 83 (3d Cir. 1975), involved the valuation of "securities traded on a stock exchange," which is the epitome of a market with robust competition. *Id.*

- *United States v. Cartwright*, 411 U.S. 546, 551 (1973), involved "the market for mutual fund shares," again a market with robust competition. *Id.* at 547.

None of these cases held that competition does not form part of the fair market value inquiry, and none of them stated that fair market value properly could be based on a sale by a seller with acknowledged monopoly power. To the contrary, the cases indicate that competition is intrinsic to the fair market value assessment, and some even expressly rely on the Black's Law Dictionary definition of "fair market value," which expressly defines that term to include competition. Thus, these cases help the Services' position, not SoundExchange's.

32. SoundExchange's reliance on the canon of statutory construction that Congress should be presumed to incorporate common law definitions of terms that it did not define expressly is misplaced. *See* SX PCL ¶ 15. As demonstrated above, the term

"fair market value," which SoundExchange asserts is equivalent to the "willing buyer-willing seller" standard, is understood in the common law to refer to a valuation that is done in a competitive market. Thus, this canon actually helps the Services' position, not SoundExchange's.

33. Moreover, it is well-established that a court should not follow the "rule that a statutory term is to be given its common-law meaning, when that meaning is . . . inconsistent with the statute's purpose." *Taylor v. United States*, 495 U.S. 575, 594 (1990); *see also Moskal v. United States*, 498 U.S. 103, 117 (1990) ("Our second reason for rejecting Moskal's reliance on the 'common-law meaning' rule is that, as this Court has previously recognized, Congress's general purpose in enacting a law may prevail over this rule of statutory construction."); *Perrin v. United States*, 444 U.S. 37, 45 (1979) (rejecting argument that the Travel Act incorporated the common-law definition of 'bribery'); *United States v. Nardello*, 393 U.S. 286 (1969); *Bell v. United States*, 462 U.S. 356, 362 (1983); *United States v. Turley*, 352 U.S. 407, 416-17 (1957); *United States v. Reich*, 479 F.3d 179, 188 (2d Cir. 2007) ("[I]t is also well-established that courts should not assign a common-law meaning to a statutory term when that meaning is . . . inconsistent with the statute's purpose." (quotation marks omitted)).

34. Here, Congress's purpose in creating the section 114 statutory license and charging the CARP, and now the Judges, to determine rates in the absence of a negotiated agreement is to ensure that those rates are "reasonable" and not set at supracompetitive levels. *See supra* PCL Part I.A. Thus, the canon on which SoundExchange relies does not help it read out competition from the rate-setting standard at issue here. To the

contrary, both this canon and the common law establish that competition is foundational to setting willing buyer-willing seller rates applying a fair market value standard.

35. SoundExchange also argues that Congress's inclusion of the term "effective competition" in the Cable Television Consumer Protection and Competition Act ("Cable Competition Act") but not the Digital Millennium Copyright Act ("DMCA") "evidences Congress's intent not to implant an 'effective' or 'workable' competition requirement in the willing buyer/willing seller standard" because "Congress has shown it knows how to" write "effective competition." SX PCL ¶ 25. But the argument that "Congress knows how to say thus and so, and would have written thus and so if that is what it really intended" is "weak" and "proves very little."[20] *Doris Day Animal League v. Veneman*, 315 F.3d 297 (D.C. Cir. 2003). As demonstrated above, the words chosen by Congress did include a requirement of competition, and the language, structure, legislative history and precedent control.

36. Moreover, the Cable Competition Act actually reinforces the core principle that Congress's overarching purpose in establishing rate regulation over an industry is to prevent entities with market power from extracting supracompetitive rates from their buyers.

37. As is true of rate regulation generally, Congress' decision to regulate rates in the cable industry was motivated by competitive concerns:

> The purpose of this legislation is to promote competition in the multichannel video marketplace and to provide protection for consumers against monopoly rates and poor customer service.

S. Rep. No. 102-92, at 1 (1991).

[20] It ignores the realities of the legislative process to assume that Congress has an encyclopedic knowledge of the entirety of the United States Code and invokes that knowledge when drafting every bill.

38. To ensure that rates would be competitive, Congress provided a two-tiered system of regulation under which cable companies operating in markets with "effective competition" would not be rate regulated, but companies operating in the absence of such competition would be. *See* 47 U.S.C. § 543(a)(2) (providing that "[i]f the Commission finds that a cable system is subject to effective competition, the rates for the provision of cable service by such system shall not be subject to regulation" but that "[i]f the Commission finds that a cable system is not subject to effective competition ... , the rates for the provision of basic cable service shall be subject to regulation," and "the rates for cable programming services shall be subject to regulation").

39. In the cable industry, Congress did not need to ensure that rates would be set at competitive levels with respect to all cable companies because the cable industry was sufficiently competitive that some of those companies already operated in an effectively competitive market:

> The Committee recognizes that not every cable operator possesses market power. When there are alternative sources of programming reasonably available to the consumer, there will be little need, if any, to regulate a cable system's rates.

