RECEIVED
Public Information Office
JAN 19 2016
COPYRIGHT OFFICE

PUBLIC VERSION

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

In the Matter of:	)	
	)	
Determination of Royalty Rates for Digital Performance in Sound Recordings and Ephemeral Recordings (Web IV)	)))	**Docket No. 14-CRB-0001-WR (2016-2020) CRB Webcasting IV**

REPLY IN SUPPORT OF SOUNDEXCHANGE'S PETITION FOR REHEARING

I. A BLENDED NONSUBSCRIPTION RATE MUST USE DISTRIBUTED SHARES

The Services' chorus that this argument is "too late" ignores what happened here. No party proposed that the Judges use market shares to derive a blended rate based on a single "indie" benchmark and a single "major" benchmark. No witness testified about calculating such a rate. The Judges adopted the blend *sua sponte*, and relied on one page of a Pandora document that SoundExchange had commented on for completely different purposes.

If there is a blend, there is a fundamental question to ask: would an indie label whose music is distributed in many forms by a major opt to have the major distribute to streaming services—in which case the indie would get paid at the [█████] rate, or would the indie opt to distribute itself at the lower [█████] rate?[1] The answer is obvious: economic incentives would drive most—if not all—indies to distribute through majors.[2] SX PFR at 3.

[1] iHeart's argument that the statutory text precludes reliance on distribution deals is absurd. The statute refers to payments made to "copyright owners" under the statutory license. That is different than the question of how the statutory rate is calculated. If the Judges use distributed shares, statutory license fees will still be paid to "copyright owners."

[2] The Services' attempt to embrace the split that Prof. Rubinfeld reported misses the point. His 76-24 split was intentionally "conservative," derived from performance data on *non*-statutory services, where indies receive compensation "comparable to that received by major[s]." SX Ex. 17 ¶¶ 221, 223. The Judges' hypothetical market has majors paid at a higher rate—[█████
(footnote continued)

The Services argue there is no evidence that indies would refrain from direct licensing with a statutory service. But Darius Van Arman testified that "a substantial portion of independently-owned sound recordings *are* digitally distributed by one of the three majors."[3] *See* SX Ex. 20 at 6-7 (emphasis added). He confirmed that "generally it is the terms of the major's license with a digital music service that govern the rates and terms for distribution of those sound recordings." *Id.* Only in "exceptional circumstances" do indies use "a major record company primarily for physical distribution [but] retain[] digital distribution rights." *Id.*[4]

The Services also fail to undermine the record evidence showing that, at a minimum, an 85%-15% split is justified. They disingenuously suggest that the 85-15 distributed share numbers are "stale."[5] But given that the Judges' decision to use different benchmarks for indies

---

[REDACTED] the indie rate. As Prof. Rubinfeld observed, indies would presumably opt for their own deals only when they "expect to obtain a more preferred agreement." *Id.* ¶ 222. The evidence proves this. The Pandora-Merlin agreement pertains to [REDACTED] of all Pandora performances, meaning owners of [REDACTED] of indie plays on Pandora chose higher rates. SX RPFOF ¶ 753.

[3] The Services assert that Mr. Van Arman once testified before Congress that "owned" shares were the proper measure of market shares. This claim takes Mr. Van Arman's testimony out of context. His testimony concerned the proper way to describe the size of the major and indie communities, not the issue confronted by the Judges—i.e., how to calculate a blended statutory rate based on how majors and indies get paid. Nor did he dispute that 85% of the market is paid at per-play rates negotiated by the majors.

[4] Pandora and iHeart offer isolated examples of indies that have licensed their digital distribution rights without a major. iHeart Opp. at 2; Pandora Opp. at 4. These examples are not illustrative of indie licensing generally, or even of those labels specifically. Instead, the examples emerge in the context of agreements for services otherwise licensing pursuant to the statute, in which the services did not have direct deals with each (or, in the case of Pandora, any) of the majors. Accordingly, the majors' role as distributors was never even implicated for Big Machine, Concord, and Secretly Group (with respect to iHeart, Secretly Group opted for statutory rates).

[5] The current distributed split far exceeds 65-35 and obviously would be greater in the hypothetical market. NAB itself elicited evidence that the current split is 85-15: "Q: So if you add your 38 percent and use 27 percent for Sony, that's 65 percent of the U.S. recorded music market, right? . . . And then Warner is about another 20 percent, right? . . . So just doing the math, it's fair to say that you guys getting together for your weekly licensing committee meetings control 85 percent of the U.S. recorded music market, right?" A: That's right. Those (footnote continued)

and majors and to blend them was not proposed by any participant, the Judges also may consider additional "new evidence" on this point.[6] Recent statistics from Billboard confirm that majors continue to *distribute* more than 85% of recorded music.[7]

II. THE CPI ADJUSTMENT FAILS THE WBWS STANDARD

The Services all argue that because evidence is absent whether rates will increase or decrease, the Judges acted reasonably in adopting an annual adjustment based only on CPI. But the Pandora-Merlin and iHeart-Warner benchmarks that the Judges relied upon include escalations [REDACTED]. *See* SX PFR 4. The Services argue that the Judges could take the rates but ignore the escalations because it is not "all-or-nothing"—but this merely endorses cherry-picking of specific terms. Further, this does not square with the Judges' reasoning for discounting other value from the agreements (which SoundExchange also disagrees with). The escalations are not other items "bundled" with the § 114 rights and there is no issue about how to value them, since the value is plainly stated.

Pandora's argument that prior deals are not evidence of what parties would agree to for 2016-2020 proves too much. The entire benchmarking exercise requires predicting future rates based on prior WBWS agreements. Having chosen to rely on Pandora-Merlin and iHeart-Warner as benchmarks, the Judges should have taken the escalations and applied them to the most recent rates. To do otherwise essentially imposes a mandatory automatic 5-year renewal term at static rates when no agreement in the record supports this.