S. Rep. No. 102-92, at 11. Therefore, Congress enacted a scheme of rate regulation whose competitive-preserving function applied only where it was actually needed.

40. Here, by contrast, Congress authorized copyright owners to negotiate copyright royalties through a single entity, thus greatly increasing the risk that monopoly rates would be demanded. *See supra* NAB Reply PCL Part X.A.1. There is thus no question that Congress needed to subject all statutory webcasting negotiations to rate regulation by the Copyright Royalty Judges, and no need for Congress to have distinguished among entities operating in an effectively competitive market and those

that do not. SoundExchange's reliance on the "effective competition" provision in Cable Competition Act gets it nowhere; rather, it reinforces the bedrock principle that rate regulation exists to promote competition.

5. The Very Purpose of a Statutory License and a Rate-Setting Body Is To Prevent Copyright Owners From Extracting Unreasonable Supracompetitive Rates.

41. SoundExchange's argument that competition plays no role in the section 112 and 114 rate-setting at issue here also flies in the face of the very reason why governmental oversight of music license rates exists in the first place. As the Copyright Office observed earlier this year:

> much of the rationale – indeed, the original rationale – for government regulation of the music marketplace revolves around antitrust concerns. The government has long wanted to ensure that the market is not unduly influenced by monopoly power.

U.S. Copyright Office, Copyright and the Music Marketplace 146 (Feb. 2015) (emphasis added). This observation is consistent with the reason underlying the establishment

42. As a review of rate-setting history reveals, guarding against supracompetitive rates was a driving force motivating the establishment of the very first statutory license, the rate courts, and the decision makers charged with setting rates under the statutory licenses where the parties are unable to negotiate those rates.

a. The First Statutory License Was Established To Preserve Competition.

43. Congress's concern regarding "a lack of competition in the marketplace" for music licenses led Congress to establish the very first statutory copyright license in the United States, covering mechanical reproductions of musical works:

> Congress was concerned about a lack of competition in the marketplace – in particular, it was alleged that the Aeolian Company, a manufacturer of

> player pianos, was seeking to buy up exclusive rights from publishers to create a monopoly for piano rolls. To address that concern, Congress simultaneously created a compulsory license for mechanical reproductions of musical works—the first compulsory license in U.S. copyright law—establishing a statutory rate of 2 cents per copy.

U.S. Copyright Office, Copyright and the Music Marketplace 26 (Feb. 2015) (footnotes omitted); *accord id.* at 146 ("Congress' uneasiness with the dominant position of the Aeolian piano roll company in 1909 led it to enact a compulsory license for musical works so others could compete with that company."); *The Performance Rights in Sound Recordings Act of 1995: Hearing on S. 227 Before the S. Comm. of the Judiciary*, 104th Congress 33 (1995) (statement of Mr. Lehman, Assistant Secretary of Commerce and Commissioner of Patents and Trademarks) ("The compulsory mechanical license was added to our copyright law in 1909 in response to fears that 'a great music monopoly' would dominate a fledgling market.").

b. The ASCAP Rate Court – the First Federally Authorized Music License Rate-Setting Body – Was Established To Ensure that Music License Rates Reflected Competitive Market Rates.

44. As is true for statutory licenses, rate-setting decisionmakers similarly have been established to ensure that music performance rights license rates are set at reasonable – rather than supracompetitive – levels. *Music Choice*, 426 F.3d at 96 ("[R]ate-setting courts must take seriously the fact that they exist as a result of monopolists exercising disproportionate power over the market for music rights.").

45. The first such rate-setting body established to set rates for music licenses was the ASCAP rate court, which was incorporated into the antitrust Consent Decree governing ASCAP's operations in 1950. *United States v. ASCAP*, 1950-1951 Trade Cas. (CCH) ¶ 62,595, art. IX (S.D.N.Y. 1950) ("1950 Decree"). "[T]he 1941 Consent Decree

and its 1950 successor were designed to limit the perceived ability of ASCAP to utilize its control of most of the music licensing market to extract supracompetitive prices from its customers." *United States v. ASCAP (Application of Buffalo Broad. Co.)*, Civ. No. 13-95 (WCC), 1993 WL 60687, at *16 (S.D.N.Y. Mar. 1, 1993) (quotation marks and citations omitted) ("*Buffalo Broad.*"), *vacated in part on other grounds sub nom. Application of Capital Cities/ABC*, 157 F.R.D. 173 (S.D.N.Y. 1994); *accord id.* at *28 ("[T]he rate-court provision of the Decree was designed to ensure against excessive fee demands by ASCAP."). "[C]ourts have repeatedly acknowledged that the rate court . . . serves to minimize the likelihood that ASCAP's evident market leverage may be exerted to obtain unacceptably inflated price levels for its licenses." *Showtime*, 912 F.2d 563, 576 (2d Cir. 1990) (Dolinger, M.J.) (citations omitted)).

46. To guard against supracompetitive music license fees, the ASCAP Consent Decree directs the rate court to establish a "reasonable" fee where the parties are unable to agree to a fee on their own. 1950 Decree art. IX(A) (providing that where parties are unable to agree to license fees, "the applicant therefor may forthwith apply to this Court for the determination of a reasonable fee").

47. Courts repeatedly and consistently have held that the term "reasonable fee" means a competitive market fee; indeed, they have described a "competitive market" fee as "[f]undamental to the concept of reasonableness." *See, e.g.*, *Broadcast Music, Inc. v. DMX Inc.*, 683 F.3d 32, 45 (2d Cir. 2012) ("Fundamental to the concept of reasonableness is a determination of what an applicant would pay in a competitive market, taking into account the fact that [the PRO], as a monopolist, exercise[s] disproportionate power over the market for music rights." (citations and quotation marks

omitted; alterations in original); *accord United States v. ASCAP, (Applications of RealNetworks, Inc. & Yahoo, Inc.)*, 627 F.3d 64, 76 (2d Cir. 2010)); *see also In re Pandora Media, Inc.*, 6 F.Supp.3d 317, 353-54 (S.D.N.Y. 2014) (finding that when rate courts set a "'reasonable' fee for a requested license," "the appropriate analysis ordinarily seeks to define a rate or range of rates that approximates the rates that would be set in a competitive market" (citations and quotations omitted)); *Showtime*, 912 F.2d at 569 (same); *Buffalo Broad.*, 1993 WL 60687, at *16 ("Necessarily, then, in carrying out its obligation to set a "reasonable" rate within the meaning of Article IX(A) of the Decree, the rate court must concern itself principally with "defin[ing] a rate or range of rates that approximates the rates that would be set in a competitive market." (*quoting Showtime*, 912 F.2d at 576)); *United States v. ASCAP (Application of Capital Cities/ABC, Inc.)*, 157 F.R.D. 173, 181 (S.D.N.Y. 1994) (citing with approval Magistrate Judge Dolinger's observation that role of rate court is to set rates that approximate competitive market rates).

48. Conversely, the rate court emphatically has rejected the suggestion that music license fees necessarily are reasonable merely because ASCAP and a buyer agreed to them. "The opportunity of users of music rights to resort to the rate court whenever they apprehend that ASCAP's market power may subject them to unreasonably high fees would have little meaning if that court were obliged to set a 'reasonable' fee solely or even primarily on the basis of the fees ASCAP had successfully obtained from other users." *Showtime*, 912 F.2d at 570; *accord In re Application of MobiTV, Inc.*, 712 F. Supp. 2d 206, 233 (S.D.N.Y. 2010), *aff'd sub nom. ASCAP v. MobiTV*, 681 F.3d 76 (2d Cir. 2012).

c. The First Decisionmaker that Congress Established To Set Statutory Rates Similarly Was Charged with Ensuring that such Rates Were Reasonable, Not Supracompetitive.

49. Some 26 years after the ASCAP rate court was established, Congress created the first entity to set and adjust rates under the statutory licenses – the Copyright Royalty Tribunal ("CRT"), the original predecessor of the Copyright Royalty Judges. Pub. L. No. 94-553, 90 Stat. 2541, 2594-96 (1976). Congress used the very same term to describe the CRT's rate-setting mission as the term used to describe the ASCAP rate court's function – rates that both entities determine must be "reasonable." *See id.* Indeed, ensuring that such rates were reasonable was the CRT's express purpose. S. Rep. No. 94-473, at 155 (1975) ("With respect to the adjustment of the statutory royalty rates and the rates for public broadcasting, the purpose of the Tribunal is to assure that such rates are reasonable." (quotation marks omitted)).

50. Congress's command that the decisionmaker charged with determining rates under the various statutory licenses set rates that are "reasonable" applies equally to the section 114 webcasting license and the section 112 ephemeral recording license at issue here. *See* 17 U.S.C. § 801(b)(1) (describing function of Judges as "[t]o make determinations and adjustments of <u>reasonable</u> terms and rates of royalty payments as provided in sections 112(e), 114, 115, 116, 118, 119, and 1004" (emphasis added)); *see also* H.R. Rep. No. 105-796, at 86 (1998) (Conf. Rep.) (providing that where parties are unable to negotiate rates under the webcasting statutory license, "a copyright arbitration proceeding should be impaneled to determine <u>reasonable rates and terms</u>" (emphasis added)).

51. Congress's use of the very same term to define the Copyright Royalty Judges' rate-setting mission as the term defining the ASCAP rate court's function – *i.e.*, requiring that rates be "reasonable" – coupled with the robust rate court precedent confirming that "reasonable" rates mean "competitive market" rates, confirms that the rates set here must be consistent with those that would be reached in an effectively competitive market.

52. In sum, the foundational purpose of both statutory licenses and music license rate-setting bodies is to ensure that music licenses are consistent with those that would be set in a competitive market and not at supracompetitive levels. SoundExchange profoundly misunderstands music licensing rate-setting history in suggesting otherwise.