NAB and iHeart disingenuously assert that the rates in these agreements will stagnate or

companies." 4/30/2015 Hr'g Tr. 1095:6-21 (Harrison).

[6] *See* Order Denying Motions for Rehearing, *SDARS II*, (Jan. 30, 2013).

[7] *See* Ed Christman, *U.S. Recording Industry 2015: Streams Double, Adele Dominates*, *available at* http://www.billboard.com/articles/business/6835216/us-recording-industry-2015-streams-double-adele-dominates-nielsen-music (Jan. 5, 2016) (in 2015, "[i]ndependent labels were 12.6[%] of the market").

possibly decrease after 2015, but both agreements include a [ ]. Pandora-Merlin [PAN Ex. 5014 at § 3(b). iHeart-Warner [ ]. SX PFOF ¶ 755.

III. THE JUDGES COMMITTED LEGAL ERROR IN DISMISSING THE EFFECT OF THE STATUTORY LICENSE SHADOW

The Judges' failure to account for the effect of the shadow does not comport with the legal standard set forth in the statute or as applied in prior decisions.[8] *See Web II*, 72 Fed. Reg. 24084, 24087 (May 1, 2007). The Services (whose experts admitted that Pandora-Merlin and iHeart-Warner were negotiated under the direct constraints of the statutory license, *see* SX PFR at 6-7), now argue that because the rates therein are "below" pureplay and statutory rates, respectively, there is no shadow concern. But the Judges explained that "the statutory rate *effectively sets a ceiling* on rates for statutory services"—that is a starting point, and that Merlin and Warner "voluntarily agreed to rates below the applicable statutory rates" in "*exchange for the steering of more plays*" and "for *more total revenue*." *Web IV* at 34, 84, 126 (emphases added).[9] These agreements necessarily were "negotiated under the constraints of a compulsory license," and cannot "*truly reflect 'fair market value.*'" *Web II* at 24087 (emphases added).

---

[8] SoundExchange argued in its findings that (1) Pandora-Merlin and iHeart-Warner were materially affected by the "shadow," and thus were improper benchmarks; and (2) that the absence of any agreements *above* the statutory rate further renders these remaining agreements unrepresentative. *See*, *e.g.*, SX PFOF ¶¶ 149, 154-60, SX RPFOF ¶¶ 319, 689, 830.

[9] Pandora claims that Prof. Talley testified that if the effective rates in the agreements were below the statutory rate, then the statutory shadow had "no effect" on the agreements. Not so. In the cited testimony, Prof. Talley states that "Pandora has put forward the view" that its deal terms "here are less than the pureplay rate," but another possibility, is that "since there are other accoutrements of the Pandora-Merlin deal, is that it's functionally the equivalent of the per-play rate." 5/27/15 Hr'g Tr. 6115:24-6116:18. It was undisputed that Merlin viewed the effective rate of the agreement as at or above the applicable statutory rate. SX PFOF ¶¶ 588, 613-656.

IV. ERRORS IN JUDGES' PROPOSED REGULATIONS REQUIRE CORRECTION[10]

NAB had the burden to support its licensed-in-the-jurisdiction proposal "by reference to the record of the proceeding," but failed in this effort. *Web III Remand*, 79 Fed. Reg. 23102, 23124 (Apr. 25, 2014). NAB now strains to revise history by saying that Prof. Weil supported the requirement with testimony about state accountancy boards and CPA organizations. The existence of such bodies in no way supports requiring that auditors be licensed in the jurisdiction where they perform audits. Prof. Weil offered no critique of the existing qualified auditor definition and did not suggest that jurisdiction-specific licensing is necessary.[11]

The Services try to say that § 380.6(g)'s provision of credit with interest for overpayments is materially distinguishable from the other overpayment provisions the Judges rejected. The evidence credited by the Judges regarding the administrative burden and fundamental unfairness to artists of such a provision applies with equal measure to *any* overpayments (*Web IV* at 194), no matter how they are discovered. *See* SX Ex. 23 at 6; SX PFOF ¶¶ 1299-1306 (explaining why overpayments cannot be recovered once distributed).

---

[10] No party opposed four of SoundExchange's requested corrections: (1) clarifying that any annual CPI adjustment must reflect cumulative inflation; (2) striking the word "final" from § 380.2(e); (3) revising § 380.6(b) to make clear that SoundExchange is not limited to an audit of just one licensee per year; and (4) changing the reference to "Public Broadcasting Entities" to "Covered Entity under Subpart D" in the § 380.6 definition of "Commercial Webcaster." *See* SX PFR at 8-10. Accordingly, the Judges should correct each of the foregoing regulations.

[11] Prof. Weil's references to state boards and organizations were made alongside references to the national AICPA Code of Professional Conduct and in the context of rebutting SoundExchange's proposed modifications to the qualified auditor definition. Further, The CPA principles he cited "allow licensed CPAs to provide services across state lines without being subject to unnecessary burdens that do not protect the public interest." *See* http://www.aicpa.org/ADVOCACY/STATE/MOBILITY/Pages/default.aspx

PUBLIC VERSION

Dated: January 19, 2016

Respectfully submitted,

By: Glenn D. Pomerantz /KJ

Glenn D. Pomerantz (CA Bar 112503)
Kelly M. Klaus (CA Bar 161091)
Anjan Choudhury (DC Bar 497271)
MUNGER, TOLLES & OLSON LLP
355 S. Grand Avenue, 35th Floor
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702
Glenn.Pomerantz@mto.com
Kelly.Klaus@mto.com
Anjan.Choudhury@mto.com

Counsel for SoundExchange, Inc.