B. SOUNDEXCHANGE IS EQUALLY MISGUIDED IN ADVANCING OTHER LEGAL ARGUMENTS.

53. In addition to SoundExchange's attempt to read competition out of the statute, it also:

- mischaracterizes the statutory provision inviting the Judges to consider voluntary statutory agreements in setting willing buyer-willing seller rates;
- incorrectly suggests that performance information under an agreement should be given equal weigh as the parties' expectations when they negotiated that agreement; and
- attacks both of Professor Katz's "zone of reasonableness" endpoints.

Each of SoundExchange's attacks is meritless.

1. SoundExchange's Claim That Interactive Benchmarks Are Superior to Statutory Benchmarks Contravenes Congress's Express Guidance Regarding the Types of Agreements that Are Most Useful To Consider.

54. SoundExchange argues that "interactive service agreements" are "more appropriate as a benchmark" than noninteractive statutory service agreement. SX PFF

Part III.B.2. This argument, however, is inconsistent with the statutory provision that expressly invites the Judges to consider license agreements entered into by noninteractive statutory services not agreements with other types of services. SoundExchange misquotes the applicable provision.

55. The provision inviting the Judges to consider certain types of prior negotiated agreements reads as follows:

> In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements described in subparagraph (A).

17 U.S.C. § 114(f)(2)(B) (emphasis added). The plain language of the provision refers to one type of license agreement, and one type alone – agreements "described in subparagraph (A)." Subparagraph (A), in turn, concerns only rates and terms for statutory – not non-statutory – services. Specifically, it provides that:

> Any copyright owners of sound recordings or any entities performing sound recordings affected by this paragraph may submit to the Copyright Royalty Judges licenses covering such eligible nonsubscription transmissions and new subscription services with respect to such sound recordings.

Id. § 114(f)(2)(A). "Eligible nonsubscription transmissions" and transmissions by "new subscription services," of course, refer exclusively to statutory noninteractive transmissions. *See id.* § 114(j)(6) ("An 'eligible nonsubscription transmission' is a noninteractive nonsubscription digital audio transmission . . . ." (emphasis added)); *id.* §114(j)(8) ("A 'new subscription service' is a service that performs sound recordings by means of noninteractive subscription digital audio transmissions . . . ." (emphasis added)).

56. When SoundExchange quoted section 114(f)(2)(B), it omitted the final clause from this provision describing the types of license agreements that the Judges are invited to consider – *i.e.*, those "described under subparagraph (A)." *See* SX PCL ¶ 4. Instead, it replaced this limiting phrase with an ellipsis, which made the provision sound much broader than it actually is. *Id.*

57. In other words, the statutory language relied upon by SoundExchange does not have the broad sweep SoundExchange suggests. The language inviting the Judges to consider voluntary agreements is limited to those entered into by statutory services. Thus, to the extent that Congress expressed a preference in this regard, that preference does not extend to interactive service agreements. SoundExchange is wrong to assert the opposite.

2. SoundExchange Is Wrong To Suggest That Actual Performance Under an Agreement Is as Relevant as the Expectations of Willing Buyers and Willing Sellers at the Time They Negotiated that Agreement.

58. SoundExchange is similarly wrong in arguing that unexpected actual performance under a license agreement should be given equal weight as the parties' expectations regarding the valuation of that agreement under the willing buyer-willing standard. SX PCL Part IV.A. To the contrary, the parties' expectations are the key determinant of what a willing buyer decided to pay and what a willing seller decided to accept under a license agreement.

59. First, the willing buyer-willing seller standard itself makes clear that parties' expectations at the time of the negotiation of an agreement – rather than unexpected results that may unfold thereafter – are by far the most relevant evidence to

determining rates that willing buyers and willing sellers "would have" agreed to. That standard provides that:

> In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.

17 U.S.C. § 114(f)(2)(B) (emphasis added). The standard specifically directs the Judges to set rates that reflect what the parties would have negotiated – not rates based on unexpected marketplace developments that skewed the actual results under a license agreement from what the parties expected and negotiated.

60. Second, the CARP itself in *Web I* found that the parties' perception of value during the negotiation of an agreement is much more important than actual value:

> [I]n determining the prices to which willing buyers and willing sellers would agree, the "true" relative value – even if that could be precisely ascertained – is less important than the parties' perception of that relative value.

CARP Report at 41 (finding that Yahoo!'s belief regarding value of sound recording rates vis-à-vis musical work rates, which led Yahoo! to enter into an agreement with RIAA, was more powerful evidence of value than expert's attempt to calculate actual relative value).

61. Third, SoundExchange's attempt to give the actual performance under a license equal weight as the parties' expectations is based a line of cases whose applicability to music and sound recording rate-setting already has been rejected by both the *Web I* CARP and the ASCAP rate court. SoundExchange claims that "[t]he willing buyer/willing seller standard is related to . . . the standard for determining the hypothetical royalty to which a patentee and an infringer would have agreed before the

infringement began" and cites, among other cases, *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), which sets forth that test. *See* SX PCL ¶ 57. But the CARP in *Web I* already disavowed reliance on that reasonable royalty assessment under patent law in applying the willing buyer-willing seller analysis:

> Another limitation on Dr. Yerman's analysis, as explicated by Webcasters' expert witness Prof. William Fisher (Fisher W.R.T. ¶13; Tr. 11606-07 (Fisher)), is that the *Georgia Pacific* case articulates standards for determining remedies for prior infringement. This context introduces an extraneous element, characterized as having "a punitive cast to it" (*id.* at 11606), which is not present in the non-infringement marketplace that the Panel is directed to replicate, and which undermines its usefulness for our purposes. Accordingly, the *Georgia Pacific* analysis does not, in any sense, undermine our previous reasoning.

CARP Report at 72 (emphasis added). The ASCAP rate court similarly rejected any reliance on patent infringement case law in setting music license rates. *See In re MobiTV*, 712 F. Supp. 2d 206, 243 (S.D.N.Y. 2010) (quoting *Music Choice*, 426 F.3d at 96 ("ASCAP has been unable to identify any copyright case that has applied the *Georgia-Pacific* factors, and this Court declines the opportunity to be the first to do so. Applying the *Georgia-Pacific* test in the context of a rate court proceeding would be inappropriate.").

62. The CARP and ASCAP rate court were right to reject any reliance on cases involving the valuation of patent infringement damages in setting generally applicable music license rates. The purpose of valuing a reasonable royalty in such cases is to make a patentee whole from wrongful prior infringement, and those cases thus involve a "punitive element" not present in rate-setting cases, as the CARP rightly noted. *See* CARP Report at 72. Indeed, even one of the cases that SoundExchange references stated that "an infringer is unlike a true 'willing' licensee" and that "the calculation is not

a mere academic exercise in setting some percentage figure as a 'royalty" but rather "one of damages to the injured party." *Fromson v. W. Litho Plate & Supply Co.*, 853 F.2d 1568, 1574, 1576 (Fed. Cir. 1988), *overruled on other grounds by Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337 (Fed. Cir. 2004); *see also* SX PCL ¶ 59.

63. Moreover, at issue in such cases is the valuation of an often undeveloped patent, which is "a thing unique" and whose market value has not yet been established. *See Sinclair Ref. Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 697 (1933); SX PCL ¶ 58 (quoting *Sinclair*). That is not the case here. It is also telling that SoundExchange's reliance on patent infringement cases is selective. For example, it is well-established that a reasonable patent royalty must allow the infringer to make a profit. *See, e.g.*, *Wang Labs., Inc. v. Toshiba Corp.*, 993 F.2d 858, 870 (Fed. Cir. 1993) ("A reasonable royalty is the amount that 'a person, desiring to manufacture [, use, or] sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able to make [, use, or] sell the patented article, in the market, at a reasonable profit.'" (alterations in original, emphasis added)). Yet SoundExchange argues that the Judges should ignore the fact that webcasters are not profitable at current rates. SX PFF, Part XIV. SoundExchange's attempt to take the slivers of favorable patent case law, while ignoring the parts that are unfavorable, confirms the irrelevance of those cases.

64. Fourth, if SoundExchange's argument were credited, it would perversely inflate the value of certain license agreements that actual experience revealed to be less valuable than the parties anticipated For example, some of Apple's agreements with major labels upon which SoundExchange relies include a [[[redacted]]].

The Services dispute the propriety of counting this [[ ]] as part of the consideration at all. *See* NAB PFF Part VIII.C.5 If, however, this [[ ]] is included, fewer performances under such a license – *i.e.*, the licensee made less use of the license than anticipated, rendering the license less valuable – ironically would result in a greater effective per play rate because there would be fewer performances made over which to allocate that [[ ]]. All that this actual experience reveals is that the licensee negotiated a bad deal and would not pay so high a price when the license is up for renewal. Yet SoundExchange's expert, Professor Rubinfeld, seeks to use the purportedly higher effective per play rate based on actual plays as better evidence of the value of the agreement than what the parties actually thought they were negotiating. That is contrary to the very language of the willing buyer-willing seller standard, which directs the Judges to consider the "fees that would have been negotiated in the marketplace," not fees based on a post hoc calculation for a service that made less use of a license than anticipated.

65. NAB notes that iHeartMedia, Inc. already has anticipated and rebutted SoundExchange's "actual performance" argument in Part I of its Proposed Conclusions of Law. NAB agrees with iHeartMedia's analysis of this issue.

3. Terrestrial Radio Is a Highly Relevant Marketplace Reference Point for the Rates That Willing Radio Broadcaster Buyers Would Agree to with Willing Record Label Sellers for Simulcasting.

66. Yet another misguided legal assertion by SoundExchange is that "terrestrial radio is an improper benchmark" because radio broadcasters are – and always have been – able to broadcast sound recordings without payment of any royalty. *See* SX PCL Part IV.B. But it is not the fact that there is no sound recording performance right

per se that makes terrestrial radio a relevant reference point here – it is the record labels' marketplace behavior that is highly relevant.

67. Even though record labels know that they will receive no royalties for the performance of their sound recordings on terrestrial radio, those labels actively seek out this airplay. *See* NAB PFF Part III.C.1-2. Given that simulcasting is merely the transmission of terrestrial radio programming over different media, this marketplace behavior of the labels, as willing sellers, is highly relevant to the willing buyer-willing seller determination, as it shows that even at a royalty price of zero, labels, as willing sellers, still view this airplay as beneficial. *See* NAB RPFF Part III.C.3. NAB responds in more detail to this argument above in Part III.A of its Reply Findings of Fact.

4. The Rates that Professor Katz Relied on from the *SDARS II* Proceeding Also Provide a Probative Marketplace Reference Point for Willing Buyer-Willing Seller Rates Applicable to Simulcasters.

68. SoundExchange also claims that "the rates established in SDARS II have no relevance to the benchmark analysis in this proceeding" and that Professor Katz's reliance on the SDARS II decision for the upper bound of his zone of reasonable rates was improper. *See* SX PCL ¶¶ 69-73. But as explained in more detail above in Part III.B of NAB's Reply Findings of Fact, SoundExchange misapprehends both how the Judges arrived at *SDARS II* rates and what Professor Katz did.

69. The Judges have made clear that to determine rates under the section 801(b)(1) policy standard, one must first determine a range of rates based on marketplace evidence and then apply the four section 801(b)(1) policy factors against that range to determine a rate. *See supra* NAB PFF Part III.B. The Judges found that 13% of revenues was the appropriate upper bound of the marketplace agreement rate range, before

applying the section 801(b) policy factors, and then determined that 11% of revenues was the appropriate rate after adjusting for the policy factors. *See id.* Professor Katz relied on the 13% pre-adjusted marketplace rate rather than the 11% rate adjusted for the section 801(b) policy factors. *See id.* Thus, SoundExchange's attack on Professor Katz's use of the upper-bound marketplace rate determined in *SDARS II* is off-base.

C. CONCLUSION

70. For the foregoing reasons, the Judges should adopt NAB's proposed rates and terms for simulcasting.

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July 10, 2015

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I hereby certify that on July 15, 2015, I caused copies of the foregoing document to be served via email on the following parties, which have consented to email service:

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The National Association of Broadcasters'
Reply Findings of Fact and Conclusions of Law

Redaction Log

Paragraph	Description
4	Characterizations of testimony contained in the RESTRICTED Deposition of Charlie Walk and information designated as RESTRICTED by iHeartMedia
13	Information designated as RESTRICTED by SoundExchange
17	Information designated as RESTRICTED by SoundExchange
27	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
38	Information designated as RESTRICTED by SoundExchange
53	Information designated as RESTRICTED by Pandora
75	Characterizations of and quotations from testimony contained in the RESTRICTED Deposition of Charlie Walk
82	Record label financial information designated as RESTRICTED by SoundExchange
84	Record label financial information designated as RESTRICTED by SoundExchange
88	Characterization of testimony contained in the RESTRICTED 5/1/15 Hearing Transcript (Harleston)
102	Service financial information
123	Characterizations of testimony contained in the RESTRICTED 5/14/15 Hearing Transcript (Peterson)
125	Characterizations of and quotation from email designated RESTRICTED by iHeartMedia
154 n. 6	Quotation from testimony contained in the RESTRICTED 4/28/15 Hearing Transcript (Kooker)

160	Characterizations of testimony contained in the RESTRICTED 5/7/15 Hearing Transcript (Wilcox)
163	iHeartMedia agreement information designated as RESTRICTED by iHeartMedia and SoundExchange
164	iHeartMedia agreement information designated as RESTRICTED by iHeartMedia
165	Record label/service agreement information designated as RESTRICTED by iHeartMedia and SoundExchange
169	Apple iTunes Radio information designated as RESTRICTED by SoundExchange
170	iHeartMedia agreement information designated as RESTRICTED by iHeartMedia and quotations from RESTRICTED hearing transcripts
171	Pandora / Merlin agreement information designated as RESTRICTED by Pandora and quotations from RESTRICTED hearing transcripts
172	Nokia Mix Radio and Rhapsody unRadio agreement information designated as RESTRICTED by SoundExchange
182	Characterization of testimony contained in the RESTRICTED 5/7/15 Hearing Transcript (Wilcox)
208	Characterizations of testimony contained in the RESTRICTED 5/21/15 Hearing Transcript
224 n. 11	Characterization of testimony contained in the RESTRICTED 6/2/15 Hearing Transcript (Van Arman)
225	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
230	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
234	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
240	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange

241	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
246	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
252	Pandora and Spotify subscriber data designated as RESTRICTED by iHeartMedia
256	Characterizations of and quotations from testimony contained in the RESTRICTED 5/6/15 Hearing Transcript (Rubinfeld)
257	Characterizations of and quotations from testimony contained in the RESTRICTED 5/5/15 Hearing Transcript (Rubinfeld)
258	Characterizations of and quotations from testimony contained in the RESTRICTED 5/5/15 Hearing Transcript (Rubinfeld)
262	Characterization of a document designated RESTRICTED by Pandora
265	Spotify Free information designated as RESTRICTED by SoundExchange and NAB
268	Streaming service information designated as RESTRICTED by SoundExchange
269	Record label/service agreement information and performance data designated as RESTRICTED by SoundExchange
270	Characterizations of and quotations from testimony contained in the RESTRICTED 5/5/15 Hearing Transcript (Rubinfeld)
272	Characterizations of RESTRICTED deposition testimony
275	Record label/service agreement information designated as RESTRICTED by SoundExchange
284	Characterizations of and quotations from documents designated RESTRICTED by SoundExchange
291	Quotation from RESTRICTED deposition testimony
293	Characterizations of and quotations from testimony contained in the RESTRICTED 5/12/15 Hearing Transcript (Katz)

295	Characterizations of and quotations from testimony contained in the RESTRICTED 5/12/15 Hearing Transcript (Katz)
299	Characterizations of testimony contained in the RESTRICTED 5/5/15 Hearing Transcript (Rubinfeld)
304	iHeartMedia agreement information designated as RESTRICTED by iHeartMedia
320	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
321	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
324	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
325	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
326	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
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340	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange

342	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
343	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange and quotation from testimony contained in the RESTRICTED 5/20/15 Hearing Transcript (Shapiro)
344	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
346	Characterizations of testimony contained in the RESTRICTED 5/6/15 Hearing Transcript (Rubinfeld)
347	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
348	Apple agreements analysis containing information designated as RESTRICTED by SoundExchange
350	Record label/service agreement information designated as RESTRICTED by SoundExchange
352	Beats Limited Service information designated as RESTRICTED by SoundExchange
355	Spotify Free information designated as RESTRICTED by SoundExchange
356	Spotify Free information designated as RESTRICTED by SoundExchange
357	Spotify Free information designated as RESTRICTED by SoundExchange
358	Spotify Free information designated as RESTRICTED by SoundExchange
360	Rhapsody Radio Service information designated as RESTRICTED by SoundExchange
361	Nokia MixRadio Plus information designated as RESTRICTED by SoundExchange
362	Nokia MixRadio Plus information designated as RESTRICTED by SoundExchange

363	Nokia MixRadio Plus information designated as RESTRICTED by SoundExchange
367	Characterization of testimony contained in the RESTRICTED 6/3/15 Hearing Transcript (Huppe)
384	Record label/service agreement information designated as RESTRICTED by SoundExchange
392	Record label/service agreement information designated as RESTRICTED by SoundExchange and iHeartMedia
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3	Record label competition information (relating to UMG/EMI merger) designated as RESTRICTED by SoundExchange
64	Apple iTunes Radio information designated as RESTRICTED by SoundExchange

Index of Witness
Testimony

Index of Witness Testimony by Citation Format

Citation Format	Witness Name	Type of Testimony	Exhibit Number
Barros WRT	Glen Barros	Written Rebuttal	SX Ex. 0001
Bender WDT	Jonathan Bender	Written Direct	SX Ex. 0002
Bender WRT	Jonathan Bender	Written Rebuttal	SX Ex. 0023
Blackburn WDT	Dr. David Blackburn	Written Direct	SX Ex. 0003
Blackburn WRT	Dr. David Blackburn	Written Rebuttal	SX Ex. 0024
Burruss WRT	Jim Burruss	Written Rebuttal	SX Ex. 0004
Butler WRT	Sarah Butler	Written Rebuttal	SX Ex. 0005
Chiang WDT	Johnny Chiang	Written Direct	NAB Ex. 4004
Cutler WDT	Steven Cutler	Written Direct	IHM Ex. 3338
Danaher WDT	Brett Danaher	Written Direct	SX Ex. 2184
Dimick WDT	John Dimick	Written Direct	NAB Ex. 4002
Dimick WRT	John Dimick	Written Rebuttal	NAB Ex. 4009
Downs WDT	Ben Downs	Written Direct	NAB Ex. 4005
Emert WDT	Joseph Emert	Written Direct	NRBNMLC Ex. 7000
Fischel & Lichtman AWDT	Professor Daniel R. Fischel and Professor Douglas G. Lichtman	Amended Written Direct	IHM Ex. 3034

Citation Format	Witness Name	Type of Testimony	Exhibit Number
Fischel & Lichtman SWRT	Professor Daniel R. Fischel and Professor Douglas G. Lichtman	Supplemental Written Rebuttal	IHM Ex. 3371
Fischel & Lichtman WRT	Professor Daniel R. Fischel and Professor Douglas G. Lichtman	Written Rebuttal	IHM Ex. 3054
Fleming-Wood CWRT	Simon Fleming-Wood	Corrected Written Rebuttal	PAN Ex. 5364
Fleming-Wood WDT	Simon Fleming-Wood	Written Direct	PAN Ex. 5002
Foster WDT	Fletcher Foster	Written Direct	SX Ex. 0006
Fowler WRT	Jennifer Fowler	Written Rebuttal	SX Ex. 0007
Frear CWDT	David J. Frear	Corrected Written Direct	SXM Ex. 6000
Gadoury WDT	Jean-Francois Gadoury	Written Direct	NAB Ex. 4007
Hair WDT	Raymond Hair	Written Direct	SX Ex. 0008
Hanssens WRT	Professor Dominique M. Hanssens	Written Rebuttal	NAB Ex. 4012
Harleston WDT	Jeffery Harleston	Written Direct	SX Ex. 0009
Harrison CWDT	Aaron Harrison	Corrected Written Direct	SX Ex. 0010
Harrison WRT	Aaron Harrison	Written Rebuttal	SX Ex. 0025
Hauser WRT	Professor John R. Hauser	Written Rebuttal	IHM Ex. 3124

Citation Format	Witness Name	Type of Testimony	Exhibit Number
Henes WDT	Gene Henes	Written Direct	NRBNMLC Ex. 7011
Herring AWRT	Michael Herring	Amended Written Rebuttal	PAN Ex. 5016
Herring WDT	Michael Herring	Written Direct	PAN Ex. 5007
Huppe WDT	Michael Huppe	Written Direct	SX Ex. 0011
Huppe WRT	Michael Huppe	Written Rebuttal	SX Ex. 0026
Kass WDT	Frederick J. Kass	Written Direct	IBS/Harvard Ex. 9000
Katz AWRT	Professor Michael L. Katz	Amended Written Rebuttal	NAB Ex. 4015
Katz WDT	Professor Michael L. Katz	Written Direct	NAB Ex. 4000
Katz WRT	Professor Michael L. Katz	Written Rebuttal	NAB Ex. 4010
Kendall WRT	Dr. Todd D. Kendall	Written Rebuttal	IHM Ex. 3148
Kocak WDT	Robert Francis Kocak (Buzz Knight)	Written Direct	NAB Ex. 4003
Koehn WDT	Julie Koehn	Written Direct	NAB Ex. 4006
Kooker WDT	Dennis Kooker	Written Direct	SX Ex. 0012
Kooker WRT	Dennis Kooker	Written Rebuttal	SX Ex. 0027
Lexton WRT	Charlie Lexton	Written Rebuttal	SX Ex. 0013
Littlejohn WDT	Jeffery L. Littlejohn	Written Direct	IHM 3210
Lys CWDT	Professor Thomas Z. Lys	Corrected Written Direct	SX Ex. 0014
Lys WRT	Professor Thomas Z. Lys	Written Rebuttal	SX Ex. 0028

Citation Format	Witness Name	Type of Testimony	Exhibit Number
McBride WDT	Dr. Stephan McBride	Written Direct	PAN Ex. 5020
McFadden WDT	Professor Daniel McFadden	Written Direct	SX Ex. 0015
Morris WRT	Marissa Morris	Written Rebuttal	IHM Ex. 3211
Newberry WDT	Steven W. Newberry	Written Direct	NAB Ex. 4001
Pakman WDT	David Pakman	Written Direct	IHM Ex. 3216
Papish WDT	Michael Papish	Written Direct	IBS/Harvard Ex. 8000
Pedersen WRT	Jon D. Pedersen	Written Rebuttal	IHM Ex. 3220
Peterson WRT	Dr. Steven R. Peterson	Written Rebuttal	NAB Ex. 4013
Pittman WDT	Robert Pittman	Written Direct	IHM 3222
Poleman WDT	Tom Poleman	Written Direct	IHM 3226
Poleman WRT	Tom Poleman	Written Rebuttal	IHM Ex. 3231
Roberts WRT	Doria Roberts	Written Rebuttal	SX Ex. 0016
Rosin WRT	Larry Rosin	Written Rebuttal	PAN Ex. 5021
Rubinfeld CWDT	Professor Daniel Rubinfeld	Corrected Written Direct	SX Ex. 0017
Rubinfeld CWRT	Professor Daniel L. Rubinfeld	Corrected Written Rebuttal	SX Ex. 0029
Rysman WRT	Professor Marc Rysman	Written Rebuttal	SX Ex. 0018
Shapiro SWRT	Professor Carl Shapiro	Supplemental Written Rebuttal	PAN Ex. 5365

Citation Format	Witness Name	Type of Testimony	Exhibit Number
Shapiro WDT	Professor Carl Shapiro	Written Direct	PAN Ex. 5022
Shapiro WRT	Professor Carl Shapiro	Written Rebuttal	PAN Ex. 5023
Talley WRT	Professor Eric Talley	Written Rebuttal	SX Ex. 0019
Van Arman WDT	Darius Van Arman	Written Direct	SX Ex. 0020
Van Arman WRT	Darius Van Arman	Written Rebuttal	SX Ex. 0030
Weil WRT	Professor Roman L. Weil	Written Rebuttal	NAB Ex. 4011
Westergren WDT	Timothy Westergren	Written Direct	PAN Ex. 5000
Wheeler WDT	Simon Wheeler	Written Direct	SX Ex. 0021
Wheeler WRT	Simon Wheeler	Written Rebuttal	SX Ex. 0031
Wilcox WDT	Ron Wilcox	Written Direct	SX Ex. 0022
Wilcox WRT	Ron Wilcox	Written Rebuttal	SX Ex. 0032